



Pyramidal structure, political intervention and firms' tax burden: Evidence from China's local SOEs



Min Zhang^{a,b}, Lijun M^a, Bo Zhang^{a,*}, Zhihong Yi^a

^a School of Business, Renmin University of China, 59 Zhongguancun Street, Haidian District, Beijing 100872, China

^b The Collaborative Innovation Centre for State-owned Assets Administration 33 Fucheng Road, Haidian District, Beijing 100048, China

ARTICLE INFO

Article history:

Received 20 June 2015

Received in revised form 4 October 2015

Accepted 9 October 2015

Available online 17 October 2015

JEL classification:

G32

G38

H25

Keywords:

Pyramidal structure

Local SOEs

Political intervention

Tax burden

ABSTRACT

Using a sample of Chinese firms, we examine the influence of state-pyramids on corporate tax burden. We find results that state-pyramidal layers are significantly and negatively associated with effective tax rates, indicating that pyramids formed by the state protect local state-owned enterprises (SOEs) from political intervention. The results hold after controlling for potential endogeneity. We further find evidences suggesting that taxation is one of the channels through which state-controlled pyramids increase firm value. Our study contributes to both corporate finance and corporate tax literatures by documenting the role of pyramidal organizational structures in reducing local SOEs' tax burden.

© 2015 Elsevier B.V. All rights reserved.

1. Introduction

A pyramidal ownership structure is generally referred to as a corporate structure in which the ultimate controlling shareholder at the top of the pyramid controls the firm indirectly via several layers of intermediate companies. This ownership structure is pervasive throughout the world and has been existing for several centuries (Chernykh, 2008; Claessens et al., 2000; de Jong et al., 2010; Faccio and Lang, 2002; Khanna and Yafeh, 2007; La Porta et al., 1999). Since pyramidal structure began to be examined in academic research for the first time, its causes, evolution, and economic consequences have been extensively studied.

Pyramidal structure is perceived as an agency problem of the second type by most of the literature, which finds that pyramids can result in the expropriation of minority shareholders (Bebchuk, 1999; Bebchuk et al., 2000; La Porta et al., 1999) and a discount on performance and firm value (Claessens et al., 2002; La Porta et al., 2002; Lemmon and Lins, 2003), thus inhibiting the efficiency of resource allocation and economic growth (Morck et al., 2004). Prior research also documents the benefits of pyramidal organizational structures (Almeida and Wolfenzen, 2006; Almeida et al., 2011; Khanna and Palepu, 2000; Khanna and Rivkin, 2001; Khanna and Thomas, 2009). For example, studies find that privately controlled pyramids allow the controlling shareholders to build internal capital markets so to help them overcome capital market frictions (Khanna and Palepu, 2000; Khanna and Rivkin, 2001).

On the other hand, the other type of pyramids, pyramids formed by the state, is relatively unexplored. Not until very recently have studies begun to examine state-pyramids (Fan et al., 2013; Liu et al., 2011). Besides agency costs, state pyramids also face

* Corresponding author. Tel.: +86 10 62514992; fax: +86 10 82509169.

E-mail addresses: minzhang@ruc.edu.cn (M. Zhang), malj324@163.com (L. M.), zhangbo@rbs.org.cn (B. Zhang), yizhihong@rbs.org.cn (Z. Yi).

political costs associated with government's incentive to interfere in the firm (Fan et al., 2013). Political costs refer to the policy burdens, such as excessive taxation and redundant employment, on the SOEs in order to assist governments in achieving certain social and political objectives (Fan et al., 2013; Lin and Li, 2008; Qian, 1996; Qian and Wu, 2003). Fan et al. (2013) document that local governments build more extensive pyramidal layers when they have more incentives to protect SOEs through reducing political costs, and they further find a positive relationship between state pyramidal structures and firm performances.

In this paper, we extend this emerging literature on the impact of state-pyramids on alleviating political intervention. Specifically, we use corporate tax burden as a proxy for government intervention and directly explore the role of pyramids in local SOEs in lessening excessive taxation. Taxation is the most common way through which the government interferes in SOEs, especially in emerging markets (Lin and Li, 2008; Lin et al., 1998). Because of their natural ties with governments, SOEs are often required to pay for the social expenses of governments through excessive taxation. As a result, a higher tax burden implies a higher extent of government intervention.

We first test the influence of pyramids on corporate tax burden in a sample of Chinese listed firms controlled by local governments. The Chinese setting has several obvious advantages. First, pyramids formed by the state are particularly common in China and political intervention is an important institutional characteristic in China, thus offering us a great opportunity to explore the role of pyramids in alleviating government intervention. In addition, the central government of China has delegated fiscal rights to local governments since the 1980s. Meanwhile, local officials' promotion depends on regional gross domestic product (GDP) growth (Chen et al., 2005; Jin et al., 2005; Li and Zhou, 2005; Whiting, 2001), resulting in political competition among local governments to boost regional tax revenues (Besley and Case, 1995; Green and Stokely, 1983; Nalebuff and Stiglitz, 1983). This special institutional arrangement provides us an environment of political intervention through taxation.

We hand-collect pyramidal structure data over 2004–2011. Using effective tax rates (ETRs) as a proxy for corporate tax burden, we find that pyramidal layers are negatively associated with ETRs for Chinese local SOEs, suggesting that state-controlled pyramids protect SOEs from political intervention through reducing local SOEs' taxation. In addition, our results hold when we use a two-stage least square (2SLS) approach to address the potential endogeneity in pyramidal ownership structure. We further find that corporate taxation partially mediates the positive impact of pyramidal layers on local SOEs' performance, suggesting that taxation is one of the channels through which state-controlled pyramids increase firm value. In addition, consistent with our expectations, we find that pyramidal layers in non-SOEs are not related to ETRs.

Our paper makes several contributions to the existing literature. First, building upon prior research (Fan et al., 2013; Liu et al., 2011), we find that pyramidal layers in local SOEs are negatively associated with tax burden, thus providing direct evidences on the role of pyramids in alleviating political intervention. We further document that taxation is one of the important channels through which pyramidal layers affect firm value. Our study extends the emerging literature on state-controlled pyramids and enriches our understandings of pyramidal organizational structures.

We also contribute to the corporate tax literature. Prior studies document that ownership structure affects corporate tax strategies (e.g., Bradshaw et al., 2013). Bradshaw et al. (2013) find that Chinese SOEs exhibit less tax avoidance than do non-SOEs. Our results further show that there are also variations among SOEs, and pyramidal structures influence local SOEs' tax rates.

In addition, our study relates to the literature on the size–ETR relationship. Wu et al. (2012) find that ownership structure is an important factor determining the relationship between firm size and ETRs. In particular, Wu et al. (2012) document that firm size is negatively associated with ETRs for Chinese SOEs but the relationship is different for non-SOEs. Political power theory explains the negative relation for SOEs: larger SOEs possess more resources and abilities than smaller SOEs in lessening corporate tax burden. Different from Wu et al. (2012), the focus of our paper is pyramidal structure formed by the state but not firm size, and our study shows that pyramidal layers can protect local SOEs from tax burden.

Finally, our results also provide some implications of the state-owned economy reform. Government can credibly decentralize real authority using pyramidal structures, thus reducing political costs and increasing the degree of autonomy and marketization of state-owned organizations. Because political intervention is a concern not only for China but also for many other developing and developed countries (Faccio, 2006; Khwaja and Mian, 2005; La Porta et al., 1999; Leuz and Oberholzer-Gee, 2006), these implications are not likely to be unique to China.

The remainder of this paper is structured as follows: Section 2 reviews the related literature and develops the hypothesis. Section 3 describes the sample, data, and research design. Section 4 presents the empirical results. Additional tests are reported in Section 5. We conclude in Section 6.

2. Literature review and hypothesis development

Pyramidal structure refers to the organization structure that the controlling shareholder at the top of the pyramid controls a firm indirectly through layers of intermediate companies (Fan et al., 2013). The organizational structure is very common around the world (Chernykh, 2008; Claessens et al., 2000; Faccio and Lang, 2002; La Porta et al., 1999). La Porta et al. (1999) suggest that the level of investor protection influences the choice of pyramidal structure. Specifically, pyramidal structure is more prevalent in poor investor protection countries as firms in those countries need concentrated control.

However, concentrated ownership can induce controlling shareholders to expropriate the interest of minority shareholders, and the agency conflicts between controlling owners and minority shareholders occur due to a separation in voting rights and cash flow rights (Fan and Wong, 2002). Prior research further finds that the pyramidal ownership structure reduces firm value (Claessens et al., 2002; Lemmon and Lins, 2003). At the economy level, Morck et al. (2004) suggest that pyramidal control structure can distort capital allocation and slower economic growth.

Download English Version:

<https://daneshyari.com/en/article/5093243>

Download Persian Version:

<https://daneshyari.com/article/5093243>

[Daneshyari.com](https://daneshyari.com)