

## State Ownership and Corporation Value in China

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This research examines the effect of the state ownership structure on firm value in China. The state ownership represents controlling rights, and at the same time, represents substantial cash flow rights in many large firms. Unlike significant separation between cash flow rights and controlling rights that exist in most of large firms in East Asia, the state has both rights because of its substantial stake in equity of a firm. Under these conditions, the conflict of interests occurs between the controlling shareholders (the state) and outside shareholders (the small investors).

Using data from companies listed by the end of 2001 on the Shanghai Stock Exchange and the Sheng Zhen Stock Exchange, we find that when the state has no controlling and cash flow rights, e.g., less than 5% of state ownership, firm value is high; and when the state has increasingly influence power, e.g., between 5% and 30% of the state ownership, it has an incentive to take advantage of the controlling rights to grab the wealth and explored minority shareholder because of the low cash flow rights. However, when the state ownership increases more than 30%, and its controlling rights and cash flow rights also increase, the state intends to protect its own interests and balance between grabbing and helping. We find a positive relationship between state ownership and Tobin's q ratio, since the exploration costs are high with the increase in the cash flow rights. Comparing those three major ownerships, we find that legal person-dominated firms are preferred to the state-controlled firms.

Top managers in Chinese corporations are closely monitored by their controlling shareholders because most of them are previous employees of the controlling shareholders. While these top executives actually run firms, most of them have little voting power themselves because they hold negligible amount of company's shares. Measured by either their stock value or the ownership multiple, we find that executives shareholdings are positively related to firm value. Further, we do not see any relationship between the state ownership and executive incentive shareholding plan. This finding, in contrast to both the incentive effect and entrenchment effect found from the US, indicates that the incentive plan has effectively aligned the executive's own interests to the shareholders' under the current ownership structure in China.

Most of firms in China are virtually controlled either by a single large shareholder (often the state), or by a few large institutional shareholders. Therefore, the ownership is highly concentrated. We find a positive relationship between q ratio and the level of concentration of the largest five shareholders (also the largest ten shareholders) in a company, but not in the case of the single largest shareholder. In addition, we find strong impacts of balanced power sharing among a few large owners on firm value. Our

results suggest that the institutional concentrated ownership may provide an alternative way of resolving agency problem for firms with less investor protections and outside legal enforcement.