

## DOCTORAL THESIS

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

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

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**for the degree of**

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## 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

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