

DOCTORAL THESIS

The market reform of non-tradable shares, firm performance, and accounting conservatism in China

Xiang, Xi

Date of Award:
2009

[Link to publication](#)

General rights

Copyright and intellectual property rights for the publications made accessible in HKBU Scholars are retained by the authors and/or other copyright owners. In addition to the restrictions prescribed by the Copyright Ordinance of Hong Kong, all users and readers must also observe the following terms of use:

- Users may download and print one copy of any publication from HKBU Scholars for the purpose of private study or research
- Users cannot further distribute the material or use it for any profit-making activity or commercial gain
- To share publications in HKBU Scholars with others, users are welcome to freely distribute the permanent URL assigned to the publication

**The Market Reform of Non-tradable Shares, Firm
Performance, and Accounting Conservatism in China**

XIANG Xi

A thesis submitted in partial fulfillment of the requirements

for the degree of

Doctor of Philosophy

Principal Supervisor: Dr. CHAN Hing Lin

Hong Kong Baptist University

July 2009

ABSTRACT

This thesis comprises of two essays.

Essay one: The Market Reform of Non-tradable Shares and Firm Performance in China. Listed state-owned enterprises (SOEs) in China are often criticized for their poor performance. The non-tradable share reform initiated in 2005 provides a natural setting for examining the impact of a market reform on Chinese SOE performance. Focusing on the characteristics of the non-tradable share reform, we hypothesize that the reform alleviates agency problems, both by increasing managerial ownership levels and external block-holdings, and by making state ownership rights tradable. Using the sample period 2001-2007, we document an improvement in firm performance in response to the reform. Consistent with our hypothesis, we find that SOE performance is more positively associated with managerial ownership, market monitoring, and growth prospects in the post-reform period. We also show an inverse U-shape relationship between firm performance and managerial ownership in the post-reform period. In addition, we find that SOEs with a higher level of managerial ownership tend to undergo the reform process earlier than their counterparts. Our study sheds light on the successes and failures of SOE privatization in China and the significant role played by managerial ownership and market monitoring in enhancing the performance of listed SOEs.

Essay two: The Market Reform of Non-tradable Shares and accounting conservatism in China. We study the role of regulatory changes on accounting conservatism using the recent market reform in China, which requires the transfer of the government's non-tradable shares into tradable shares. We hypothesize that the reform, which reduces the state ownership and control, has enhanced the incentives of the preparers and users of financial statements to supply and demand more conservative accounting. Consistent with our hypothesis, we find that the listed state-owned enterprises (SOEs) have reported more conservative accounting in response to the reform and investors now place more value on such conservative accounting earnings. Our results suggest that this market reform has influenced the incentives of preparers and provide the evidence of a regulatory change on conservatism called for by Watts (2003b).

Keywords: Market reform of non-tradable shares, managerial ownership, monitoring, growth prospects, agency costs, firm performance, accounting conservatism, China

TABLE OF CONTENTS

DECLARATION.....	i
ABSTRACT.....	ii
ACKNOWLEDGEMENTS.....	iii
TABLE OF CONTENTS.....	v
LIST OF TABLES.....	vii
LIST OF FIGURES.....	viii
Chapter 1 Introduction.....	1
Chapter 2 Essay One: The Market Reform of Non-tradable Shares and Firm Performance in China.....	5
2.1 Introduction.....	5
2.2 Background and Relevant Literature.....	11
2.2.1 The design and reform of non-tradable shares.....	11
2.2.2 Literature on the privatization and performance of SOEs.....	13
2.3 Theory and hypothesis development.....	18
2.3.1 The model.....	18
2.3.2 A two-period model.....	22
2.3.3 Research hypotheses.....	24
2.4 Sample Selection and Descriptive Statistics.....	27
2.4.1 The sample.....	27
2.4.2 Descriptive statistics.....	28
2.5 Results.....	32
2.5.1 The non-tradable share reform and firm performance.....	32
2.5.2 Factors accounting for the effect of the non-tradable share reform.....	33
2.5.3 The inverse U-shape relationship between managerial ownership and firm performance.....	37
2.5.4 Timing of the reform and its determinants.....	38
2.6 Robustness Checks.....	43
2.6.1 Using alternative sample periods.....	43
2.6.2 Operating cash flow, discretionary accruals, and the reform.....	43
2.6.3 Alternative measure of Tobin's q.....	45
2.7 Conclusion.....	47
List of Figures for Essay One.....	49
List of Tables for Essay One.....	51
Chapter 3 Essay Two: The Market reform of Non-tradable Shares and Accounting Conservatism in China.....	59
3.1 Introduction.....	59
3.2 Background to the market reform of non-tradable shares.....	64
3.2.1 Design of non-tradable shares.....	64
3.2.2 Reform of non-tradable shares.....	65
3.3 Hypothesis Development.....	67

3.4 Sample Description	73
3.4.1 Sample	73
3.4.2 Descriptive statistics	75
3.5 Model Design and Empirical Results	77
3.5.1 Share reform and the timely recognition of gains and losses	77
3.5.2 Role of accruals in the timely recognition of gains and losses	80
3.5.3 Earnings Informativeness	82
3.6 Robustness tests	85
3.6.1 Alternative sample period and alternative R_{it} measure	85
3.6.2 Alternative model specification	85
3.6.3 Alternative perspective on the role of accruals	86
3.6.4 Alternative measures of NIE_{it}	87
3.6.5 Sub-sample examination of the role of the debt market in demanding conservatism	87
3.7 Conclusion	89
List of Tables for Essay Two	91
Chapter 4 Conclusion and Policy Implication	107
List of References	110
References for Essay one	110
References for Essay two	117
Curriculum Vitae	122