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State ownership and market orientation in China's public firms: An agency theory perspective

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ABSTRACT

In China, an increasing number of state-owned firms have gone public, which suggests a dual-principal phenomenon such that firms are owned by both the government and non-state shareholders. Non-state shareholders tend to focus on the firm's market orientation and performance, while state shareholders seek political goals over profit-maximization. This manuscript attempts to investigate this issue based on agency theory with both qualitative and quantitative studies. Our findings suggest that state-controlled public firms indeed exhibit a lower degree of market orientation than privately controlled public firms in China, and that the firm's market orientation is relatively high when firm ownership is concentrated in the hands of non-state shareholders.

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1. Introduction

It is believed that market orientation leads to good organizational performance, and thus public firms often are associated with a high degree of market orientation given the expectations from their shareholders (Hunt & Morgan, 1995; Kirca, Jayachandran, & Bearden, 2005; Kohli & Jaworski, 1990 for a review). While the literature mainly is based on western modernized firms, there is a dearth of empirical evidence to verify the findings in other types of firms such as state-owned firms in emerging markets. Whether and how state ownership affects market orientation remains an important but understudied research question. As an initial attempt to fill this gap, the main purpose of our paper is to investigate this issue in China, the largest emerging market.

Shifting from a planned economy toward a market economy, China aims to transform state-owned firms into market-oriented firms by selling partial ownership to private shareholders. Thus, state-controlled public firms in China are often owned both by the government and non-state shareholders. This raises the issue that different focuses from these two kinds of shareholders would influence firms' market orientation in different way. According to agency theory, this creates a dual principal problem for firms due to the goal incongruence between dominant and minority principals (Dharwadkar, George, & Brandes, 2000; Shleifer & Vishny, 1997). Building on these extant studies, we attempt to investigate whether the conflicting goals or interests between principals (shareholders) may impose constraints on firm outcomes such as market orientation.

We argue that the goal incongruence between state controlling shareholders and non-state minority shareholders make state-controlled public firms not as market oriented as other public firms. Empirical evidence suggests that the state continues to play a significant role in many public firms, where the mixed ownership has been found to significantly affect performance (Nee, 1992; Xu & Wang, 1999). It has been found that the state owner often pursues political goals, such as low output price, employment, and non-profit-maximizing goals relative to profitability (Ramaswamy, 2001). Thus we propose that compared to other public firms, state-controlled firms have a lower degree of market orientation due to the dual-principal problem. In addition, we wish to examine the influence of a contingency factor (i.e., concentration of shares of minority shareholders) on this issue. According to agency theory, when stock shares are more concentrated, it is more likely for these shareholders to take concerted actions (Shleifer & Vishny, 1997). Concentrated ownership affords non-state shareholders enough voting power to improve firm market actions and outcomes (Hill & Snell, 1989), and we therefore propose this helps a firm's market orientation development.

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Our research attempts to contribute to market orientation literature in two ways. First, the literature argues that studies are heavily biased and that more than 80% of the samples are from developed countries, where most firms are privately owned (Grinstein, 2008). However, this may not be the case in emerging and transitional economies characterized by a variety of ownership structures (Peng, Tan, & Tong, 2004). For this reason, scholars argue that future research will benefit from investigations based on developing countries (Grinstein, 2008) and "mixed economies with heterogeneous ownership groups" (Gedajlovic, 1993, p. 748). To fill this research gap, we select China, the largest emerging market in the world, as the research context to explore the role of state ownership in market orientation development for public firms. The emerging-market context of this investigation may extend current knowledge regarding the role of ownership structure in market orientation development and enrich the literature by adding new findings from non-western context. Second, we suggest that ownership concentration of non-state shareholders may affect market orientation development in state-controlled public firms. This has not been considered in previous studies. Studying this unknown impact of ownership concentration of non-state minority shareholders may make contributions to the literature by providing important new insights in the literature and new implications for business practice.

We conduct both qualitative and quantitative studies to examine our research hypotheses. Based on qualitative investigations of China's public firms, we validate our hypotheses through a detailed comparison of firms regarding their background, history, strategies, and business practices (Miles & Huberman, 1994). We empirically test the hypotheses using secondary-source data collected from several reliable sources covering a large number of Chinese manufacturing firms. A merged dataset consisting of 259 public firms on stock markets in an emerging market (China) is assembled to test our framework.

The remainder of this manuscript is organized as follows. First, the theoretical background is presented and hypotheses are developed. This is followed by a section addressing research methodology. Next, findings are presented. Finally, we conclude with a discussion of research implications and suggestions for future research.

2. Theoretical hypotheses development

2.1. The dual-principal phenomenon and firm market orientation

Agency theory has been characterized as a theory of the ownership structure of the firm and discusses the relationships between principals and agents (Eisenhardt, 1989; Jensen & Meckling, 1976). Recent research demonstrates that principals can be heterogeneous as they can differ in their incentives (Ramaswamy, Li, & Veliyath, 2002). Particularly in emerging economies, a dual-principal problem arises when state and non-state shareholders both own state-controlled public firms and have different goals (Dharwadkar et al., 2000; Gedajlovic, 1993; Thomsen & Pedersen, 2000). As aforementioned, such a dual-principal phenomenon characterizes many China's public firms, where firm shareholders concurrently consist of state and non-state shareholders as a result of partial privatization (Hoskisson, Eden, Lau, & Wright, 2000; Li & Tang, 2010). As a consequence of an enormous endeavor toward partial privatization, a number of institutions and individuals (for simplicity, hereafter referred to as "non-state shareholders"), besides state shareholders, have become owners of formerly state-owned firms.

Substantial government representation frequently characterizes state-owned public firms. The representation enables governments to exercise extensive control and intervention in the firm (Tian, 2005; Xu & Chen, 2003), and thus increases the possibility of goal conflicts between state and non-state owners (Dharwadkar et al., 2000). The dominant state and minority non-state shareholders may impose important limits on corporate priorities and behavior in different directions, and normally the dominant shareholder matters as it has significant implications for determining the goals and strategies ultimately pursued by the firm (Gedajlovic, 1993; Levin & Levin, 1982; Thomsen & Pedersen, 2000).

The state owner in China often pursues political goals, such as low output price, employment, and non-profit-maximizing goals rather than market performance (Li, 2005; Lin, Liu, & Zhang, 2004; Mascarenhas, 1989). In fact, state-controlled public firms are still supervised by various government bureaus of the central or local level. More specifically, state-controlled public firms in China are usually under the supervision of Bureaus of State Property Management (BSPM) or the local finance bureau. It is noteworthy that the top priority of these state bureaus has been stated as "preserving and increasing the value of state properties", which is evaluated by the book value of the state assets rather than market-based performance indicators (SASAC, 2000). Further, top management of state owned/controlled firms is often appointed by governments. As such, performance of these top managers is often assessed by the government rather than shareholders in the stock market (Fottler, 1981). This exacerbates the issue of "an absence of a direct link between the agents (managers) rewards and the financial performance of the companies they oversee" (Chen & Al-Najjar, 2012, p. 834). The state shareholder can override other shareholders in setting priority goals for the firm. In addition, the help and support from the government make these firms have less pressure to survive in the market and are thus less motivated to pursue market orientation. Since extensive government influence can attenuate the firm's motivation and capacity to be responsive to the market (Porter, 1990), the development of firm market orientation may be inhibited.

Unlike state-controlled public firms, privately controlled firms are more likely to develop market orientation due to the survival pressure. The majority of privately controlled firms in China are in highly competitive industries, where they do not enjoy many privileges from either the central or local governments, and frequently have difficulty in obtaining capital, land, and other resources (Neil, Tenev, & Wagle, 2000). Therefore, privately controlled public firms may be more inclined to adopt market orientation in response to intense competition and ever-changing customer needs. Therefore:

Hypothesis 1. In China, state-controlled public firms have a lower degree of market orientation than privately controlled public firms.

2.2. The moderation of ownership concentration

The dual-principal phenomenon suggests that there are an increasing number of non-state shareholders in China's state-controlled public firms. These non-state shareholders may find it difficult to achieve profit-maximization goal due to the dual-principal issue and the dominance of the state shareholder. When share holdings of these minority non-state shareholders are widely diffused, these owners have relatively weak influence over corporate policies and practices (Berle & Means, 1932; Jensen & Meckling, 1976). In such a case, ownership concentration takes on heightened significance in safeguarding minority shareholder interest (Hill & Snell, 1989). Particularly, ownership concentration can play an effective monitoring role in the weak institutional

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