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# Board leadership structure for Chinese public listed companies

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ABSTRACT

It is widely accepted that board leadership structure and whether the chairperson and CEO roles should be undertaken jointly or separately affects the performance of a firm. Despite this consensus, empirical evidence presents major uncertainties as to the direction and degree of this influence. This study contributes to this debate by examining the relationship between board leadership structure and firm performance and the expense ratio, using propensity-score matching methods for Chinese PLCs from 2003–2010. It is reported that whilst CEO duality is not related to companies' profitability ratios, it is linked to a higher expense ratio compared to matched companies with a separate board leadership structure. This indicates that a separate board leadership structure is an effective corporate governance arrangement to reduce agency costs for Chinese PLCs.



## 1. Introduction

Following its impressive economic transformation of the past 35 years there is an urgent need for a workable corporate governance model within China (Fan, 2004). This study contributes to this policy area by examining the veracity of one of the many corporate governance principles introduced into China in the last twenty years. Specifically we scrutinise whether the western prescription for dividing the role of chairperson and CEO is appropriate in the Chinese context. To achieve this goal the study addresses three questions:

a) Which factors determine the board leadership structure for Chinese PLCs?
b) Does the CEO duality have implications for the performance of Chinese PLCs?
c) Does a separate board leadership structure reduce agency costs for Chinese PLCs compared to CEO duality?

Separate board leadership structure and CEO duality encapsulates circumstances where the CEO and chairperson positions are separated and combined respectively. These questions are tested using logit regression analysis and propensity-score matching methods to examine the determinants and effects of board leadership structure for 9371 firm-year observations of non-financial Chinese PLCs, between 2003 and 2010. Firm performance is examined using firms' profitability ratios (return on assets and return

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on equity; hereafter ROA and ROE) and agency costs using the expense ratio. It is reported that a board leadership structure with separate CEO and chairperson positions is an effective corporate governance arrangement for Chinese PLCs.

Whilst it is widely acknowledged that the board of directors plays a vital role in a firms' corporate governance, board organisation is important to examine in the Chinese context. Our current comprehension of board leadership structure was developed and refined in the UK and the USA which organise, own and run firms in very different ways from China. China differs from many western nations in terms of corporate governance, law, business culture and ownership. In contrast to US companies, Chinese companies normally have a relatively concentrated ownership structure with state ownership of many firms, limited information disclosure, poor investor protection and reliance on the banking system for finance. Subsequently, Chinese companies face conflicts beyond the traditional principal-agent problem observed in western nations, with the expropriation of minority shareholders by controlling shareholders a growing concern (e.g. Huyghebaert & Wang, 2012; Jian & Wong, 2010; Zhu & Ma, 2009). Through this examination we determine whether board leadership structure, derived from experience in the USA and Europe and often assumed to be universal in application, has a similar influence on firm performance and agency costs in a distinct Chinese corporate environment.

This study is timely as whilst the academic literature includes abundant studies examining the effect of board structure in respect of firm performance, only a handful of studies have examined the determinants of board structure. Whilst these studies have focused on the determinants of board size and outside directors (e.g. Cierco, Wintoki, & Yang, 2013; Guest, 2008), relatively few studies have examined the determinants of board leadership structure (e.g. Dey, Engel, & Liu, 2011; Linck, Netter, & Yang, 2008; Pathan & Skully, 2010) and considered these concerns within Western nations. This assessment also builds on past studies which have examined the determinants of board size and independence (see Chen & Al-Najjar, 2011; Su, Xu, & Phan, 2008) and board leadership structure (e.g. Xie, 2012) for Chinese companies in earlier periods. This study differs from and extends these past contributions by examining the determinants of board leadership and the effects of board leadership structure on firm performance for Chinese PLCs between 2003 and 2010. Further we address long standing concerns that endogeneity which may influence key relationships in this debate by using propensity-score matching methods.

The paper is organised as follows. Section 2 introduces the relevant literature and empirical evidence. Section 3 describes the hypotheses, model design and variable definition. The results of the data analysis are presented in Section 4. Finally, conclusions are presented in Section 5.

## 2. Literature review

Explanations of how corporate governance arrangements operate in the USA and Europe have been shaped by a literature of a considerable lineage. Concerns as to the separation of ownership and control were raised by Berle and Means (1932) and agency theory (Jensen & Meckling, 1976) arose to examine whether managers of firms would follow the maximisation of the owners' wealth or pursue personal gains when facing a dispersed ownership structure. This literature assumed the agency relationship between the owners of the firm and managers gave rise to agency costs as managers may not act in the best interest of the owners (Jensen & Meckling, 1976). These agency costs arise when the interests of the firm's managers are not aligned with those of the owners, take the form of perks, shirking, and making self-interested and entrenched decisions that reduce shareholder wealth (Ang, Cole, & Lin, 2000). Building on a belief that boards of directors are one of the most efficient internal governance mechanisms to control and supervise top management (Daily, Dalton, & Cannella, 2003; Jensen, 1993) many corporate governance arrangements have been developed in Western nations and introduced into China under the belief that they would enhance firm performance through alleviating these agency costs. As these corporate governance arrangements have been numerous this study focuses on the determinants and effects of board leadership structure due to both its widespread dissemination internationally and pertinence to the Chinese context.

### *2.1. Chinese experience of corporate governance arrangements*

China is an informative case to examine the determinants and effects of board leadership structure due to the distinct ownership structure and external operating environment. Indeed many of these differences could have a significant influence on the relationship between board leadership structure and firm performance.

A critical difference between China and many European and North American nations is that state ownership of firms is significant in China. During China's economic reforms of the 1980s, the Chinese government privatised small and medium sized state owned enterprises (SOEs) and corporatized large SOEs. Though state ownership has been reduced over time, the state and other government institutions have retained a majority stake in privatised firms (Li, Moshirian, Nguyen, & Tan, 2007). As property rights theory claims property rights in the private sector are more clearly defined and private ownership leads to more effective monitoring of management performance (Alchian, 1965; McCormick & Meiners, 1988), this situation could limit firm performance. Alternatively the Chinese state could play both a 'helping hand' as well as a 'grabbing hand' in its role as shareholder. The state can provide support regarding finance and resources and a higher level of state shareholding may overcome 'free rider' problems (Tian & Estrin, 2008; Yu, 2013).

Relative to many Western nations, investor protection is poor and law enforcement can be weak in China. Whilst there is variation amongst European nations particularly in levels of investor protection, these concerns are amplified in China. Many Chinese PLCs have a large controlling shareholder which enables wealth to the tunnelled from smaller investors. Subsequently Chinese companies face conflicts between controlling shareholders and minority shareholders with the expropriation of minority shareholders by controlling shareholders a growing concern (e.g. Huyghebaert & Wang, 2012; Jian & Wong, 2010; Zhu & Ma, 2009).