Improving corporate governance where the State is the controlling block holder: Evidence from China

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Improving corporate governance where the State is the controlling block holder: Evidence from China

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Abstract:
We examine changes in market values and accounting returns for a sample of publicly traded Chinese firms around announcements of block-share transfers among government agencies ("State Bureaucrats"), market-oriented State-owned enterprises ("MOSOEs") and private investors ("Private Entities"). We provide evidence that transfers from State Bureaucrats to Private Entities result in larger increases in market value and accounting returns than transfers to MOSOEs. We also find that CEO turnover occurs more quickly when shares are transferred to Private Entities. Moreover, we find that the changes in firm value and accounting returns, as well as the likelihood of CEO turnover, are all functions of the incentives and managerial expertise of the new block holder. We conclude that corporate governance can be improved at State-controlled firms by improving the incentives and managerial expertise of controlling block holders, and that this is better accomplished by transferring ownership to private investors rather than by shuffling ownership among State-controlled entities.

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1. Introduction

The State usually remains the controlling block holder after a share-issuance privatization ("SIP"). In a study of 630 SIPs from 59 countries, Jones *et al.* (1999) find that the median offering by the State was only 35%, leaving the government not only with a controlling stake but also with majority-ownership. This raises several important questions: Who is the more effective monitor of management of a listed firm: the State or a private owner? Can the State improve performance by making governance changes that go short of full privatization? For example, can the State improve performance by transferring ownership from bureaucrats to managers of corporatized State-owned enterprises, who have better incentives and experience than bureaucrats? In this study, we attempt to shed light on these important questions by examining 631 negotiated block trades among different State-controlled and private shareholders in China during 1998-2002.

Most empirical studies of privatizations find that full privatizations and, to a lesser extent, partial privatizations lead to improvements in firm performance (see the surveys by Megginson and Netter (2001) and Djankov and Murrell (2002)).[1] Our study analyzes the impact of changes in corporate governance *after* partial privatization of State-owned enterprises (SOEs) has been completed. Focusing on these "second round" changes in ownership, we find that significantly larger improvements in firm performance do occur when control is transferred to private owners than when control is transferred to market-oriented SOEs. Thus, consistent with the literature on block-holder identity, we show that the

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[1] *Full privatization* refers to the transfer of control from the State to private owners whereas *partial privatization* refers to the issuance of publicly traded shares by a State-owned enterprise where the State maintains majority ownership and/or control. Sun and Tong (2003) and Gupta (2005) study the impact of partial privatizations in China and India, respectively.

specific managerial expertise and incentives of block holders are important determinants of firm value (see the survey by Holderness (2003)).

We choose to analyze Chinese firms because intra-governmental block transfers are relatively common in China and, until recently, reflected efforts by the Chinese government to improve corporate governance while maintaining ultimate control at the country's largest firms.[2] The Chinese government uses two basic ownership structures to participate in the equity of listed companies: (i) direct control through *State Bureaucrats* at government agencies and ministries; and (ii) indirect, but ultimate, control through *market-oriented State-Owned Enterprises* (MOSOEs).[3]

At *MOSOEs*, the wedge between cash-flow and control rights is smaller than at *State Bureaucrats* due, in part, to differences in managerial compensation. *State Bureaucrats* are not directly rewarded based on the financial performance of the firms they monitor (Xu and Wang, 1999), whereas managers of *MOSOEs* are partially rewarded based on their firm's financial performance (Groves *et al.*, 1995; Firth, Fung and Rui, 2006). In addition, *MOSOEs* are allowed to retain after-tax profits for internal use, providing management with additional incentive to maximize profits.[4] Furthermore, as separate legal entities, *MOSOEs* are expected to be more focused on commercial objectives (Broadman, 1997).

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[2] Official documents and speeches indicate that the Chinese government intended to maintain ultimate control over a large segment of the Chinese economy, including those that had been partially privatized. See, for example, President Jiang Zemin's speech at the 15th Congress of the Chinese Communist Party in the fall of 1997. According to some observers, Chinese authorities sought to improve the corporate governance of State-controlled firms as a means of avoiding further privatization (Lin, 2000; Cao, 2000).

[3] This classification relies, in part, on the concept of the "ultimate controlling shareholder" introduced in La Porta *et al.* (1999, pp. 475-476). Without the concept of the ultimate controlling shareholder, we would not be able to identify firms controlled by SOEs as being ultimately controlled by the State.

[4] According to Lin (2004, p. 130), "state enterprises, collective enterprises, private enterprises, and any other enterprises pay an income tax of 33%" and, in addition, must pay a value-added tax at 17% for most products. However, managers of SOEs face a number of restrictions on how they can use these retained earnings.

In this study, we investigate changes in value and performance when block transfers occur at firms that have been partially privatized, but where the State maintained a controlling interest. We find significantly larger improvements in value and performance if blocks are transferred from State control to private control relative to transfers between State-controlled entities. We are able to mitigate concerns regarding the endogeneity of ownership structure and performance by examining how changes in ownership are valued by the stock market. Clearly, it is the changes in ownership that lead to the changes in market valuation and not vice versa.

Our results show the importance of these differences in identity of the block holder. For example, focusing on block transfers of at least 20%, we find the excess returns surrounding the announcement of transfers from *State Bureaucrats* to *Private Entities* average 33.6%, as compared with 26.6% for block transfers between *State Bureaucrats* and *MOSOEs* and 20.9% for block transfers between two *State Bureaucrats*. These large value increases around control transfers to *Private Entities* are mirrored in significant improvements in accounting performance following block transfers from *State Bureaucrats* or *MOSOEs* to *Private Entities*. In the two years after the year these transfers are announced, the annual return on assets is more than 130 basis points higher than in the two years before the transfer announcement.

Furthermore, CEO turnover is faster when control is transferred to *Private Entities*. Replacement of the CEO within three months of the block-transfer announcement is significantly less likely when a *State Bureaucrat* is the transferor or transferee. These differences disappear when we look at replacements within 12 months of the block transfer announcement.

We contribute to the literature in at least five important ways. First, we contribute to the literature on how State ownership affects the performance of partially privatized firms

(Kole and Mulherin, 1997; Sun and Tong, 2003; Boubakri, Cosset and Guedhami, 2005a; D'Souza, Megginson and Nash, 2005; Gupta, 2005). Our results show that block transfers at partially privatized State-controlled firms where the State reduces or relinquishes its ownership share are associated with increases in market values and improvements in accounting performance that are significantly greater than those associated with block transfers among other types of block holders. This is innovative because we isolate the effect of privatization, i.e., change from State to private control, from the effects of issuing public equity.[5]

Second, we contribute to the literature on *why* State-owned firms perform poorly. The "political view" posits that politicians interfere and pursue political objectives other than profit maximization (Shleifer and Vishny, 1994), whereas the "managerial view" posits that States are poor monitors because there is no individual with strong incentive nor is there a public price to provide information (Laffont and Tirole, 1993).[6] It is difficult to separate both effects for SIPs. However, the firms in our sample do have public prices and managers of market-oriented SOEs do have incentives to maximize firm value, yet we find that private monitors are superior to State monitors. Hence, our evidence is more supportive of the political view than the managerial view, and complements Fan, Wong and Zhang (2007), who find that politically connected Chinese firms perform more poorly than other listed Chinese firms on both a market-value and accounting basis.

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[5] Gupta (2005) shows that stock market listing of State-controlled firms improves performance because of the role the stock market plays in monitoring and rewarding managerial performance even when there is no change in control. In addition, studies of equity offerings have shown that changes in firm performance around the time of initial public offerings are affected by decisions to issue shares during hot markets (Ritter 1991; Loughran and Ritter, 1995), or to manipulate earnings prior to share issuance (Teoh, Welch and Wong, 1998; Aharony, Lee and Wong, 2000; DuCharme, Malatesta and Sefcik, 2003; Chen and Yuan, 2004).

[6] Without share-price information, managers miss important signals about their behaviour, face restrictions on performance compensation and are insulated from the market from corporate control.

Third, we extend the literature on block-holder identity and partial corporate control (Holderness and Sheehan, 1985 and 1990; Barclay and Holderness, 1991; Bethel, Leibeskind, and Opler, 1998; Franks and Mayer, 2001). We provide new evidence from Chinese markets that changes in firm value associated with block transfers, and subsequent changes in top management, are functions of the incentives and managerial skills of the new block holders. Specifically, we find that share transfers to private block holders are most effective in improving corporate governance and increasing firm value (Grossman and Hart, 1988; Harris and Raviv, 1988; Shleifer and Vishny, 1997). Because many of the world's largest enterprises, both listed and unlisted, have the State as the controlling block holder (La Porta *et al*., 1999; Claessens, Djankov and Lang, 2000), we regard this as an important extension of current research that has focused exclusively on share transfers between private block holders.

Fourth, our findings contribute to the literature on the consequences of non-tradable shares (Karpoff and Rice, 1989; Fan, Wong and Zhang, 2007). Here, we provide evidence that changes in block-holder identity can mitigate the adverse consequences of non-tradable shares.

Finally, we contribute to the growing body of work on China that abandons the official ownership scheme, which classifies owners of non-tradable shares primarily into two categories—*State Shares* and *Legal-Person Shares*. As Delios *et al*. (2006, p. 319) write, "There are liabilities in the official scheme that extend from how it obfuscates the ultimate identity and control of a shareholder." Both *State Shares* and *Legal-Person Shares* can be owned by the government directly or indirectly through SOEs, while *Legal-person Shares* also can be owned by private domestic investors and private foreign investors. Our classification, based upon the work of Delios *et al*. (2006) and described in detail below,

avoids the confusion regarding control and incentives inherent in the official share classifications.

The remainder of the paper is organized as follows. In Section 2, we present a brief review of the literature on privatization and block holder identity, while, in Section 3, we provide institutional details about Chinese stock market and ownership structure of Chinese firms. We discuss the role of the Chinese government and develop hypotheses in Section 4. In Section 5, we describe our data and methodology. In Section 6, we present the results of our empirical analysis and, in Section 7, we provide a summary and conclusions.

2. Literature Review

Denis and McConnell (2003) write that "privatization is a natural experiment allowing us to examine how corporate governance mechanisms evolve, interact and affect firm performance." Megginson and Netter (2001) and Djankov and Murrell (2002) provide comprehensive reviews of studies published prior to 2000, which generally find that privately owned firms are more profitable and efficient than similar SOEs. We briefly summarize the findings of some of the most prominent multi-country studies and then review some of the more recent studies that look at partially privatized firms.

2.1 Multi-country studies of privatization

Boardman and Vining (1989) examine the 500 largest industrial firms outside of the U.S. to compare the performance of SOEs, private companies and mixed enterprises. They find that SOEs and mixed enterprises perform significantly worse than private companies.

Megginson, Nash and Randenborgh (1994) examine changes in performance of 61 State-owned enterprises from 12 developed and developing countries that were partially or

completely privatized during 1961-90. They find that accounting performance improved significantly.

Boubakri and Cosset (1998) extend the work of Megginson, Nash and Randenborgh (1994) by focusing on firms in developing countries, which constituted only a small portion of the earlier study. Analyzing data from 79 State-owned enterprises in 21 developing countries that underwent either partial or complete share-issuance privatizations, they also find significant improvements in accounting performance.

D'Souza and Megginson (1999) compare pre- and post-privatization performance of 85 SIPs from 28 industrialized countries that occurred from 1990-96. They find that profitability, output and efficiency increased significantly after privatization. They conclude (p. 1,400) that their results, in conjunction with those of Megginson, Nash and Randenborgh (1994) and Boubakri and Cosset (1998), "strongly suggest that privatization is a powerful tool for improving the financial and operating performance of former state-owned enterprises in many different institutional settings."

Jones *et al.* (1999) analyze 630 SIPs in 59 countries for evidence regarding how political and economic factors affect the terms of SIPs. Most relevant for our study, they find that the State remains the majority owner in 71.1% of the SIPs, with 35% being the median percentage of shares offered.

Boubakri, Cosset and Guedhami (2005a, b) investigate the relation between ownership structure, investor protection and firm performance using data on 209 privatized firms from 39 countries. They find that the State relinquishes control over time to benefit local institutions, individuals and foreign investors and that private ownership becomes more concentrated over time. The positive effect of private ownership concentration is more pronounced in countries with poor investor protection.

D'Souza, Megginson and Nash (2005) find that post-privatization performance improvements in developed countries result from changes in government and foreign ownership affecting employment and capital expenditures. They also find that institutional factors are not very important, in contrast with Boubakri, Cossett and Guedhami (2005b).

A few studies cast doubts on the performance benefits of privatization. For example, Kole and Mulherin (1997) examine 17 U.S. firms where the U.S. government seized enterprises owned by German and Japanese companies, resulting in controlling State blocks of 35% or more. During the post-WWII period when the government maintained its controlling ownership, they find that the accounting performance of these State-controlled firms was not significantly different from privately controlled firms in the same industry. They conclude that the comparable performance of State and private firms results from the availability and implementation of monitoring devices (e.g., the board of directors and the managerial labour market), which, they argue, can favorably affect performance of partially privatized but State-controlled firms.

Dewenter and Malatesta (2001) use panel data for 63 privatized firms and find earnings improve prior to, but decline following, SIPs. They conclude that privatization does little to improve performance because the improvements they observe occur just prior to privatization, when the State is still the majority shareholder and no public shares have been issued.

2.2. Partial-privatization studies

Is it necessary for State to give up control in order to improve performance, or is partial privatization a viable alternative? Nellis (1994, 1999), Boyko *et al.* (1996) and Shleifer (1998), among others, argue that full privatization is necessary to obtain significant improvement in the performance of an SOE. On the opposing side, Yarrow (1986), Vickers

and Yarrow (1991), Allen and Gale (2000), among others, argue that less drastic measures, such as competition, deregulation and partial privatization, can be effective.

Evidence from a number of empirical studies suggests that less drastic measures can, indeed, be effective. Groves *et al*. (1995) examine the performance of Chinese SOEs following a series of 1980s reforms, including corporatization and implementation of incentive pay for managers. They find that SOE productivity improved following these reforms, and link these improvements to pay-for-performance.

Li (1997) also examines changes in the productivity of Chinese SOEs during the 1980s. He provides evidence that total factor productivity increased significantly between 1980 and 1989, and provides evidence that most of this increase was attributable to the new incentive mechanisms, greater product market competition and better factor allocation. These findings imply that significant economic reform of SOEs can be accomplished without formal privatization.

Aivazian, Ge and Qiu (2005) examine the restructuring of SOEs into corporations under the Corporate Law of 1993. They find that corporatization significantly improved the performance of SOEs as measured by profitability and efficiency. Additionally, they find that past performance was not a major consideration in the government's selection of firms to corporatize. However, their analysis is based upon a non-random survey of 429 SOEs of which 308 were corporatized, which is not likely to be representative of the thousands of SOEs involved in the corporatization process.

Allen, Qian and Qian (2005) examine three sectors of the Chinese economy: *State*, *listed* and *private*. They find that China's rapid economic growth during the 1997-2002 period was driven primarily by activity in the private sector. Within the listed sector, they find that dividend ratios and firm values are lower than those of comparable firms in countries with better legal protection.

Several recent studies examine partial privatization, where the government issues publicly traded shares but maintains a controlling stake in the firm. Sun and Tong (2003) evaluate changes in accounting performance following the share-issuance privatization of 634 Chinese firms that went public during 1994-98. They find that earnings, sales and productivity improve but ratio measures of profitability (return on sales) deteriorate. They also find that performance is related to the type of State ownership, but base this analysis upon the official Chinese share classifications.

Wei, Varela, D'Souza and Hassan (2003) examine the financial and operating performance of 208 Chinese corporations that were partially privatized during 1990-97 by share-issuance privatization. They find that real output, real assets and sale efficiency improve, while leverage declines, following share issuance, but do not find any changes in profitability. They also find superior performance for firms where control passed from the State to private investors.

Chan, Wang and Wei (2004) examine the long-term performance of Chinese firms that went public during 1993-98. They find that IPO abnormal returns are partly explained by the ownership of State and Legal Person entities, based upon official Chinese share classifications. They also find that, in the long-term, firms issuing A-shares for domestic investors under-perform non-IPO benchmarks.

Gupta (2005) investigates whether performance improves following partial privatization, i.e., after sale of a non-controlling interest by the State. He uses data on the population of Indian SOEs from 1990-2000, to compare the accounting performance of partially privatized State-controlled firms with that of SOEs that did not issue public equity. The government maintained majority ownership in each of the partially privatized firms, so that shares trade but control remains with the State. This enables him to test if it is inadequate information about managers that is important to the inefficiency of SOEs. Gupta finds that

partial privatization significantly improves performance and that the source of gains is a reduction in agency costs that improve firm efficiency.

Wei, Xie and Zhang (2005) analyze the relation between ownership and firm value as measured by Tobin's Q for partially privatized Chinese firms during the 1991-2001 period. Using official share classifications, they find that both State and legal-person ownership are negatively related, whereas foreign ownership is positively related, to firm value.

Fan, Wong and Zhang (2007) examine a sample of partially privatized Chinese firms for evidence on how political connections affect performance. They proxy government intervention in a firm's operations by the political connections of the CEO—whether she is a current or former Chinese government bureaucrat. They find that politically connected firms constitute more than a quarter of their sample of 790 companies and exhibit significantly inferior performance relative to their unconnected counterparts, on both accounting and market-value bases.

Finally, Deng, Gan and He (2007) examine the role of large block holders in determining the success of partial privatization in China. They find that parent-company block holders are more likely to tunnel resources from listed firms than are other types of block holders.

3. Institutional Background

3.1. Historical Perspective

In the traditional Chinese SOE that existed from the 1950s until the early 1980s, the central government held 100% of the control rights and cash-flow rights, although much of the residual cash flows from SOEs were allocated to local governments where the SOEs were located. Managers of SOEs were hired and fired by Communist Party officials who led the government agencies or ministries responsible for overseeing the SOEs and to which the SOE

managers reported. Managers were evaluated based upon their ability to meet agency/ministry plans, which involved political as much as economic criteria. Funding for SOEs came in the form of "policy loans" from State-owned banks, which essentially allocated capital to the Chinese economy rather than performing traditional banking functions. So long as an SOE fulfilled its policy role, the central government would ensure that it received funds needed for operations regardless of profitability or solvency. Under such a system, it is not surprising that SOEs were notoriously unprofitable and inefficient.

Beginning in 1984, the Chinese government sought to improve the efficiency of its SOEs through a series of gradual reforms that began with the accordance of "legal-person" status to SOEs, which was intended to make SOEs responsible for performance.[7] In addition, the central government transferred both the control rights and residual cash-flow rights to local-government entities. By pairing cash-flow rights with control rights at the local government level, this reform provided local government with the incentive to improve SOE performance.

Local governments responded to the incentives provided by their newfound cash-flow and control rights by implementing a series of governance reforms that Groves *et al.* (1995) classify into three strands: (i) giving SOE managers more autonomy from Communist Party officials at the agencies and ministries to which they reported; (ii) allowing SOEs to retain a portion of any profits they produced; and (iii) developing governance mechanisms to reward SOE managers for superior firm productivity.

In 1993, the National People's Congress enacted the Chinese Corporate Law of 1993, which paved the way for partial privatization of the largest of SOEs. This law defined two types of corporations: closely held and publicly held. For publicly held corporations, the law required a governance structure consisting of shareholders who exercise their rights at a

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[7] See Schipani and Liu (2002).

general meeting, a board of directors and a board of supervisors. The law also established the positions of CEO and Chairman of the Board of Directors.

For closely held corporations, the Corporate Law sets forth similar requirements, but with some exceptions. For corporations wholly owned by the State, the law requires only a Board of Directors and a CEO. There is no need for an annual meeting, as the State is the sole shareholder, but neither is there a Board of Supervisors or a Chairman of the Board. This gave the CEO and Board of Directors of a wholly-State-owned corporation considerably more power than their counterparts at other corporations, which allegedly led to problems of corruption. In response, the NPC amended the Corporate Law in 1999, requiring wholly-State-owned corporations to create a Board of Supervisors, whose members would be chosen by central government.

3.2 Partial Privatization and official Share Classification

The (partial) privatization of Chinese SOEs began years before passage of the Corporate Law of 1993 when the Shanghai Municipal Government approved a set of regional securities regulations in 1984. That approval was followed in the same year by the issuance of shares in an electronics company, which began to trade on an over-the-counter market run by the Industrial and Commercial Bank of China in 1986 (see Ellman, 1988; Qi, Wu and Zhang, 2000).

The Shanghai Stock Exchange (SHSE) was established in December of 1990, followed by the Shenzhen Stock Exchange (SZSE) in April 1991. Seven SOEs went public during 1991.[8] Also in 1991, the Chinese Securities Regulatory Commission ("CSRC")—the Chinese equivalent of the U.S. Securities and Exchange Commission—was established to monitor and regulate the two stock exchanges and their members.

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[8] The primary difference between the SHSE and SZSE exchanges is geographic. The reason for establishing two stock exchanges rather than one was to stimulate competition.

Table 1 provides some descriptive statistics about the Chinese stock markets for the period from 1992-2002. During this period the number of firms rose from 53 to 1,224, while the market capitalization rose from $13 billion in 1992 to a peak of $579 billion in 2000, before declining to $465 billion at the end of 2002.[9] Each exchange accounts for approximately half of the total number of firms in each year, but there were 206 more firms trading on the SHSE than on the SZSE in 2002.

In China, there are several different "official" classes of shares. Shares are classified based on the residency of their owner as *domestic* (A shares) or *foreign* (B, H and N shares). Because more than 90 percent of the listed firms have only domestic shares, we delegate the description of foreign shares to Appendix I. Domestic *A* shares are further divided into *State* shares, *Legal-Person* shares, *Tradable A* shares, and *Employee* shares, of which only *Tradable A* shares, as the name implies, are publicly traded on one of China's two stock exchanges. All shares of a listed company have the same voting rights and cash-flow rights, i.e., one share is entitled to one vote. Each of the official share classes is described below.

Tradable A shares are owned by individual Chinese residents and domestic legal persons, but are not allowed to be owned by foreign investors. They are the only type of equity that can be publicly traded among domestic investors. Individuals are prohibited from holding more than 0.5% of total shares outstanding for any listed company. Regulators

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[9] The Chinese government has struggled for many years in its attempts to resolve the problems arising from non-tradable State shares. In 2001, for example, it proposed transferring State shares to private investors through open market transactions, but this proposal triggered a collapse in the Chinese markets beginning in June of that year. Not until 2005 did the Chinese government come up with a suitable plan for converting non-tradable shares into tradable shares. This plan involved offering various forms of compensation to holders of Tradable A shares in exchange for approving the conversion. Most companies approved the conversions during 2005-2006 and Chinese share prices rocketed. The Shanghai Composite index rose from a low of 1,100 in January 2006 to new highs of more than 5,000 in September of 2007. However, as of September 2007, the State had yet to relinquish its controlling interest in most listed firms because of limitations on the sale of converted shares put into place to allay concerns of investors about the potential effects of such sales on share prices.

typically require that *Tradable A* shares account for more than 25% of total outstanding shares when a company is listed. The market price of a listed company refers to the price of *Tradable A* shares.

State shares, *Legal-Person* shares and *Employee* shares are non-tradable, meaning that they do not trade freely on a stock exchange. These types of shares can only be transferred with approval of the CSRC.

Employee shares are owned by the employees of a listed company. Employee shares are registered under the title of the labour union of the company, which represents the shareholding employees and exercises their rights. After a holding period of six to twelve months, the company may file with the CSRC to allow its employees to sell their shares in the open market. Shareholding by managers is small. Tian (2001) reports that average managerial ownership for listed Chinese firms during 1994-1998 was as small as 0.005% of the total number of shares outstanding. Managers are not allowed to transfer their shares during their tenure.

The distinction between *State* shares and *Legal-Person* shares is murky, at best, and emanate from a 1994 regulation dealing with restructuring of SOEs.[10] *State* shares are those held by government agencies (e.g., the Bureau of State Property Management and local finance bureaus) and by some types of corporatized SOEs. For most listed companies, *State* shares make up the largest percentage ownership of any classification. *Legal-Person* (LP)

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[10] Article 8 of the Regulation for State-owned Shares in Stock Corporations, which was announced on November 3, 1994 by the State Reform Commission for Economic Restructuring and the State Assets Management Bureau, sets forth how contribution of State assets to a stock corporation are to be classified. If a stock corporation is created out of the assets of existing SOEs and the percentage of the stock corporation's assets accounted for by contributed State assets is less than 50, then the assets are classified as State-owned *Legal-Person* shares; if greater than 50, then the assets are classified as *State* shares. If a subsidiary of an SOE is restructured as a stock company, then all of the assets should be classified as State-owned *Legal Person*. If an entire SOE is restructured into a stock corporation, then all of the assets should be classified as *State* share. If the stock corporation is newly set up, then assets from the government should be classified as *State* shares, and assets from SOEs or their subsidiaries should be classified as State-owned *Legal-Person* shares.

shares are those owned by domestic corporations or other non-individual legal persons. Hence, this category includes shares held by the government through legal-person entities, as well as shares held by private entities, both domestic and foreign. Like *State* shares, *Legal-Person* shares cannot be traded on the two exchanges or transferred to foreign investors, but can be transferred to domestic corporations, when approved by the CSRC.

Table 2 presents an overview of the percentage of total shares in each of the different share classes across Chinese firms from 1992 to 2002. The table shows that *State* shares, *Legal-Person* shares, and *Tradable A* shares are the three dominant share categories. *Tradable A* shares have been growing steadily during the past 15 years. In the year 2002, listed firms had, on average, 47.2% *State* shares, 17.3% *Legal-Person* shares, 25.7% *Tradable A* shares and 9.0% Foreign (*Tradable B* and *Tradable H*) shares. It is interesting that, although the total percentage of *State* shares is relatively stable, State ownership underwent substantial changes throughout our sample period.

The typical method used to transfer control at listed companies is known as a share-transfer agreement. Once a share-transfer agreement is reached between two parties, the listed company will apply to the CSRC and the Ministry of Finance to obtain approval. At the same time, the firm will make a public announcement regarding the proposed changes in its ownership structure. For example, on November 20, 1998, both the *Securities Times* and the *Chinese Securities* published the announcement by the board of Shaanxi Precision Alloy Co., Ltd. that the original shareholder—Shan Xi Province State Asset Management Bureau—had signed a stock transfer agreement with Shenzhen HuaTian Electricity Investment Co., to transfer its 31.64% State block holding of Shaanxi Precision Alloy Co., Ltd. to Shenzhen HuaTian Electricity Investment Co. In the announcement, Shenzhen HuaTian Electricity Investment Co. is described as a corporatized SOE.

3.3 Alternative Share Classification

There are serious shortcomings in the official share classification for any analysis of corporate governance of listed firms in China. To illustrate the confusion, we refer to Table 5 in Delios *et al*. (2006) where the authors report the overlap between their 17 (ultimate) ownership categories and the official Share Classification. For example, of the 556 times a State Asset Management Bureau (SAMB) was classified as a top-10 shareholder in a listed firm in their sample, the SAMB was officially classified as holder of State shares 105 times (19 percent), as a Legal Person shareholder 221 times (40 percent), and in 230 cases the SAMB was classified as A-shareholder or 'Other'. Similarly, Private Corporations were officially classified as holders of State shares in 7.4 percent of the cases, as holder of Legal Person shares in 59.8 percent of the cases, and as holder of Tradable A shares or 'Other' in 32.8 percent of the cases.

Because of these ambiguities, we adopt the classification scheme of Chinese ownership developed by the National University of Singapore ("NUS") Business School and described in Delios *et al*. (2006). The NUS-classification produces 17 detailed classes of non-tradable shares, which we regroup in four groups of ultimate owners. The groups are as follows (where we refer to the Delios *et al*. (2006) detailed classifications in parentheses). *State Bureaucrats* includes: central government (1); local governments (2); government ministries (3); government bureaus (4); State asset-investment bureaus (6); State asset-management bureaus (7); State research institutes (10); and State-owned banks (16). The group *Market-Oriented SOEs* includes companies that formerly were government ministries (5); market-oriented state-owned enterprises (9) and infrastructure construction companies (8). The *Private Entities* classification includes security companies (11); investment funds (12); private companies (13); private individuals (14); and work unions (17). The group *Foreign Entities* includes foreign companies and individuals (15).

The distinction between *State Bureaucrats* and *Market Oriented SOEs* (MOSOEs) is important because the incentives (e.g., profit-sharing) and expertise (e.g., managerial and industry expertise) of managers of market-oriented SOEs are fundamentally different from those of government bureaucrats. We return to this issue in the next section.

Table 3 shows the distribution of ownership categories of the largest block holder for listed firms by year, from 1993-2002, based upon our classification scheme. Beginning in 1996, *MOSOEs* dominate the sample. The number of *State Bureaucrats* remains relatively constant from 1996-2002, while the number of *Private Entities* steadily increases from 13 in 1993 to 155 in 2002. The number of *Foreign Entities* ranges from 9 in 1993, to 18 in 1996. The annual total numbers of firms in Table 3 differs from totals in Table 1 because NUS was unable to classify a small number of firms.

4. Ownership Structures and Hypotheses

4.1 Government Ownership Structures

Because of differences in incentives and residual cash-flow rights, we expect that the two alternative government ownership structures (*State Bureaucrats* vs. *MOSOEs*) have differential impacts on firm value, even though the State is the ultimate controlling shareholder in each case. *State Bureaucrats* ("*SBs*") such as the Bureau of State Property Management or local finance bureaus exercise ownership rights on behalf of the Chinese State. When a *SB* controls the majority of the shares in a company, officials of the block holder have the right to select board members and chief officers, and to veto business and investment plans proposed by firm management. As government officials, however, they are prohibited from involvement in the management of State-controlled firms.[11]

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[11] In the 1984 "Decision on Reform of the Economic Structure," it is declared that government departments will not manage or operate enterprises directly (Cao, 2000). This measure was aimed at transforming State-*run* enterprises into State-*owned* enterprises.

SB officials have no residual cash-flow rights from the companies they monitor; all dividend revenues from the companies under their control are submitted to the Ministry of Finance or to local governments. Moreover, *SB* officials are not rewarded based on the performance of the SOEs that they monitor (Xu and Wang, 1999; Lin 2000).[12]

SB officials typically have little or no management experience and little industry-specific knowledge (Firth, Fung and Rui, 2006). Hence, it is difficult for them to evaluate management decisions. The promotion of *SB* officials depends largely on how well they execute the instructions of central or local government rather than how much they contribute to creating firm value or dividend revenues. Based on these characteristics, we hypothesize that *SB*-officials are unlikely to have profit maximization as the primary goal for *SB*-controlled listed firms.

In contrast to *SB* officials, the managers of *MOSOEs* typically receive explicit monetary rewards based on their firm's performance (Groves *et al.,* 1995; Firth, Fung and Rui, 2006). This incentive compensation at *MOSOEs* reduces the wedge between cash-flow and control rights, which should mitigate agency problems between the controlling block holders (the MOSOE) and minority shareholders of the listed firm. Furthermore, *MOSOEs* have a degree of autonomy and are allowed to retain their after-tax profits, which can be used according to their own plans. This provides managers of *MOSOEs* with greater incentive to focus on profitability than managers of *SBs*.[13]

Finally, changes in the identity of the block holder can increase firm value by improving the quality of management and/or monitoring (Barclay and Holderness 1991).

[12] Of course, *SB*-officials (as well as *MOSOE*-officials) enjoy the benefits of indirect perquisites, which can be substantial, including luxury housing, car with driver, expense accounts, etc.

[13] When we analyze share transfers among State entities, it is unlikely that there is a substantial change in the calculated control rights and cash flow rights of the ultimate owner around the share transfers in our study. Fan, Wong and Zhang (2005) show that, across a sample of 750 State-controlled firms, the average ratio of cash flow to voting rights of the ultimate owner equals 96 percent.

Because of their managerial experience in industry, we expect that MOSOE block holders are more efficient and professional than government officials in monitoring the firms under their control. In some cases, *MOSOEs* contribute directly to the listed firms under their control, in the form of management, capital or new technology. According to Zou (2004), the Chairman of the SOE-controlled listed firms is also the Chairman of the parent SOE in more than 60 percent of the cases. This number is only 16 percent for listed companies that are controlled by *SB*s. Furthermore, Chen and Wang (2004) show that top-executive turnover is significantly more sensitive to firm performance at listed firms controlled by *MOSOEs* than at listed firms controlled by *SB*s.

4.2 Private Ownership Structure

When a private entity is the controlling block holder, the incentives of the block holder are most closely aligned with those of minority shareholders. Private block holders receive 100% of the cash flows to which the block holder is entitled, in contrast to both government ownership structures. Hence, private block holders are more likely than State block holders to pursue the maximization of shareholder wealth.[14] Also, private block holders choose managers on the basis of their ability to maximize shareholder wealth (or, at least, to maximize the controlling block holder's wealth) whereas State block holders choose managers based, often in large part, upon political considerations and the ability to meet social objectives.

However, controlling block holders also have incentives to expropriate wealth from minority shareholders, especially in countries with weak investor protection (La Porta *et al.* 1999; Johnson *et al.* 2000). Fan, Wong and Zhang (2005) show that, across a sample of 750 State-controlled firms, the average ratio of cash flow to voting rights of the ultimate owner

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[14] Cull and Xu (2005) find that private owners reinvest profits in the firm at higher rates than State owners.

equals 0.96. For the 62 listed firms in their sample that are controlled by private entities, they find that the average ratio of the cash flow to voting rights is 0.54. Given the larger wedge between cash flow and control rights at listed firms with private entities as ultimate owner, we conjecture that expropriation of minority shareholder wealth is more severe after block transfers to private owners.

Evidence in Berkman, Cole and Fu (2008) is consistent with this conjecture. These authors find that Chinese firms are more likely to issue loan guarantees to their controlling block holder—a form of tunneling—when the controlling block holder is private rather than State controlled, either directly or indirectly through an SOE. However, Cheung *et al*. (2005) analyse a sample of 294 connected transactions between Chinese listed firms and their controlling shareholders during 2001-2002, and conclude that state ownership does not appear to protect firms from expropriation. They report that minority shareholders in firms conducting connected transactions with SOEs, end up significantly worse off than minority shareholders in firms conducting connected transaction with non-SOEs.

4.3 Hypotheses

Based on the differences in corporate governance among *SB*s, *MOSOEs* and *Private Entities,* we hypothesize that *MOSOE* block holders are more likely to contribute to value creation than *SB* block holders, and that *Private Entity* block holders are more likely to contribute to value creation than either type of *State* block holder. This should be observable in differences in abnormal returns and subsequent accounting performance following the announcements of block share transfers from *SB*s to *MOSOEs,* relative to share transfers from *SB*s to *SB*s, and from *SB*s or *MOSOEs* to *Private Entities*. We refer to this as the *incentive hypothesis*.

One alternative view of block transfers from *SB*s to *MOSOEs* is that such transfers introduce an additional level of bureaucracy that might oppose changes (Broadman 1997).

MOSOEs are typically fully owned and controlled by the State. Their weak governance structure might simply be mapped onto the listed company as *MOSOEs* themselves are often owned by *SB*s. If so, then we should expect zero or negative returns around the announcements of block transfers from *SB*s to *MOSOEs*, and we should expect accounting performance to deteriorate in years following the announcement. We refer to this as the *added-bureaucracy hypothesis*.

Yet another view of block transfers arises from the widely publicized manipulation of stock prices at Chinese firms. According to this view of the world, negotiated block transfers are revealed to insiders long before they are publicly announced in the financial press. This presents insiders who own non-tradable shares the opportunity to accumulate large positions in Tradeable A shares in the names of family, friends or fictitious parties prior to public announcement of the block transfer. Once the transfer is made public, along with promises to restructure the listed firm, investors bid up the stock price. At that point, the insiders dump their shares, earning substantial profits, but also putting downward pressure on the share price. Longer term, the attractive restructuring plan that caused the share price increase is never implemented, so the accounting performance fails to improve or deteriorates during the years subsequent to the block transfer. We refer to this as the *manipulation hypothesis*.[15] The

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[15] One example of share price manipulation is the Zhongke Changye scandal (See Business China, March 26th 2001, pp. 2-3, "Scam of the century"). This particular case started with a sharp decrease in the stock price of Zhongke Changye—a listed chicken farm—due to an outbreak of bird flu in 1998. The share price dropped to around 14 Rmb in Oct 1998. Mr. Lu convinced the largest holder of tradable shares of Zhongke Changye—Mr. Zhu—to transfer blocks of tradable shares to him and persuaded several block holders to transfer their State shares to high tech companies owned by him. Mr. Lu, who now effectively controlled the firm, was in a position to manipulate the flow of public information. In addition, he used thousands of ID cards to open new individual share holder accounts, which were used to buy shares. In this process, Mr. Lu used the newly purchased shares as collateral to buy even more shares. The share price increased to about 40 Rmb in May 1999 when Mr. Zhu (unbeknownst to Mr. Lu) started selling. Still, the share price increased further and reached a high of 84 Rmb in February 2000 before it collapsed and the scam was revealed.

Another example is the Yellow River Chemical scandal (SHSE ticker 600091). This case began on December 23, 1998, with the sale of a subsidiary of Yellow River to Baotuo

manipulation hypothesis predicts large positive abnormal returns preceding share transfers, irrespective of the identity of the initial owner.

Our final hypothesis deals with the incentive of a controlling block holder to expropriate wealth from minority shareholders. While all three types of controlling block holders face this incentive, a private block holder might be able to more easily accomplish expropriation by funnelling resources from the listed firm to a privately held company that she also controls, but where she holds all of the cash-flow rights rather than only a portion. A scandal surrounding the De Long Group is an example of this type of behaviour, where a private controlling block holder—Tang Wanxin—expropriated wealth from listed companies that he controlled to a privately held parent company that he also controlled, but where he held greater cash-flow rights.[16] We refer to this hypothesis as the *expropriation* hypothesis.

Chuangye. Baotuo Chuangye, in turn, was partially owned by Beida Tomorrow Materials Science & Technology Co., Ltd. ("Beida Materials")—a firm linked to the Beijing University group. Sale of the subsidiary resulted in more than 30 percent increase in Yellow River Chemical's profits, which would give the firm the right to issue new shares. On July 29, 1999, press reports announced that Beida Materials had bought 47 percent of the shares of the parent of Yellow River—Baotou Chemical Industry Group. When the transfer was announced, the share price of Yellow River Chemical was 24.5 Rmb—almost double its 12.8 Rmb price two months earlier. The gradual increase in share price during the two months before the announcement was allegedly attributable to insider trading. Supposedly, insiders were buying Yellow River Chemical shares in anticipation of a positive reaction of investors to the share transfer, which suggested a move away from the chemical industry into the high tech industry. However, in the six weeks following the announcement, the share price of Yellow River Chemical dropped almost 20 percent, which was attributed to profit taking by insiders. (See Larry Lang in *New Fortune* magazine, August 2001)

A very similar incident, where a block transfer suggested a link to Beijing University, took place on August 25, 1999 when 51 percent of the shares in the second largest shareholder of Huazi Shiye (SHSE ticker 600191) were transferred to Beida Materials. In the three months prior to the transfer announcement, the share price of Huazi Shiye increased from 13.3 RMB to 22.58 RMB; in the three months subsequent to the transfer announcement, Huazi Shiye's share price declined to 15.6 RMB.

It is noteworthy that, in both the Yellow River Chemical and Huazi Shiye examples, the block transfer took place in the shares of a firm that controlled a listed firm, rather than in the shares of the listed firm itself. It is much easier to conduct such transfers anonymously because disclosure requirements are much less stringent for share transfers of unlisted firms.

[16] In what many newspapers referred to as "China's biggest stock scandal," Tang Wanxin used his family's control of De Long International Strategic Investment Co., Ltd—a privately held conglomerate—to manipulate the share prices of three of its publicly traded

This hypothesis predicts that accounting performance will deteriorate during the years subsequent to the block transfer and that this deterioration will be greatest for transfers to private block holders. To the extent that investors anticipate this expropriation, the hypothesis also predicts negative excess returns around the announcement of such block transfers, and that these negative excess returns will be greatest for announcements of transfers to private block holders.

Summary of Predictions by Alternative Hypotheses

	Pre-Announcement CARs	Announcement CARs	Post-Announcement CARs	Change in Accounting Performance
Incentive Hypothesis	+	+	0	+
Added Bureaucracy Hypothesis	−	−	0	−
Manipulation Hypothesis	+	+	−	0/−
Expropriation Hypothesis	−	−	0	−

Above is a summary of the predictions by each of our four competing hypotheses regarding the expected stock price reactions to the block transfer announcements and the expected change in accounting performance following the block transfers.[17] During the pre-announcement period, both the *incentive* and *manipulation* hypotheses predict positive abnormal returns as insiders buy up shares in anticipation, while both the added bureaucracy and expropriation hypotheses predict negative abnormal returns, as insiders would dump shares.

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subsidiaries—Shenyang Hejin, Torch Automobile and Xinjiang Tuhne—each of which experienced share-price increases of more than six-fold between 1997 and 2004. De Long then pledged equity of its subsidiaries as collateral to obtain bank loans for the parent company. Beginning in May of 2004, the share prices of the three subsidiaries began to plunge as investors learned about the loans and sold off shares of the listed subsidiaries. As the value of lenders' collateral dropped, they called upon De Long for additional collateral, which De Long could not provide, leading to its financial collapse. Ultimately, the Chinese government took over De Long and liquidated its assets to pay off the bad loans. See Hirson (2006).

[17] These predictions are for the sample as a whole, and are based on the observed shift in average ownership from *SBs* to *MOSOEs*, and from *SBs* and *MOSOEs* to *Private Entities*.

At the public announcement of the block transfers, the *incentive* hypothesis predicts positive abnormal returns as investors react to the prospects of more efficient operation of the firm, especially when shares are transferred to private block holders. The *added bureaucracy* hypothesis predicts negative abnormal returns as investors react to the prospects of less efficient operation of the firm, if control is transferred to a MOSOE. The *manipulation* hypothesis predicts positive abnormal returns at the announcement regardless of transferee identity. However, in the post-announcement period, negative CARs are predicted as insiders take profits by dumping their shares. The *expropriation* hypothesis predicts negative abnormal returns, as investors react to the prospects of expropriation by another block holder, especially when the block holder is private.

During the years subsequent to the block transfer, only the *incentive* hypothesis predicts positive performance relative to the pre-announcement period, as more efficient operation of the firm leads to improvement in profitability, especially where the new block holder is private. Each of the remaining hypotheses predict negative changes in performance, as the firm is run less efficiently or is plundered by the new block holder.

5. Data and Methodology

5.1.1 Sample Selection

We include in our sample all SHSE and SZSE firms that, during the five-year period from 1998 through 2002, reported share transfers that are greater than 5% of the total number of shares outstanding. The announcement dates were obtained from GTA/CSMAR, one of the largest corporate information providers in China. Our sample period starts in 1998, so that all events in our sample were announced subsequent to the September 1997 Chinese Communist Party's 15th Congress where the Central Committee endorsed a major policy shift, committing to a large privatization program. We confirmed each block transfer using

ownership data obtained from the database of Chinese ownership developed by the National University of Singapore ("NUS") Business School, and described in Section 3. This database ends in 2002.

We begin with a sample of 1,040 successful block-share transfers. We are unable to match 189 of these transfers with the NUS database, leaving 851 share transfers. Of these transfers, 171 involve more than one transaction on the same day for the same firm. We delete 36 of these transfers from our sample because the transferors or transferees involved in the multiple transfers are from different ownership categories. We combine the percentage of shares transferred for the remaining transactions if the parties involved in the multiple transfers are the same, or if the transferors involved are from the same ownership category (*State Bureaucrat*, *MOSOE* or *Private Entity*), and the transferees involved are from the same ownership category (*State Bureaucrat*, *MOSOE* or *Private Entity*). This procedure leaves us with 717 observations.

In order to have a sharp distinction between the three main ownership groups—*State Bureaucrats*, *MOSOEs* and *Private Entities*—we exclude 50 transfers involving parties that are classified as 'companies that formerly were government ministries' (NUS category 5); State research institutes (NUS category 10); State-owned banks (NUS category 16) and work unions (NUS category 17).

We also exclude 21 transfers involving foreign entities (NUS category 15). Most of these transfers only involve transfers between two foreign entities, and only three of these transfers are larger than 20 percent of the shares. This leaves us with our 646 transfers.

In the final step in the sample selection, we require that the firms in our sample have accounting data and stock-price data in the year prior to the transfer. This requirement reduces our final sample to 631 block transfers.

5.1.2 Descriptive Statistics

Table 4 presents descriptive statistics regarding the pre-transfer ownership structure and firm characteristics of the sample. Panel A of Table 4 reports the results for the total sample, while Panels B-F of Table 4 report the results for the different subsamples based on the identity of the transferor and transferee.

In Panel A of Table 4, we see that the average percentage of shares being transferred is 22.0 and ranges from 5 percent to 74.8 percent. We measure firm size by the natural logarithm of the book value of total assets. The average size of firms in our sample is RMB1.18 billion (US$143 million), and firm size ranges from RMB 70 million to RMB 22.1 billion.

We calculate the leverage ratio for each firm as its book value of total liabilities divided by its book value of total assets. The average leverage ratio is 46.8%.[18] The high leverage ratios in our sample reflect the fact that most listed Chinese companies use bank loans as their primary source of capital. The four largest banks in China, which control the majority of banking assets in the country, are directly controlled by the Chinese government. These banks typically allocate credit to individual firms on the basis of national policy, but do not have the power to force a firm into liquidation.

Industry-adjusted return on assets (ROA) is the firm's net income divided by the book value of total assets as of year-end minus the median ROA for the firms in the same industry. We define industry sectors at the level of two-digit SIC codes, which we obtained from the CSRC. The average industry-adjusted ROA of our sample firms in the year before the transfer is significantly negative at -1.2 percent (t-statistic is -3.5).

In Panels B through F of Table 4, we present the descriptive statistics for each of the nine transferor- transferee pairs. From Panel B, we see that *State Bureaucrats* were involved

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[18] There are no finance companies in the sample.

as transferor in 167 transfers, and as transferees in 85 transfers. *MOSOEs* were transferor in 340 transfers and transferee in 308 transfers. Finally, *Private Entities* were involved as transferor in 124 transfers and as transferee in 238 transfers. These numbers reflect a clear shift in ownership from *State Bureaucrats* to *Private Entities* over our five-year sample period.

Panel C of Table 4 shows that transfers involving *State Bureaucrats* as transferor are largest on average at 26.5 percent of the shares outstanding. When *State Bureaucrats* are involved in the transfer as transferee, the average transfer size is 25 percent. Test 1 in the last column of Panel C, reports the results of an *F*-test of equality of the mean transfer percentage between the three ownership categories, and shows the percentage of shares transferred is significantly different across the three transferor categories. Similarly, Test 2, in the bottom row of Panel C, indicates significant differences in the percentage of shares transferred across the different types of transferees.

From Panel D of Table 4, we see that transfers where *State Bureaucrats* or *MOSOEs* are involved in transfers as buyer or seller are significantly larger than transfers to or from private owners.

Panels E and F of Table 4 show the leverage and industry-adjusted ROA, respectively, for each pair of transferor and transferee. Average leverage is 0.47 and average industry-adjusted ROA is -0.012, but there are no significant differences across types of transferor/transferee.

5.2 Methodology

The purpose of our empirical analysis is to evaluate the efficiency of alternative categories of block owners of listed firms in China. First, we analyze share-price responses around block-transfer announcement dates for the full sample, and for several portfolios,

based on the ownership of the transferor and the transferee. Second, we analyze the change in accounting performance in the years around the block transfer. Finally, we examine changes in the top management during the period following the block transfer announcements.

Our event-study approach to analyse the impact of ownership changes reduces any endogeneity problems, which affects studies using cross-sectional regressions of firm value against ownership variables (see Holderness (2003)). In our study, it is likely that changes in firm value, or firm performance, in the period around changes in ownership structure, are the direct result of these ownership changes.

We use the market-adjusted return model to calculate daily abnormal returns as the difference between the realized return and the market return.[19] To estimate the market-adjusted model, we use as the market index either the SHSE or the SZSE composite index, depending on where the firm's stock is listed. Both composite indices are value-weighted, consisting of all listed companies on each stock exchange. Our primary event window spans day $t–210$ through day $t+40$.[20] We use a long event window motivated by concerns that market information leakage and insider trading are not unusual in the Chinese markets.[21] For robustness, we also examine abnormal returns from a short, 5-day window from day $t–3$ to day $t+1$. In addition, we analyze changes in industry-adjusted return on assets and industry-adjusted return on equity around ownership transfers, and CEO turnover in the 3 months and twelve months after the transfer announcement.

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[19] Our results are robust to use of the market model for estimation of abnormal returns.
[20] For some companies, trading is halted on the event day. In these cases, we use the closing price for the next day as the day $t−0$ share price.
[21] See, for example, the article 'Stocks, Lies and Manipulation', *Business China*, September 11, 2000, pp. 4-5.

6. Results

We first present the results of univariate analyses, where we focus on the relation between the variables of interest (changes in firm value, accounting performance and CEO turnover) and the identity of the transferee and the identity of the transferor. In the second part of this section, we present the results of cross-sectional regression models, where we account for characteristics of the transfer and of the listed firm whose shares are transferred.

6.1 Univariate Analysis

6.1.1 Cumulative Abnormal Returns

Figure 1 graphs the cumulative abnormal returns from day *t–300* to day *t+100*. Clearly evident in the graph is the share-price run-up from approximately day *t–210* through day *t–1*, suggestive of information leakage and insider trading. Barclay and Holderness (1991, p. 865) document a similar pattern for negotiated block transfers between private U.S. firms, beginning at about day *t–160*.

Panel A of Table 5 presents descriptive statistics for the cumulative average abnormal returns (CAR) for day *t–210* through day *t+40*, and for the CARs for day *t–3* through day *t+1*. We present these results for the whole sample of 631 transfers that are larger than five percent of the shares outstanding, and for a smaller sample of 292 transfers that are larger than 20 percent of the shares outstanding.

As shown in column 3, the average CAR for the full sample is 17.1%, significant at better than the 0.01 level. The CAR for our full sample is substantially larger than the 5.7% CAR for day *t–40* through *t+40* reported by Barclay and Holderness (1991) for firms remaining independent after the block transfer announcement.[22] Franks and Mayer (2001)

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[22] When making this comparison, it is important to keep in mind the significant differences in the Chinese stock market, where insider trading is rampant and the U.S. market, where

analyze a sample of block transfers at German firms and find that the benefits of control transfers do not accrue to minority shareholders. They attribute this result to the weak protection of minority shareholders in Germany. In light of their finding and given the relatively weak minority shareholder protection in China[23], the large value increase around the block transfers in China is remarkable and suggestive of substantial improvement in firm performance after the block transfer.

The average CAR over the period (−210, 40) for the 292 transfers of blocks of shares larger than 20% of the shares outstanding is 21.0 percent, which is also significant at the 1 percent level.[24] The CAR over the shorter five-day window from day t–3 through day $t+1$ is 1.1 percent for the whole sample and 1.7 percent for the block transfers in excess of 20 percent of the shares outstanding.[25] Both these CARs are also significant at the 1 percent level.

In Panel B of Table 5, we present the average 250-day CARs for the nine different groups of block transfers. With the exception of transfers from *Private Entities* to *State Bureaucrats* and *MOSOEs*, the CARs in all cells are significantly different from zero. Transfers where the *State Bureaucrats* are transferor have the largest average CAR of 21.6 percent. For transfers from *MOSOEs*, the average CAR is 16.7 percent, whereas transfers from *Private Entities* have an average CAR of 11.9 percent. The difference in CARs between different transferors is significant at the 5 percent level (Test 1 in the last column of Table 5,

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insider trading is closely monitored and, when identified, is vigorously prosecuted by the U.S. securities regulators.

[23] MacNeil (2002) estimates that the LLSV-index of minority shareholder protection for China is only two out of a possible score of six, compared to an average score of four for common-law jurisdictions and an average of three for all countries. He also discusses the difficulties of enforcing minority shareholder rights in China.

[24] The average CAR of the 339 transfers that are smaller than 20 percent of the shares outstanding is 13.7 percent and is significantly smaller than the average CAR of the large transfers at the 1 percent level.

[25] Again, the CAR around large transfers is significantly larger than the 0.6 percent CAR around the transfers smaller than 20 percent of the shares outstanding.

Panel B). There is no evidence that the identity of the transferee is significantly related to the CAR (Test 2 in the last row in Table 5, Panel B). For the full sample, the CAR ranges from 13.8 percent if *State Bureaucrats* are the transferee to 16.6 percent if *Private Entities* are the transferee.

The results in Panel C of Table 5, for transfers in excess of 20 percent of the shares, show even larger differences, ranging from 26.4 percent for transfers from *State Bureaucrats* to 9.3 percent for transfers from *Private Entities*. Again, these differences are significant at the 5 percent level (Test 1 in the last column of Table 5, Panel B). Focusing on the transferees, we see that the CARs range from 17.6 percent for transfers where *State Bureaucrats* are the transferee to 24.9 percent for transfers where *Private Entities* are the buyer. Even though these return differences have the expected ordering, the differences are not significant (Test 2 in the last row in Table 5, Panel C).

Overall, the results in Table 5 are supportive of the *incentive hypothesis,* which states that block transfers from *State Bureaucrats* result in the largest wealth gains to shareholders. However, in this univariate analysis, there is no evidence that wealth gains are significantly smaller when *State Bureaucrats* are the buyer of larger blocks. The results in Table 5 are inconsistent with the *added-bureaucracy hypothesis* that a transfer from a *State Bureaucrats* to *MOSOEs* simply adds an additional level of bureaucracy to the governance structure, thereby reducing the quality of the government control. On the contrary, further tests show that the average CAR is significantly higher around transfers when *State Bureaucrats* are the transferors, than around transfers where *MOSOEs* are the transferors (the *p*-value for this difference in average CAR of 4.9 percent for the full sample is 0.04). The results in Table 5 are also inconsistent with the idea that expropriation by private entities results in value decreases after private entities obtain control over the listed firm.

The substantial value increase before the announcement is consistent with the *manipulation hypothesis* as well as the *incentive hypothesis*. In order to distinguish between the two, we partition our event window into a pre-announcement period from day $t–210$ through day $t–0$ and a post-announcement period from *day $t+1$* through day *$t+40$*. According to the *manipulation hypothesis*, we would expect positive CARs during the pre-announcement period, negative CARs during the post-announcement period, and a negative and significant correlation coefficient between the CAR in the pre-announcement period and the CAR in the post-announcement period. According to the *incentive hypothesis*, we would expect positive CARs during the pre-announcement period, non-negative CARs during the post-announcement period, and a non-negative correlation coefficient between the two.

Consistent with both hypotheses, the average CAR during the pre-announcement period for the full sample is a statistically significant 16.0%. However, the average CARs during the post-announcement period is positive 1.1 percent (insignificant), which is inconsistent with the *manipulation hypothesis* but supportive of the *incentive hypothesis*. Moreover, the correlation between pre-announcement (*$t–210$* through *$t–0$)* and post-announcement (*$t+1$* through *$t+40$*) CARs is 0.01 and statistically insignificant, which also is inconsistent with the *manipulation hypothesis*, but supportive of the *incentive hypothesis*.

We repeat these tests for each of the nine classes of block transfers and find no evidence of significant negative correlations for any of these classes. We also obtain qualitatively similar results analyzing the correlations between the CAR for a 50-day pre-announcement window and the CAR for a 10-day post-announcement window.

6.1.2 Changes in Accounting Performance

According to the *incentive hypothesis*, we expect to find significant improvements in accounting performance following the block transfers, and we expect these improvements to be significantly related to the 250-day CAR and five-day CAR.

For each firm involved in a block transfer, we collect accounting data on firm performance for two years before, and two years after, the year of the block transfer announcement (thus excluding the year of the transfer). We test two alternative measures of firm performance: industry-adjusted return on assets and industry-adjusted return on equity.

Return on assets is defined as net income divided by total assets, and return on equity is defined as net income divided by total equity. For 106 firms, we were unable to obtain the required accounting data in the pre- or post-announcement periods and these 106 firms are omitted from this part of our analysis. For the 525 remaining firms, we calculate industry-adjusted performance in each year by subtracting the industry median for that year from the firm's performance measure. We then average industry-adjusted performance for the 2 years in the pre-announcement period and the 2 years in the post-announcement period. Finally, we subtract the performance in the pre-announcement period from the performance in the post-announcement period. Results of this analysis appear in Table 6.

From Panel A of Table 6, we see that, for the full sample, ROA increased by 78 basis points and ROE increased by 150 basis points—both significant at the 1 percent level. Focusing on the group of block transfers in excess of 20 percent, the improvement in adjusted ROA is 87 basis points, and the improvement in adjusted ROE is 169 basis points. Again, the improvement in each performance measure is significant at conventional levels.[26]

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[26] There is no significant difference in the change in industry-adjusted ROA and industry-adjusted ROE between the transfers that are larger than 20 percent and the transfers that are smaller than 20 percent.

Panel B of Table 6 reports the change in industry-adjusted ROAs for the different combinations of transferors and transferees. The largest increase in industry-adjusted ROA, 2.6 percent, is realized for the group of transfers where the transferor is *State Bureaucrat* and the transferee is a *Private Entity*. The differences across transferors are significant at the 10-percent level, with the increase in adjusted ROAs highest when *State Bureaucrats* are transferor and lowest when *Private Entities* are transferor. The change in adjusted ROA is lowest when *State Bureaucrats* are the buyer of the block of shares and highest when *Private Entities* are the buyer of the block. Test 2, in the last row of Table 6, Panel B, indicates that the change in ROA is significantly related to the identity of the transferee.

Panel C of Table 6 reports the results for the transfers in excess of 20 percent of the shares outstanding. For these transfers the change in ROA is not related to the identity of the transferor. However, similar to Panel A of Table 6, the change in adjusted ROA is significantly different across transferees, with the change in adjusted ROA lowest when *State Bureaucrats* are the transferees and highest when *Private Entities* are involved as transferees.

In general, the results in Table 6 suggest that accounting performance improved following the block transfers, again favoring the *incentive hypothesis* over the *manipulation hypothesis*, the *expropriation hypothesis*, and the *added-bureaucracy hypothesis*. The differences in improvement based on the identity of the parties involved, suggest that *State Bureaucrats* are less efficient monitors than *Private Entities*, with *MOSOEs* somewhere in between.

In Table 7, we report the correlations between the two performance measures and the two CAR measures. For both the long-term window and the short-term window, and for both industry-adjusted ROA and industry adjusted-ROE, we find significant positive correlations, ranging from 0.124 to 0.272. These highly significant correlations suggest that investors were

able to successfully anticipate future improvements in operating performance subsequent to share transfers.

6.1.3. Post-transfer Changes in Top Management

According to Barclay and Holderness (1991), a block transfer is a control event if it is associated with large abnormal stock returns and top-management turnover. Even though in China, firms operate in a very different control environment, it is still instructive to analyze cross-sectional differences in top management turnover at our sample of firms.

The results of this analysis are in Table 8. Panel A of Table 8 shows that the proportion of firms where the CEO was replaced within 3 months of the transfer is 22 percent, and, within 12 months of the transfer, is 38 percent. For block transfers larger than 20 percent, CEO turnover is 30 percent in the 3 months after the transfer, and is 50 percent in the 12 months after the transfer.[27] These results compare with 33 percent CEO turnover within the 12 months following negotiated block trades at U.S. firms, as reported by Barclay and Holderness (1991). Also note that the turnover rates after block transfers are high compared to the average frequency with which CEOs are replaced at the typical listed Chinese firm, which, for our sample period, is 24 percent per annum.

In Panels B and C of Table 8, we document the impact of the identity of the transferor and transferee on CEO turnover within the first 3 months after the transfer. We find that the frequency of CEO replacement within three months depends significantly on the transferor, and is highest for transfers from *Private Entities*, at 29 percent, and lowest when *State Bureaucrats* are the transferors, at 18 percent. There is no significant relation between the type of transferee and CEO turnover for the full sample. However, for the block transfers in

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[27] The likelihood of CEO turnover in the 3 months (12 months) following the transfer announcement for the 339 transfers that are smaller than 20 percent of the shares outstanding is 15 percent (27 percent), and is significantly smaller than the likelihood of CEO turnover following large transfers.

excess of 20 percent, we do find CEO turnover is also significantly related to the type of

transferee, with turnover ranging from 19 percent when *State Bureaucrats* are the buyers of

the block to 39 percent when a *Private Entity* is the buyer of the block. These results are

supportive of the hypothesis that the identity of the block holder is an important determinant

of CEO turnover.

Finally, in Panel D, we explore the reasons for CEO Turnover using data from the

GTA corporate governance database. GTA classifies the reason for CEO turnover into twelve

categories that we collapse into seven: (1) change in work assignment; (2) expiration of term

in office; (3) change of controlling shareholder; (4) resignation; (5) corporate governance

improvement; (6) missing; and (7) other. [28]

In columns 2-4 of Panel D are the results for CEO turnover at all listed Chinese firms

during the period spanning 1998-2002. There are a total of 5,272 firm-years covered by these

data. In columns 5-7 of Panel D are the results for our full sample of 631 firms covering CEO

turnover during the 3 months following the transfer announcements. There are a total of 631

firms $\times$ 0.25 years = 157.75 firm-years in this group. In columns 8-10 are the results for our

full sample covering CEO turnover during the 12 months following the transfer

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[28] The 13 categorized reasons for CEO turnover available from the GTA corporate governance database are: (1) change of work assignment—the CEO was removed from the position because of being assigned another position; (2) retirement—the CEO no longer held the position because of retirement or age; (3) expiration of term of office—the CEO no longer held the position because her term expired and she was not re-elected; (4) change of share-controlling rights—the CEO no longer held the position because of a change in the identity of the controlling shareholder ; (5) resignation—the predecessor voluntarily resigned the position for unknown reasons; (6) dismissal—a listed company dismissed the predecessor for unknown reasons (7) health related reason—the predecessor no longer held the position because of bad health, including death (8) personal reason—the CEO no longer held the position because of personal reasons; (9) corporate governance improvement—improving corporate governance led to the CEO no longer holding the position; (10) litigation involved—the CEO was removed from office because of involvement in litigation; (11) others; (12) end of proxy—the CEO holding the position in deputy no longer exercised the duty because of end of the deputy; and (13) not disclosed. We combine (2), (6), (7), (8), (10), (11) and (12) into our "other" category because of the small numbers of CEO turnovers accounted for these categories.
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announcements. There are 631 firms × 1.00 years = 631 firm-years in this group. For each of these three groups, we report the total number of CEO changes (columns 2, 5 and 8), the number of CEO changes per firm-year (columns 3, 6 and 9), and the percentage of the total number of CEO changes for that group accounted for by each reason identified in column (1).

Most relevant are the number of CEO changes per firm-year (columns 3, 6 and 9). CEO turnover attributable to a 'change of share controlling rights' is 0.02 per firm year for all listed firms, 0.37 per firm year for our sample during the 3 months following the block transfer announcement and 0.12 for our sample during the 12 months following the block transfer announcement. Using the binomial test, we find that these proportions are significantly higher for our sample firms than for the total sample. The same result holds for the categories 'change of work assignment', 'expiration of term of office', 'resignation' and 'missing' for the three-month sample, and 'expiration of term of office', 'resignation', 'missing', and 'other' for the twelve-month sample.

Also relevant are the percentage of all CEO changes in each group accounted for by the 'change of share controlling rights.' For all listed firms, change in control rights accounts for 10 percent of all CEO turnovers; but for our sample, this reason accounts for 42 percent of the CEO changes that occur with 3 months, and 33 percent of the CEO changes that occur with 12 months, of the block-transfer announcements. Clearly, these results demonstrate that the high incidence of CEO turnover in our sample is a direct result of the block transfers.

6.2 Cross-sectional Regressions

To provide additional evidence on the sources of abnormal returns, the changes in accounting performance and CEO turnover, we also perform cross-sectional regressions. We use the type of transferor and transferee as our explanatory variables and include several

control variables. For each of the dependent variables, we estimate the following cross-sectional regression model:

$$DV_i = \beta_0 + \beta_1 \text{ Transferor-Bureaucrat}_i + \beta_2 \text{ Transferor-MOSOE}_i + \beta_3 \text{ Transferee-}$$

$$\text{Bureaucrat}_i + \beta_4 \text{ Transferee-MOSOE}_i + \beta_5 \text{ Related}_i + \beta_6 \text{ Largest Change}_i + \beta_7 \text{ PCT}_i$$

$$+ \beta_8 \text{ Leverage Ratio}_i + \beta_9 \text{ Size}_i + \varepsilon_i$$

where:

DV_i is, for firm i, the 250–day or 5–day cumulative abnormal return; the change in industry-adjusted return on assets or industry-adjusted return on equity; or a dummy variable that is equal to one if the CEO was replaced in the first 3 months or 12 months after the transfer announcement.

Transferor-Bureaucrat$_i$, *Transferor-MOSOE*$_i$ *Transferee-Bureaucrat*$_i$ *and Transferee-MOSOE*$_i$ are dummy variables indicating the type of negotiated block transfer; *Transferor-Private* and *Transferee-Private* are the omitted categories, so the coefficient on each of the Transferor and Transferee dummy variables measures the difference in the dependent variable (DV) of that category and the dependent variable of transfers involving *Private Entities*.

Related$_i$ is a dummy variable indicating that the transferee is a related party of the transferor. Parties are related if, one party is directly or indirectly controlling or controlled by another party, or both parties are under the control of the same enterprise. We expect the benefits of block transfers to be lower when the transfer is to a related party.

Largest Change$_i$ is a dummy variable indicating that the transfer created a new controlling block holder for firm i. It might be important to distinguish between a transfer that creates a new controlling block holder and one that does not. When the block transfer creates a new largest shareholder, there has been a change in corporate control. According to Barclay and Holderness (1991), block transfers as small as ten percent of outstanding shares can transfer

de facto control rights. Because of the strong position of the controlling shareholder in China, we expect the positive effects of the block transfers to be larger when the new block holder obtains a controlling share.

PCT_i *is* defined as the number of shares that is transferred in the block transfer as percentage of the shares outstanding.

As general control variables, we include:

Leverage Ratio as measured by the ratio of total debt to total assets and

Firm Size as measured by the natural logarithm of the firm's total assets.

We expect that excess returns and operating performance improvement will be larger at firms with greater informational asymmetries, as agency costs are expected to increase with the level of informational asymmetries. Because larger firms are less opaque than smaller firms, we hypothesize that excess returns will be inversely related to firm size. In Western economies, firms with greater leverage are subject to more stringent monitoring by large creditors, including commercial banks, so that informational asymmetries should be smaller than at firms with greater leverage. However, in China, commercial banks are often directed by the State to make policy loans, so that banks do not serve this monitoring role in China. Instead, banks are directed by the State to make additional loans to poorly performing firms, increasing their leverage over time. Hence, we expect that excess returns will be positively related to the debt-to-asset ratio, as the worst performing firms have the most to gain from improved governance.[29]

Table 9 presents the results of our cross-sectional regression models. For each dependent variable, we first present the results for the total sample and then, in the next column, report the results for the sample of transfers larger than 20 percent.

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[29] We have estimated all models including year dummy variables, industry dummy variables and exchange dummy variables. Our results are robust to inclusion of these dummy variables.

6.2.1 Cumulative Abnormal Returns

In columns 2 and 3 of Table 9, we use the 250–day CAR as our dependent variable. Column 2 reports the results for the full sample, and column 3 reports the results for the sample of transfers that are larger than 20 percent of the shares outstanding. Both *Transferor_Bureaucrat* and *Transferor_MOSOE* are significantly positive. Both *Transferee_Bureaucrat* and *Transferee_MOSOE* are negative, as expected, but are insignificant. The dummy variables are economically significant. *Ceteris paribus*, transfers from *State Bureaucrats* to *Private Entities* result in a 250-day CAR that is 13 percent greater than that for transfers between *Private Entities* (the omitted dummy variables) for the full sample. For the group of transfers larger than 20 percent of the shares outstanding, this difference in the 250-day CARs is 25 percent.

The results using the 5-day CAR, in columns 4 and 5 of Table 9, are generally consistent with those using the 250-day CAR, again suggesting that investors perceive *Private Entities* to be superior monitors compared to *State Bureaucrats* and *MOSOEs*.

The coefficient of *Related* is always insignificant, indicating that investors do not perceive the value change resulting from transactions between related parties as different from transactions between unrelated parties.

The coefficient of *Largest Change* is positive but insignificant. We had expected that transfers creating a new controlling block holder would be associated with greater cumulative abnormal returns, but this does not appear to be the case when we control for the type of block transfer. Similarly, *Percentage* is only weakly related to the 250-day or the 5-day CARs.

Contrary to our expectations, we find that firms with lower *Leverage* experience larger value increases over the 250-day period. Consistent with our expectations, *Firm Size* is significantly negatively related to the increase in firm value. This smaller value increase for

larger firms could reflect the lower information asymmetry at larger firms. The negative relation between firm size and the value change could also indicate that it is more difficult to restructure a larger firm.

In summary, the cross-sectional analysis of abnormal returns shows no consistent evidence that *State Bureaucrats* are less effective monitors than *MOSOEs*. However, we do find consistent evidence that investors perceive *Private Entities* as the most effective monitors of listed firms.

6.2.2 Changes in Accounting Performance

Columns 6-9 of Table 9 present the results for changes in industry-adjusted return on assets (columns 6-7) and industry-adjusted return on equity (columns 8-9). The evidence in these four columns consistently shows that improvements in operating performance are larger where *State Bureaucrats* or *MOSOEs* are replaced by *Private Entities* as the block holder. The coefficients indicate that, relative to transfers between *Private Entities* (the omitted dummy variables), very substantial improvements in return on assets of 240 basis points or more are realized after block transfers from *State Bureaucrats* or *MOSOEs* to *Private Entities*. Using the ROE as performance measure (columns 8-9), relative improvements are even larger, at 530 basis points or more. If a block is sold to a *State Bureaucrat*, performance is significantly worse relative to a having a new *Private Entity* as owner. However, when a *MOSOE* is the new block holder, the listed firm does not significantly under-perform listed firms where a *Private Entity* is the new owner.

With the exception of firm size, all control variables are insignificant. The negative relation between the improvement in firm performance and firm size suggests that it is more difficult for new block holders to transform larger firms.

6.2.3 CEO turnover

In columns 10 through 13 of Table 9 are the results from a logistic regression, where the dependent variable is an indicator variable that is equal to one if the firm's CEO was replaced within 3 months (columns 10-11) or twelve months (columns 12-13) of the block trade announcement. In each cell, we now report the marginal effect with the *t*-statistic underneath. After inclusion of the control variables, we find only limited evidence that the ownership type affects CEO replacement. Most interesting is that, for the full sample, replacement of the CEO within 3 months is significantly lower if a *State Bureaucrat* is transferor and that, for the sample of large transfers, CEO-replacement within 3 months is less likely if a *State Bureaucrat* is transferee. These coefficients are no longer significant when we use CEO-replacement within 12 months as dependent variable. Thus, even though *Private Entities* seem to be faster in forcing CEO replacement, the probability of CEO replacement within a year is not significantly related to ownership type.

The control variables are more effective in explaining CEO turnover. The variable *Related* is negative and significant, suggesting that the probability of CEO replacement within 12 months is lower if the block is transferred to a related party. The variable *Largest Change*, which indicates that the new block holder is also a new controlling block holder, is positive and generally significant, indicating that changes in direct control lead to a greater probability of CEO turnover. Contrary to our expectations, we do not find that *Leverage* is related to CEO turnover. However, *Size* is negative and significant, indicating that larger firms are significantly less likely to experience a change in top management following a block transfer. We speculate that this result also may be a consequence of the stronger political connections of CEOs at China's larger firms.

7. Summary and Conclusions

In this study, we analyze share price reactions and changes in accounting performance around the announcements of negotiated block transfers between different ownership structures, using a sample of firms that are publicly traded on Chinese stock exchanges. We also analyze top-management turnover following these block transfers.

We find that both changes in firm value and accounting performance are much greater when ownership is transferred from *State Bureaucrats* or *Market-Oriented SOEs* to *Private Entities*, than when ownership is transferred between different State-controlled entities. The improvements in performance following block transfers from State-controlled entities to private owners indicates that the latter are better equipped and have greater incentives to monitor and discipline firm management than are the former. This result is consistent with a smaller wedge between cash-flow rights and control rights for private block holders than for State-controlled block holders. We find no consistent evidence that *Market-Oriented SOEs* are superior monitors relative to *State Bureaucrats*. This result is important, as it suggests that the intermediate step of 'corporatizing' organizations that act as block holder, is an ineffective mechanism for dealing with the agency problems that result from State ownership.

Our results provide strong evidence that the block transfers between the different ownership categories are true control events, as defined by Barclay and Holderness (1991). First, they result in large positive cumulative abnormal returns of more than 10 percent, and the cross-sectional variation in these abnormal returns can be explained by differences in identities of the block holders. Second, the block transfers are followed by top management changes within 3 months of the transfer at more than 20 percent of the sample firms, and, again, these changes are related to the identities of the new block holders. Our interpretation of these block transfers as significant control events is further corroborated by the evidence that the value changes around transfers are strongly correlated with improvements in

accounting performance around the block transfer. Hence, we contribute new evidence from Chinese markets confirming that the identity of the block holder is an important determinant of firm value.

Finally, it is remarkable that the improvements in performance around the block transfers to private entities in our sample are substantially larger than the changes in performance observed after Share-Issue Privatization (SIP) in China (see Sun and Tong, 2003). The common explanation for the limited success of the SIP process in China is that the SIPs failed to transfer true control from the State to the private sector and only helped to create many dispersed and powerless owners of Tradable A shares. Our evidence is consistent with this explanation and shows that substantial value increases are realized when the State relinquishes substantial control rights to private block holders. Of great interest is how further or complete privatization of listed State-controlled firms will affect firm value. Many such transfers of control are now taking place in China, and we leave this as an interesting avenue for future research.

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Appendix I

Shares are classified based on the residency of their owner as *domestic* (A shares) or *foreign* (B, H and N shares). The B, H, and N shares are traded on the Chinese, Hong Kong, and New York Stock Exchanges, respectively. *Tradable B* shares used to be available exclusively to foreign investors and some authorized domestic securities firms. However, the Chinese government recently opened the B-share market to domestic investors. The B-share market is separated from the A-share market, with SHSE B-shares denominated in U.S. dollars, and SZSE B-shares denominated in Hong Kong dollars. *Tradable H* shares and *Tradable N* shares are essentially the same as *Tradable B* shares, except that they are issued and traded on the Hong Kong Stock Exchange and the New York Stock Exchange, respectively.

Appendix Table A1 presents a classification of listed firms by share categories from 1993 to 2002. From Table A1, it can be seen that companies with A-shares only are most common, and their numbers are growing at a relatively rapid rate. Companies with A-shares and B-shares represent the second most prevalent category.

Appendix Table A1:
Classification of firms by official share categories for the Chinese stock markets: 1993-2002

This table shows the number of listed Chinese firms issuing different categories of common shares. *A-Shares* are common shares that can only be held by domestic owners. *B-Shares* are common shares that are only available to foreign investors and some authorized domestic securities firms. The market for *B-Shares* is separated from that for *A-shares*, with Shanghai Stock Exchange *B-Shares* denominated in U.S. dollars, and Shenzhen *B-Shares* denominated in Hong-Kong dollars. *Source*: China Securities Regulatory Commission, 2004.

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Issuing A shares only	140	227	242	431	627	727	822	955	1,025	1,085
Issuing A and H shares	3	6	11	14	17	18	19	19	23	28
Issuing A and B shares	34	54	58	69	76	80	82	86	88	87
Issuing B shares only	6	4	12	16	25	26	26	28	24	24
Total	183	291	323	530	745	851	949	1,088	1,160	1,224

Table 1:
Number of listed companies on the Chinese stock exchanges by year: 1992-2002

Total listed refers to the total number of companies listing shares on either the Shanghai Stock Exchange (SHSE) or the Shenzhen Stock Exchange (SZSE) in each year from 1992 through 2002. *Market Capitalization* and *Annual Turnover* (annual sales) are in billions of U.S. dollars. *Source*: China Securities Regulatory Commission, 2004.

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Shanghai Stock Exchange	29	106	171	188	293	383	438	484	572	646	715
Shenzhen Stock Exchange	24	77	120	135	237	362	413	465	516	512	509
Total Listed Firms	53	183	291	323	530	745	851	949	1,088	1,158	1,224
Market Capitalization	12.7	42.5	44.4	41.8	118.5	211.2	235	318.9	579.4	527.5	464.6
Annual Turnover	8.3	44.2	47.9	48.6	257	370.1	283.6	377.3	732.8	464.3	339.3

Table 2:

Official share classifications for the Chinese stock market from 1992 to 2002

Each row presents the percentage of total common shares by share classification, with the exception of the last row, which shows the total number of shares outstanding in millions. Official share classifications as defined by the China Securities Regulatory Commission are classified based on the residency of their owner as *domestic* (A shares) or *foreign* (B, H and N shares). Domestic A shares are further divided into *State* shares, *Legal-Person* shares, *Tradable A* shares, and *Employee* shares. *State* shares are those held by government agencies (the Bureau of State Property Management and local finance bureaus) and State-owned enterprises. *Legal-Person* (LP) shares are those owned by domestic institutions or a legal entity that is not an individual. *Tradable A* shares are owned by individuals and domestic corporations, but are not allowed to be owned by foreign investors. Tradable A-shares are the only type of equity that can be publicly traded among domestic investors. *Employee* shares are owned by the employees of a listed company. Foreign shares include *Tradable B* and *H* shares, which are traded on the Shanghai/Shenzhen Exchanges and the Hong-Kong Exchange, respectively. *Tradable B* shares are only available to foreign investors and some authorized domestic securities firms. *Tradable H* shares are essentially the same as *Tradable B* shares, except that they are issued and traded on the Hong Kong Stock Exchange. Source: China Securities Regulatory Commission 2004

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Tradable Shares											
A Shares	15.8%	15.8%	21.0%	21.2%	21.9%	22.8%	24.1%	26.3%	28.4%	25.3%	25.7%
B Shares	14.8%	6.4%	6.1%	6.7%	6.4%	6.0%	5.3%	4.6%	4.0%	3.1%	2.9%
H Shares	0.0%	5.6%	6.0%	7.7%	6.9%	5.7%	4.7%	4.0%	3.3%	6.4%	6.1%
Non-Tradable Shares											
State Shares	41.8%	49.1%	43.3%	38.7%	35.4%	31.5%	34.3%	36.2%	38.9%	46.2%	47.2%
Legal-Person Shares	26.4%	20.7%	22.5%	24.6%	27.2%	30.7%	28.3%	26.6%	23.8%	18.3%	17.3%
Employee Shares	1.2%	2.4%	1.0%	0.4%	1.2%	2.0%	2.0%	1.2%	0.6%	0.5%	0.3%
Others	0.0%	0.0%	0.2%	0.7%	1.0%	1.2%	1.2%	1.1%	0.9%	0.3%	0.5%
Total Number of Common Shares	69.37	387.73	684.54	848.42	1,220	1,943	2,527	3,087	3,792	5,218	5,875

Table 3
Share classifications for the Chinese Stock Market for 1993-2002 based upon NUS ownership categories

State Bureaucrat is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market-oriented State-owned enterprise; *Private Entity* is a dummy variable equal to one if the largest block holder is a private entity. *Foreign* is a dummy variable equal to one if the largest block holder is a foreign entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al.* (2006). The total number of firms in each year does not match those in Table 1 because NUS researchers were unable to classify ultimate ownership for a small number of firms in some years.
Source: Authors' tabulations based upon NUS ownership categories.

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
State Bureaucrat	53	77	121	166	179	160	144	153	154	155
Market-Oriented SOE	46	71	141	277	462	572	681	796	836	888
Private Entity	13	12	23	35	44	63	78	103	121	155
Foreign Entity	9	10	13	18	16	13	11	15	13	13

Descriptive statistics for block transfers
The sample consists of 631 observations of block-share transfers between different ownership categories during 1998-2002. Panel A presents descriptive statistics for four variables: *Shares Transferred* is the percentage of total common shares transferred in the block trade; *Size* is the natural logarithm of the book value of total assets; *Leverage* is measured by ratio of the book value of total liabilities to the book value of total assets; and *Industry-adjusted ROA* is the firm's net income divided by the book value of total assets (ROA) as of year-end less the median ROA for the firms in the same industry in the same year. Panel B presents the number of transfers for each pair of transferor/transferee. Panel C presents the percentage of shares transferred for each pair of transferor/transferee. Panel D presents the firm size for each pair of transferor/transferee. Panel E presents firm leverage for each pair of transferor/transferee. Panel F presents industry-adjusted ROA for pair of transferor/transferee. *Transferor* refers to the party selling the block of shares while *Transferee* refers to the party purchasing the block of shares. *Bureaucrats* is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market-oriented State-owned enterprise; *Private* is a dummy variable equal to one if the largest block holder is a private entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al*. (2006). Test 1 refers to the p-value from an F-test for equality of means across the three different types of transferors. Test 2 refers to the p-value from an F-test for equality of means across the three different types of transferees.

Panel A: Descriptive Statistics

	Mean	Std. Dev.	Minimum	Maximum
Shares Transferred	22.0	15.5	5.0	74.8
Size	20.5	0.8	18.1	23.8
Leverage	0.47	0.29	0.01	4.87
Industry-adjusted ROA	-0.012	0.051	-0.323	0.159

Panel B: Number of Transfers for each Transferor/Transferee pair

	Transferee			
Transferor	Bureaucrats	MOSOE	Private	All
Bureaucrats	38	80	49	167
MOSOE	39	187	114	340
Private	8	41	75	124
All	85	308	238	631

Panel C: Transfer Percentage for each Transferor/Transferee pair

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureaucrats	28.24	31.12	17.64	26.51	
MOSOE	22.67	25.18	16.34	22.01	Test 1:
Private	21.05	17.76	14.80	17.64	p-value = 0.01
All	25.01	25.73	16.12	22.01	

Test 2: p-value = 0.01

Panel D: Firm Size for each Transferor/Transferee pair

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureaucrats	20.61	20.57	20.37	20.52	
MOSOE	20.66	20.61	20.47	20.58	Test 1:
Private	19.92	20.09	20.21	20.09	p-value = 0.01
All	20.57	20.53	20.37	20.48	

Test 2: p-value = 0.05

Panel E: Leverage for each Transferor/Transferee pair

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureaucrats	0.445	0.485	0.483	0.48	
MOSOE	0.475	0.468	0.486	0.48	Test 1:
Private	0.381	0.440	0.441	0.43	p-value = 0.46
All	0.45	0.47	0.47	0.47	

Test 2: p-value = 0.87

Panel F: Industry-Adjusted ROA for each Transferor/Transferee pair

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureaucrats	-0.006	-0.020	-0.023	-0.018	
MOSOE	-0.007	-0.012	-0.010	-0.010	Test 1:
Private	0.016	-0.009	-0.011	-0.004	p-value = 0.55
All	-0.005	-0.014	-0.013	-0.012	

Test 2: p-value = 0.98

Table 5:
Cumulative Abnormal Returns around Announcements of Block Transfers
By Type of Block Transfer

Cumulative abnormal returns around announcements of block transfers are calculated as the difference between the realized return and the market return using the market-adjusted return model. To estimate the market-adjusted model, we use as the market index either the Shanghai Stock Exchange (SHSE) or Shenzhen Stock Exchange (SZSE) composite index, depending on where the firm's stock is listed. Our primary event window spans day $t–210$ through day $t+40$. We also examine abnormal returns from a shorter five-day window from day $t–3$ through day $t+1$. The sample consists of 631 observations of block share transfers of more than five percent of common shares between different ownership categories during 1998-2002. The categories are *Bureaucrats*, *MOSOE* and *Private*. *Bureaucrats* is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market-oriented State-owned enterprise; *Private* is a dummy variable equal to one if the largest block holder is a private entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al*. (2006). We also examine block transfers where at least 20 percent of the common shares are transferred.

Panel A: Cumulative Abnormal Returns around Transfer Announcements

		N	Mean	Std. Dev.	T-stat	Minimum	Maximum
Transfers	Car(-210,40)	631	0.171	0.370	11.59	-1.464	2.325
Greater than 5%	Car(-3,1)	631	0.011	0.043	6.57	-0.319	0.198
Transfers	Car(-210,40)	292	0.210	0.402	8.91	-1.465	1.485
Greater than 20%	Car(-3,1)	292	0.017	0.048	6.21	-0.103	0.198

Panel B: CARs for transfers >5% of Common Shares by Type of Transfer

	Transferee				
Transferor	*Bureaucrats*	*MOSOE*	*Private*	*All*	
Bureaucrats	0.172 **	0.214 **	0.250 **	0.216**	
	38	80	49	167	
MOSOE	0.111 **	0.185 **	0.158 **	0.167**	
	39	187	114	340	
Private	0.106	0.106	0.128 **	0.119**	Test 1
	8	41	75	124	*p*-value=0.04
All	0.138 **	0.181 **	0.166 **	0.171**	
	85	308	238	631	

Test 2: *p*-value=0.62

Panel C: CARs for transfers >20% of Common Shares by Type of Transfer

	Transferee				
Transferor	*Bureaucrats*	*MOSOE*	*Private*	*All*	
Bureaucrats	0.209 **	0.266 **	0.336 **	0.264**	
	27	56	19	102	
MOSOE	0.171	0.198 **	0.246 **	0.205**	
	17	99	33	149	
Private	-0.026	0.039	0.168 **	0.093**	Test 1
	4	18	19	41	*p*-value=0.05
All	0.176 **	0.203 **	0.249 **	0.210**	
	48	173	71	292	

Test 2: *p*-value = 0.58

Table 6:

Changes in Accounting Performance surrounding Block Transfers

Changes in accounting performance are measured by the changes in return on assets (ROA) or return on equity (ROE) from the two years prior to the block transfer to the two years subsequent to the block transfer. The sample consists of 631 observations of block share transfers of more than five percent of common shares between different ownership categories during 1998-2002. The categories are *Bureaucrats*, *MOSOE* and *Private*. *Bureaucrat* is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market-oriented State-owned enterprise; *Private* is a dummy variable equal to one if the largest block holder is a private entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al*. (2006). We also examine block transfers where at least 20 percent of the common shares are transferred

Panel A: Changes in ROA and Changes in ROE

		N	Mean	Std. Dev.	t-stat	Minimum	Maximum
Transfers	Δ ROA	525	0.0078	0.058	3.07	-0.258	0.265
> 5%	Δ ROE	525	0.0150	0.122	2.81	-0.470	0.570
Transfers	Δ ROA	249	0.0087	0.061	2.25	-0.258	0.210
>20%	Δ ROE	249	0.0169	0.138	1.94	-0.470	0.531

Panel B: Changes in ROA for Transfers > 5% of Common Shares by Type of Transfer

	Transferee				
Transferor	*Bureaucrats*	*MOSOE*	*Private*	*All*	
Bureaucrats	-0.007	0.015 *	0.026 **	0.012 **	
	34	67	36	137	
MOSOE	-0.009	0.013 **	0.010 *	0.009 **	
	34	162	89	285	
Private	-0.007	-0.008	0.001	-0.003	Test 1:
	7	36	60	103	p-value=0.10
All	-0.008 *	0.011 **	0.010 **	0.008	
	75	265	185	525	
	Test 2: p-value=0.04				

Panel C: Changes in ROA for Transfers > 20% of Common Shares by Type of Transfer

	Transferee				
Transferor	*Bureaucrats*	*MOSOE*	*Private*	*All*	
Bureaucrat	-0.010	0.013	0.018	0.008	
	24	48	15	87	
MOSOE	-0.009	0.013 *	0.019 **	0.012 *	
	15	84	27	126	
Private	-0.005	-0.023	0.022	0.000	Test 1:
	2	17	17	36	p-value=0.56
All	-0.010	0.009 *	0.020 **	0.009	
	41	149	59	249	
	Test 2: p-value=0.05				

Table 7:
Correlations between CARs and Changes in Accounting Performance

This table presents the Spearman correlation coefficient between the cumulative abnormal return around 525 block transfers of listed firms in China in the period 1998 through 2002 and changes in industry-adjusted return on assets and return on equity. We use the market-adjusted return model to calculate daily abnormal returns as the difference between the realized return and the market return. The CAR is measured over a window that spans day t-210 through day t+40, and a 5-day window from day t-3 through day t+1. Industry-adjusted return on assets (ROA) is the firm's net income divided by the book value of total assets as of year-end minus the median ROA for the firms in the same industry. Industry-adjusted return on equity (ROE) is the firm's net income divided by the book value of equity as of year-end minus the median ROE for the firms in the same industry. We define industry sectors at the level of two-digit SIC codes, which we obtained from the CSRC. Change in ROA/ROE is the difference in the averages for the two years prior to the announcement and the two years subsequent to the announcement. The year of the announcement is excluded from the analysis.

	Car(-150,50)	Car(-3,1)
Change in ROA	0.250 **	0.124 **
Change in ROE	0.272 **	0.158 **

Table 8:
CEO Turnover following Announcements of Block Transfers

This table reports CEO turnover during the 3 months or 12 months following announcement of 631 block transfers of at least 5% of common shares between different ownership categories for listed firms in China during 1998-2002. The categories are *Bureaucrats*, *MOSOE* and *Private*. *Bureaucrats* is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market-oriented State-owned enterprise; *Private* is a dummy variable equal to one if the largest block holder is a private entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al*. (2006). We also examine block transfers where at least 20 percent of the common shares are transferred.

Panel A: CEO Turnover in the 3 months and 12 months after Share Transfer Announcement

	N	Mean	Std Dev.	t-stat	Minim	Maxim
Within 3 months	631	0.22	0.41	13.2	0	1
Withing 12 months	631	0.38	0.49	19.5	0	1
Within 3 months	292	0.30	0.46	11.1	0	1
Within 12 months	292	0.50	0.50	16.9	0	1

Panel B: CEO Turnover in the 3 months following Transfers > 5% of Common Shares

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureacrats	0.211	0.175	0.163	0.180	
	38	80	49	167	
MOSOE	0.103	0.214	0.237	0.209	
	39	187	114	340	
Private	0.375	0.366	0.240	0.290	Test 1:
	8	41	75	124	p-value=0.07
All	0.176	0.224	0.223	0.217	
	85	308	238	631	

Test 2: p-value=0.62

Panel C: CEO Turnover in the 3 months following Transfers > 20% of Common Shares

	Transferee				
Transferor	Bureaucrats	MOSOE	Private	All	
Bureacrats	0.185	0.232	0.368	0.245	
	27	56	19	102	
MOSOE	0.118	0.293	0.364	0.289	
	17	99	33	149	
Private	0.500	0.444	0.474	0.463	Test 1:
	4	18	19	41	p-value=0.03
All	0.188	0.289	0.394	0.298	
	48	173	71	292	

Test 2: p-value=0.04

Panel D: Reason for CEO Turnover

Reason for CEO Turnover	All firms 1998-2002			Transfer sample < 3 months			Transfer sample < 12 months		
	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Change of Work Assignment	345	0.065	0.28	14	0.089 **	0.10	43	0.068	0.18
Expiration of Term of Office	290	0.055	0.23	28	0.178 **	0.20	54	0.086 **	0.23
Change of Share Controlling Right	120	0.023	0.10	58	0.368 **	0.42	78	0.124 **	0.33
Resignation	229	0.043	0.18	24	0.152 **	0.18	37	0.059 **	0.16
Corporate Governance Improvement	31	0.006	0.03	0	0.000 **	0.00	3	0.005	0.01
Missing	77	0.015	0.06	9	0.057 **	0.07	14	0.022 **	0.06
Other	148	0.028	0.12	4	0.025	0.03	9	0.014 **	0.04
Total	1240	0.235	1.00	137	0.869	1.00	238	0.377	1.00

Table 9:
Cross-sectional Regression Results Analyzing Block Transfers

Column (1) identifies the independent variable being analyzed. Columns (2) and (3) present the results for analysis of the 250-day cumulative abnormal return from *t-210* to *t+40* around the announcement of block transfers. Columns (4) and (5) present the results for analysis of the five-day cumulative abnormal returns from t-3 to t+1 around announcements of block transfers. Columns (6) and (7) present the results for analysis of changes in profitability as measured by ROA during the two years before to the two years after the year of block transfers. Columns (8) and (9) present the results for analysis of changes in profitability as measured by ROE during the two years before to the two years after the year of block transfers. Columns (10) and (11) present the results for analysis of CEO turnover during the 3 months following announcements of block transfers and columns (12) and (13) present the results for analysis of CEO turnover during 12 months following announcements of block transfers. For each pair of columns, the first presents results for block transfers greater than 5 percent while the second presents results for block transfers greater than 20 percent of common shares.

The sample consists of 631 observations of block share transfers of more than five percent of common shares between different ownership categories during 1998-2002. The categories are *Bureaucrats*, *MOSOE* and *Private*. *Bureaucrats* is a dummy variable equal to one if the largest block holder classified as a State Bureaucrat; *MOSOE* is a dummy variable equal to one if the largest block holder is a market oriented State-owned enterprise; *Private* is a dummy variable equal to one if the largest block holder is a private entity. Classifications are based upon 17 detailed categories of ultimate ownership established by researchers at the National University of Singapore ("NUS") as described in Delios *et al.* (2006).

(1)	(2) All Car_250	(3) >20 Car_250	(4) All Car_5	(5) >20 Car_5	(6) All ROA	(7) >20 ROA	(8) All ROE	(9) >20 ROE	(10) All CEO_3	(11) >20 CEO_3	(12) All CEO_12	(13) >20 CEO_12
Intercept	2.186	2.713	0.128	0.223	0.330	0.301	0.779	0.721				
	6.1 a	4.7 a	3.0 a	3.3 a	5.2 a	3.0 a	6.0 a	3.3 a				
Transferor												
Bureaucrats	0.128	0.247	0.007	0.018	0.030	0.028	0.062	0.081	-0.103	0.131	-0.084	-0.131
	2.8 a	3.3 a	1.4	1.9	3.7 a	2.0 b	3.7 a	2.7 a	-2.1 b	-1.6	-1.5	-1.4
MOSOE	0.082	0.186	0.011	0.020	0.024	0.028	0.053	0.089	-0.056	-0.094	-0.037	-0.066
	2.1 b	2.6 b	2.4 b	2.3 b	3.3 a	2.1 b	3.7 a	3.1 a	-1.4	-1.3	-0.7	-0.8
Transferee												
Bureaucrats	-0.051	-0.099	-0.007	-0.009	-0.022	-0.027	-0.046	-0.069	-0.035	-0.143	0.023	-0.115
	-1.1	-1.3	-1.3	-1.0	-2.7 a	-1.9	-2.7 a	-2.3 b	-0.7	-2.1 b	0.4	-1.3
MOSOE	-0.004	-0.066	-0.010	-0.020	-0.003	-0.008	-0.002	-0.035	-0.004	-0.055	0.057	-0.014
	-0.1	-1.1	-2.5 a	-2.9 a	-0.4	-0.7	-0.2	-1.5	-0.1	-0.9	1.4	-0.2
Related	0.039	0.011	0.002	0.006	0.007	0.011	0.015	0.022	-0.049	-0.018	-0.134	-0.161
	0.9	0.2	0.4	0.8	1.0	0.9	1.0	0.9	-0.9	-0.2	-2.1 b	-2.0 b
Largest Change	-0.001	-0.037	0.005	0.003	0.000	-0.010	-0.014	-0.013	0.139	0.138	0.201	0.187
	-0.8	-0.6	1.1	0.3	-0.1	-0.9	-1.1	-0.5	3.6 a	1.9	4.4 a	2.4 a
Percentage Transferred	0.001	0.000	0.000	0.000	0.000	0.000	0.001	0.001	0.001	0.000	0.001	-0.001
	1.1	0.1	2.2 b	1.1	0.4	0.9	1.2	1.5	1.0	0.2	0.5	-0.7
Leverage	-0.049	-0.217	0.002	0.017	0.007	-0.007	0.028	-0.003	0.002	0.011	-0.003	0.174
	-2.1 b	-2.1 b	0.6	1.4	0.8	-0.3	1.4	-0.1	0.1	0.1	0.1	1.3
Size	-0.102	0.123	-0.006	-0.011	-0.017	-0.015	-0.040	-0.038	-0.089	-0.106	-0.114	-0.125
	-5.8 a	-4.3 a	-3.0 a	-3.3 a	-5.4 a	-3.0 a	-6.2 a	-3.4 a	-4.2 a	-2.9 a	-4.8 a	-3.3 a

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Figure 1:
Cumulative Abnormal Returns around Announcements of Negotiated Block Transfers at Chinese Firms

Cumulative abnormal returns around announcements of block transfers are calculated as the difference between the realized return and the market return using the market-adjusted return model. To estimate the market-adjusted model, we use as the market index either the Shanghai Stock Exchange (SHSE) or Shenzhen Stock Exchange (SZSE) composite index, depending on where the firm's stock is listed. The sample consists of 631 observations of block share transfers of more than five percent of common shares between different ownership categories during 1998-2002.