The Relationship Between Ownership Structure and Firm Performance: an Empirical Analysis over Heilongjiang Listed Companies

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Abstract: This paper investigates whether ownership structure has significant effects on the performance of listed companies in Heilongjiang Province, and in what ways it does. We will use the descriptive and empirical method to analysis the relationship between ownership structure and corporation performance. The studies also show the efficiency of corporation governance and its effect on performance of Heilongjiang listed-companies. Ownership structure has two implications: structure of ownership and ownership concentration. [Nature and Science. 2004;2(4):87-90].

Key Words: ownership structure; firm performance; corporation governance; ownership concentration

1. Introduction

The number of listed companies, trading volume, and total market capitalization has increased drastically since the opening of the two exchanges of Shanghai and Shenzhen of China. Shares are classified as domestic (A share) and foreign share (B share) by holder's residency. There are four categories of A shares. The state share, the legal person shares, the employee share, and the tradable. A share mostly held by individuals. The state shares are those held by the central government, local governments or solely government-owned enterprise. State shares are not allowed for trading at the two exchanges, but transferable to domestic institutions, upon approval of China Securities Regulatory Commission (CSRC). In many of the public-trade corporations, the state is the largest or majority shareholder. The legal person shares are the shares owned by domestic institutions as stock companies and non-bank financial institutions. Like state shares, legal person shares are not tradable at the two exchanges, but can be transferred to domestic institutions upon approval from CSRS. The employee shares are offered to worker and managers of a listed company, usually at a substantial discount. Employee shares are registered under the title of the labor union of the company, which also represents shareholding employees to exercise their rights. After a holding period of 6 to 12 months, the company may file with CSRC for allowing its employees to sell the shares in the open markets.

A typical listed Chinese stock company has mixed ownership structure with state, legal persons and domestic individual investors as the three predominate group of shareholders. China listed companies have a special ownership structure. State shares and legal or person shares are not permitted trading on the market. According to the research of Duyajun and Zhouyaping (2004), at the end of 2001, among 140 china listed companies, 63.5% shares were held by the top 10 share holders. Such high share holdings, will influence the internal governance and external supervision, and form "internal governance". The over control of top owners may bring financial and operate risk. So the benefit of ownership concentration will be deducted by the drawback of itself.

Prior studies show that ownership structure has relations with corporation governance, which is the key issue of state-owned enterprise (SOE) reform. Since Heilongjiang Province of China has higher percent of SOE among its enterprises, state shareholders play an important role on corporation governance of Heilongjiang listed company. To study the effects of ownership structure on performance, will help us to know the potential problems in performance and ownership structure.

2. Theoretical background and prior empirical work

Ownership structure has two implications:

structure of ownership (share percents of state, legal or institution, domestic individual holders) and ownership concentration (share percents of top five or 10 holders).

The relationship between ownership structure and corporation performance is one that has received considerable attention in the finance literature .The typical achievement among ownership structure and firm performance researches are the results of Jensen and Meckling. They divided shareholders into internal (investors with management right) and external shareholders (investors without ballot right). The conclusion of their research is value of firm depends on the internal shareholder's share, which is called ownership structure. Theoretically, more internal shareholder's share more firm value. The research also definite firm value as a function of ownership structure. Because ownership structure has links with corporate governance, it can have both positive and negative effects on corporation governance. The existing of top stockholders can give promotion to firm operating to some extends. According to the Shleifer's research, in the enterprise where corporate governance lacking protection to external investors, there is a trend that ownership became concentrate, which is a natural reaction of extend investors to protect their own benefit. Thus we can assume that at the circumstances corporation governance lacking well protection to external stockholders benefit, the firm performance will get better with the first top holders shares holdings increasing.

Empirical studies of Chinese scholars develop dramatically. Results from prior studies show that ownership structure (both the mix and concentration) has significant effects on the performance of stock companies. First, performance has negative correlations with state shares and positive correlations with legal shares. Typical researchers are Xiaonian Xu (1997) and Yan Wang. Second, the effect of ownership concentration is stronger for companies dominated by legal person shareholders than for those dominated by state. Such as Du Yajun (2003). Third, different shareholders play different effects on corporation governance. Chen Xiao (2000) showed that firm's profitability was positively correlated with the fraction of legal person shares, but it was either negatively correlated or uncorrelated with the fraction of state shares and tradable A-shares.

3. Materials and Method

Pooled data are used for Heilongjiang listed companies at year 2003. There were 33 enterprises issued shares on Shanghai and Shenzhen stock exchanges located in Heilongjiang Province by the end of 2003. For the financial position, 4 ST companies were among them.

Accounting ratios to measure firm's performance in the prior literatures are Tobin's Q, ROE and ROA. Tobin's Q is a market value of equity divided by the replacement cost of all assets, and it has been used as a major indicator of firm's performance. Since few of Chinese stock companies issues debt securities, it is impossible to estimate the market value of the companies' debt. We employed ROE (average weighted) as the performance indicator. Variables are structure of ownership (share percents of state, legal or institution, domestic individual holders), and ownership concentration (share percents of the top five holders). To reduce the possibility of spurious results caused by correlation among these variables, we included two control measures DAR—capital structure ratio, and InAssets (firm scale indicator). In the top 10 shareholders if state shares exceed the total of legal, traded A shares and others, we determined the characteristic of the company that is SOE. On the contrary the company is legal or person dominated.

Estimate equation to test the simples is $ROE=ß_0+ ß_1CO+ ß_2CR+ ß_3DAR+ ß_4InASSETS+ é$. Let ROE (average weighted) is Performance variables, and CO is ownership structure. If the firm's is SOE we state 1, otherwise 0 as the legal or person dominated firms. Let ownership concentration rations as CR, which is the share percent of TOP5 shareholders. Control variables are DAR (Total liabilities/Total Assets), and InAssets. We use SPSS software and get the results.

4. Results and Analysis

Empirical Statistics are shown as Tables 1 to

Table 1. Correlations

		ROE(W)	SOE	TOP5	InAssets	DAR
ROE(W)	Pearson Correlation	1.000	.300	-222	.378	*-.608
	Sig. (2-tailed)	.	.090	.215	.030	.000
	N	33	33	33	33	33
SOE	Pearson Correlation	.300	1.000	.588	**-.008	-.141
	Sig. (2-tailed)	.090	.	.000	.967	.433
	N	33	33	33	33	33
TOP5	Pearson Correlation	-222	.588	*1.000	-.007	-.338
	Sig. (2-tailed)	0215	.000	.	.969	.055
	N	33	33	33	33	33
InAssets	Pearson Correlation	.378	*-.008	-.007	1.000	.002
	Sig. (2-tailed)	.030	.967	.969	.	.990
	N	33	33	33	33	33
DAR	Pearson Correlation	-.608	**-.141	-.338	.002	1.000
	Sig. (2-tailed)	.000	.433	.055	.990	.
	N	33	33	33	33	33

: Correlation is significant at the 0.05 level (2-tailed)** *: Correlation is significant at the 0.01 level (2-tailed)**

Table 2. Variables and Regression

Model	Variables Entered	Variables Removed	Method
1	DAR InAssets SOE TOP5	.	Enter

a. All requested variables entered. **b: Dependent Variable: ROE weight.**

Table 3. Model Summary of Table4.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.761	.579	.519	.28473817

a. Predictors: (Constant), DAR, InSaaets, SOE, TOP5.

Table 5. Coefficients

Model	Unstandardized Coefficients	Standardized Coefficients		t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-.567	.535		-1.060	.298
SOE	.439	.211	.316	2.077	.047
TOP5	-.512	.477	-.171	-1.310	.153
InAssets	.110	.036	.380	3.103	.004
DAR	-1.465	.307	-.622	-4.765	.000

a. Dependent Variable: ROE(W)

Firstly, we make the correlations of variables for equation ROE=$ß_0$+ $ß_1$CO+ $ß_2$CR+ $ß_3$DAR+ $ß_4$InASSETS+ é. As Table 1 shows, there is a positive correlations between performance and ownership structure as well as the scale of Assets (InAssets). On the contrary, ownership concentration and capital structure (DAR) have negative effects on performance.

Then we run regression of performance variables. Table 3 shows $R^2=0.579$, that means the equation is effective. The relations between ROE and every variable are obviously. As Table 5 shows, the coefficients of variables are effective except constant $ß_0$. ROE has good correlations with SOE and InAssets as the *Sig.<0.05*. Though ownership concentration *Sig. is 0.153>0.1*, it is acceptable.

The results imply some problems arise from performance, ownership structure and corporation governance in Heilongjiang listed companies. One problem is this study gives an opposite result that compare with prior literatures. For listed companies in which the state owners equity, local offices or officials of local finance bureaus exercise owner's rights on behalf of the state. This may arise a series of principle-agent problems from this institutional setting in the state-controlled stock companies. Such as shareholders of government may not have sufficient incentives to preserve and increase the value of state properties. So most researches show that the performance of SOE is not better than legal or person enterprises. For this study, Heilongjiang shows an opposite results that there is a slight positive correlations between firm's performance and state shares, because of the internal and external effects. These state enterprises have operated many years before they transfer to listed stock companies, some of them have regular management and human resource, which are the factors to improve firm performance. Another reason is Heilongjiang Province have more SOE than other areas in china, its national economy is strongly depended on SOE. Due to their important role in the national economy, some SOE still under the protection of government such as they have preference purchase and sale rights, which are not owned by legal or person firms. The other problem is corporation governance in legal or person listed companies are not developed and performed very well. Shown as data, three among four ST companies in Heilongjiang are legal or person firms. Performance of most legal or person quoted companies are not good enough compare with the SOE listed firms located in developed areas in China. Internal control and management in such firms should be strengthened. The last one is a firm profitability is negatively correlated with ownership concentration which has the same result with prior literatures, but it is not very strong. The negative effect of ownership concentration suggests that an over concentrate ownership structure is not a best way to improve efficiency of the both state and legal or person stock companies. To improve performance ownership diversification is a trend in the future enterprise reform.

5. Conclusions

It emerges from the above discussion that the different forms of ownership may have implications for corporation governance and performance of firms. First, empirical evidence showed in this paper points to the efficient correlations to state ownership, there are still some government interference and protection in Heilongjiang listed companies. Second, performance of legal or person enterprise are not good enough, so ownership diversification of state shares should be taken in a long run but not immediately. Third, excepting to strength corporation governance and internal management control, legal or person listed firms should get some support and motivation from the Heilongjiang government.

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