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State Ownership, Political Institutions, and Stock Price Informativeness: Evidence from Privatization☆

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ABSTRACT

In this paper, we examine the relation between government ownership and stock price informativeness around the world. Using a sample of privatized firms from 41 countries between 1980 and 2012, we find strong and robust evidence that state ownership is associated with lower firm-level stock price variation, i.e., stock price informativeness. Furthermore, we find that the relation between state ownership and stock price informativeness depends on political institutions. In particular, the adverse effects of state ownership on stock price informativeness are more pronounced in countries with lower political rights (i.e., lower political constraints on the government).

1. Introduction

The information environment, particularly the degree to which firm-specific information is incorporated into stock prices (i.e., stock price informativeness), has recently drawn the interest of numerous scholars. One strand of literature examines the impact of economic development and legal investor protection on stock price informativeness. For instance, Morck et al. (2000) argue that stock price informativeness is lower (higher) in less economically developed countries that have weak investor protections (developed countries that have strong investor protections).[1] Some other emphasizes the quality of accounting

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[1] Morck et al. (2000) use GDP per capita as a measure of economic development.

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information. For example, Jin and Myers (2006) predict higher stock price informativeness in countries with a higher degree of transparency and a lower cost of acquiring private information.[2] Grossman and Stiglitz (1980) further show that a lower cost of acquiring private information encourages informed trading and facilitates the incorporation of firm-specific private information into stock prices, resulting in more informative stock prices. More recently, Kim and Shi (2010) show that enhanced disclosures via voluntary adoption of International Financial Reporting Standards (IFRS) are associated with higher stock price informativeness.

In this study, we extend the aforementioned studies by analyzing the importance of government ownership around the world to stock price informativeness. Specifically, we attempt to answer the following questions: Does the residual government ownership associated with a less transparent environment, which renders private information acquisition costly, discourage informed trading and impede the incorporation of firm-specific information into stock prices? Do the political characteristics of the government, and in particular the degree of political constraints on the government, affect the relation between state ownership and stock price informativeness?

Despite the large privatizations of state-owned enterprises (SOEs) that have occurred in both developing and developed countries, the state remains one of the most important shareholders around the world. Prior research (e.g., Bortolotti and Faccio, 2009; Boubakri et al., 2011) suggests that the state is reluctant to relinquish control in privatized firms even several years after privatization. As a particular shareholder, the state tends to pursue political objectives that do not coincide with profit maximization, for example, maintaining a high level of employment and promoting regional development by locating production in politically desirable rather than economically attractive regions (e.g., Dewenter and Malatesta, 2001; Megginson and Netter, 2001). The state therefore has incentives to tunnel corporate resources — and expropriate other shareholders — for political benefit. To hide this expropriation, governments may lead managers/bureaucrats in state-owned firms to manipulate earnings or selectively disclose accounting information, which results in a less informative environment. Since the collection of private firm-specific information is costly in a less transparent environment, state ownership may discourage informed trading, reducing the incorporation of firm-specific information (Grossman and Stiglitz, 1980) and hence leading to less informative stock prices. With this in mind, we investigate the impact of state ownership on stock price informativeness.

We conduct our research using a multinational sample of privatized firms for several reasons. First, as we mentioned above, the government often continues to be a shareholder in newly privatized firms, even several years after privatization (e.g., Bortolotti and Faccio, 2009; Boubakri et al., 2011), which provides us a natural laboratory to examine the impact of government intervention on stock price informativeness. Second, a worldwide sample of privatized firms involves firms from different countries with different political environments, which gives us a unique setting to investigate the impact of political institutions, in the presence of government participation, on the information environment, and in particular the degree to which firm-specific information is incorporated into stock prices.

Examination of these issues is timely and important for several reasons. First, the recent financial crisis was accompanied by an increase in government participation in bailed-out firms and state ownership appears to be an increasing trend. However, little is known about the link between the firm-level information environment and state participation around the world. Second, stock price informativeness is of paramount importance since it affects capital allocation (Wurgler, 2000; Durnev et al., 2004) and in turn economic growth (Durnev and Fauver, 2010; Wurgler, 2000). Indeed, Chen et al. (2007) show that stock price informativeness is associated with higher investment to stock price sensitivity (i.e., more efficient investments), which contributes to better resource allocation (Durnev et al., 2004; Wurgler, 2000) and ultimately economic growth (Durnev and Fauver, 2010; Wurgler, 2000). These considerations motivate our interest in studying the stock price informativeness of newly privatized firms (NPFs).

Using a multinational sample of privatized firms from 41 countries between 1980 and 2012, we provide strong and robust evidence that state ownership is associated with lower stock price informativeness. This result is consistent with the conjecture that state ownership is associated with a less transparent environment, which discourages investors from trading on private information and impedes the incorporation of private firm-specific information into stock prices. Furthermore, we find that lower political constraints magnify the impact of state ownership on stock price informativeness. In particular, we document that state ownership is associated with lower stock price informativeness in countries with lower political rights (i.e., fewer political constraints on the government). Our results are robust to the use of alternative proxies for the soundness of political institutions and alternative proxies for stock price informativeness.

Our paper contributes to the literature on firm-specific information by providing evidence that stock price informativeness is negatively related to state ownership around the world. In particular, our study is related to those of Brockman and Yan (2009), who examine the impact of block ownership on firm-specific information in the U.S. context; Gul et al. (2010), who examine the impact of government ownership on stock price synchronocity in the specific context of China; and Boubaker et al. (2014), who examine the influence of the divergence between control rights and ownership rights on firm-specific information in the specific context of France. The results of single-country studies could depend on the country's specific conditions. Our study extends this strand of literature using a multinational sample of firms from emerging/developing and advanced countries and the higher-power setting of NPFs. A worldwide sample allows us to examine how political institutions that vary across countries might affect firm-specific information in the presence of government participation.

[2] Similarly, Veldkamp (2006) develops a model in which stock price co-movement is higher, and hence stock price informativeness is lower, when the acquisition of private information is costly.