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Foreign Institutional Investors and Corporate Governance in Emerging Markets: Evidence of a Split-Share Structure Reform in China

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Abstract

Using data on China's split-share structure reform that floats non-tradable shares, we find that Qualified Foreign Institutional Investors (QFIIs) have greater influence over the controlling state shareholders than local mutual funds. QFIIs are less prone to political pressure and are more likely to participate in arm's-length negotiation and monitoring in state-controlled companies. The presence of QFII ownership shortens the duration of the reform and increases the compensation to minority tradable shareholders. Unlike local mutual funds, the positive relationship between state ownership and the compensation to tradable shareholders *increases* with the presence of QFII ownership. Furthermore, QFIIs increase the likelihood of revision in reform proposals among state-controlled companies. Domestic mutual funds seem to make earnest negotiations in non-state-controlled companies in the absence of political pressure. Evidence suggests that involving foreign institutional investors in corporate governance practices can significantly reduce expropriation by controlling shareholders in emerging markets.

JEL classifications: G15, G34

Keywords: Qualified Foreign Institutional Investors (QFIIs), Split-Share Structure Reform Chinese Equity Markets, Corporate Governance

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