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Ownership structure and the diversification and performance of publicly-listed companies in China

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Abstract The growth and heightened competitiveness of listed companies in China share several central features. These include the gradual transition of state-owned assets to private investors, a rapid pace of product diversification, and impending rapid growth into international markets. In this article, we focus on measuring and identifying the implications of the ownership structure and diversification strategy of listed companies in China. We highlight recent developments in the ownership transition of China's companies, and point to an ownership classification system that can better identify and address differences in the motivations, strategies, and performance of these companies.

1. Company ownership and strategy in China

For nearly two decades, China's strong economic development has been a dominant story in the business press. Underlying and spurring this growth is the transition of state-owned assets to private ownership, facilitated by the creation in the early 1990s of the Shenzhen and Shanghai stock markets. Via these avenues, formerly state-owned firms began to shift ownership shares to various types of private owners, ostensibly independent from the state.

While in many transition economies the shift from state to private ownership has been accomplished in one swift, wholesale transfer of formerly state-owned assets, the ownership transition in China has been gradual, albeit inexorable. With the reallocation in ownership shares of major companies (e.g., Sinopec, Qingdao, DoubleStar, Jiangling Motors) in China to increasingly high levels of private ownership has come a shift in their strategies and performance.

Underlying this shift is the fact that the motivations, goals, and capabilities of a company are strongly related to the identity of its owners and how widely-held or dispersed is the shareholding in the company (Shleifer & Vishny, 1994). Companies that have widely-held shares by private investors, or those owned by institutional shareholders, tend to have a greater focus on shareholder wealth maximization strategies than do companies that have a dominant

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majority owner, or are state-owned. This consideration of the connection between company ownership and strategy means that the issue of ownership identity and concentration has critical implications for understanding the emerging strategies and performance of mainland Chinese companies that are listed in stock markets in China. This understanding is becoming increasingly crucial as China's listed companies continue to grow strongly in domestic markets and assume dominant market positions in China, while also beginning to expand aggressively into international markets (Deng, 2007).

In this article, we focus on measuring and identifying the implications of the ownership structure and strategy of listed companies in China. We contend that the strategies of these companies diverge along the dimensions of product and geographic growth, depending on the nature of ownership in these companies. This divergence extends from the multi-faceted nature of ownership structure in these companies. We highlight recent developments in the ownership transition of China's companies, and point to an ownership classification system that can better identify and address differences in the motivations, strategies, and performance of these companies.

2. Ownership structure in China

2.1. Official ownership classification scheme

A company in mainland China can be listed on either the Shanghai Stock Exchange (SHSE) or the Shenzhen Stock Exchange (SZSE). Regardless of which exchange it is on, the company can have several types of shareholders: the state, legal persons, employees, individual domestic owners of A shares, and foreign private owners of B shares. In addition, companies may issue shares in overseas exchanges, such as Hong Kong, where such shares are called H shares. This categorization of shareholders is defined by Chinese law in its official documents and regulations. It is designed to capture the shifts in ownership of these companies from state shareholders (state shares) to private shareholders of various types: legal person, employee, and private investors (A share, B share, and H share owners).

More specifically, state shares are the shares held by the central government, local governments, or solely-government-owned enterprises. Legal person shares, which are roughly analogous to the institutional share-holder identity as recognized in the United States, are shares owned by domestic institutions which are themselves either independent from or partially owned by the central or local government. A shares are similar to ordinary equity shares as generally accepted in other equity markets, except that they were exclusively available to Chinese citizens and domestic institutions. B shares are also similar to ordinary equity shares, but they were available to foreign individuals and institutions. For most listed companies, the top 10 shareholders are normally the state and legal persons.

This commonly used ownership categorization scheme is the official one mandated by regulators in China. This scheme effectively classifies the shareholders of a firm into three dominant groups—state, legal person, and tradable A and B shares—which each hold approximately 30% of the total stock in these listed companies (Sun, Tong, & Tong, 2002).

Importantly, however, this official categorization does not point out who ultimately owns the firm. Instead, it provides an approximation of the shift in ownership from the state to private individuals. Further, these owner categories have substantially ambiguous definitions and memberships, which makes it difficult to determine both the identity of owners and what might be their consequent motivations and skills to manage the firm.

Consider that the state can own a public company in China through two types of shares: state shares (*guojia gu*) and state-owned legal person shares (*guoyou faren gu*). Under the official categorization, these two types of state owners fall into the state share and legal person share categories. From this, it is evident the official classification scheme fails to clarify that the identity of one type of legal person shareholder is actually a state shareholder.

In fact, a close look at all listed companies in China reveals that a large portion of owners classified as legal person shareholders are, in fact, owners with strong state affiliations. Take, for example, the case of Yanjing Beer. The largest owner of Yanjing Beer is Beijing Yanjing Brewery Co., Ltd., which controls 70% of the shares and is classified under the official scheme as a legal person shareholder. According to this classification, one would expect the shareholder to be largely independent of the state. Yet, the Beijing Yanjing Brewery Co. is, in fact, controlled by the Beijing Municipal Government. As such, the ownership of Yanjing Beer still resides largely in the hands of the state, not the private sector as implied by the classification of the Beijing Yanjing Brewery Co. as a legal person shareholder.

2.2. Identifying who is who in China's listed companies

In our research, we refined the existing classification to overcome ambiguities in the official categorization