ABSTRACT

Privatization is the chief method for transition countries to shift centrally planned economies to market economies with state ownership transferring to private investors. Does privatization in China work? This study examines the relation between ownership structure and firm performance for China's listed firms in 2002 (1069 firms), 2003(1167 firms), and 2004(1217 firms). Unlike previous privatization studies of China where state-owned shares are defined as the sum of state shares and state-owned legal person shares, the study argues that these two types of shares should affect corporate performance differently. In addition, legal person ownership has received limited attention compared to the already extensive research on China's state ownership. As a new form of ownership in State-owned Enterprises, this study also shows that the importance of legal person ownership grows over time. To further examine the impact of legal person ownership on firm performance, legal person shares are divided into state-owned legal person shares and social (non-state) legal person shares. Lastly, as China is undergoing rapid and continuous developments in its financial market, the study of a more recent and larger sample of firms is needed.

The overall results show that the relation between state ownership and market performance is convex. Initially, it reflects that a lower degree of state ownership is beneficial, but beyond an inflection point, a higher degree of state ownership improves

market performance. Another type of ownership, legal person ownership, improves market performance. The result also implies that social (non-state) legal person ownership actually has stronger positive effect on market performance. With regard to the determinants of state ownership, since the Chinese government is evolving towards more privatization, the surrender of its equity share to legal person supports the inverse relation between the two types of shares. Other factors, which might influence the degree of state ownership, include the industry type and the market performance of companies. Finally, further analyses on ownership structure suggest that the financial performance of companies with mixed ownership structure is poorer when compared with either the non-state controlled or state controlled group. The potential reasons are agent incentives, ambiguity of property and control rights, and profit and state welfare objectives.