

# Managerial Discretion and Firm Performance in China's Listed Firms

**Eric C. Chang\***

*Faculty of Business and Economics  
The University of Hong Kong  
Pokfulam Road, Hong Kong*

E-mail: [ecchang@business.hku.hk](mailto:ecchang@business.hku.hk)

and

**Sonia M. L. Wong**

*Faculty of Business and Economics  
The University of Hong Kong  
Pokfulam Road, Hong Kong*

E-mail: [mlswong@business.hku.hk](mailto:mlswong@business.hku.hk)

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\* **The corresponding author**

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## **Abstract**

Agency theory suggests that managerial discretion is negatively related to firm performance. In this study, we investigate how the relationship may be affected by the existence of controlling parties with non-profit-maximizing objectives. In particular, we examine the relationship in China's listed firms and offer evidence that managerial discretion is related positively to firm performance. Our results suggest that managerial discretion is not necessarily detrimental to firm performance, as traditional agency theory suggests. Rather, managerial discretion may have a positive impact on firm performance if managers' objectives are better aligned with firm performance than those of controlling parties.

***Keys Words:* managerial discretion; agency theory; controlling shareholder; political control, China's corporate governance; transitional economy**

Suggested running headline: **Managerial Discretion in China**

## **I. Introduction**

The relationship between managerial discretion and firm performance is a much-studied topic in agency theory. Research on this issue dates back to Berle and Means (1932), who argue that shareholders have a desire to maximize profits, but managers' objectives often differ from shareholders' assumed profit maximization motive (Berle and Means 1932, Jensen and Meckling 1976). Managerial discretion, defined as managers' decision-making latitude, allows managers to serve their own rather than shareholders' objectives and therefore is likely to be associated negatively with firm performance (Jensen and Meckling 1976, Fama 1980, Fama and Jensen 1983a, 1983b, Jensen and Ruback 1983).

Most existing studies of the relationship between managerial discretion and firm performance focus mainly on managers' incentive problems. According to Thomsen and Perdersen (2000:690), the possibility that the parties who exercise control over managers may "have objectives other than profit maximization is rarely considered in this literature." In the corporate governance literature, a large body of theoretical and empirical studies suggest that controlling parties may also have non-profit-maximizing objectives, however. Examples of such controlling parties are state shareholders and politicians who seek not to maximize firm performance but to use firms to serve social and political objectives (Thomsen and Perdersen 2000, Shleifer 1998, Boycho et al. 1996, Shleifer and Vishny 1994). Furthermore, large shareholders in firms characterized by separation of ownership and control may not wish to maximize profits or shareholders' value if these shareholders' control rights allow them to pursue their own personal objectives at the expense of outside investors including minority shareholders and creditors ( La Porta et al. 1999, Shleifer and Vishny 1997, Claessen et al. 1999).

This study attempts to introduce controlling parties' incentive problems into the traditional agency theory and to examine the relationship between managerial discretion and firm performance when both managers and controlling parties have non-profit-maximizing

objectives. (Hereafter, we refer to non-profit-maximizing objectives as “incentive problems.”) Under these circumstances, the relationship between managerial discretion and firm performance depends on a comparison of managers’ objectives and those of controlling parties. If controlling parties’ objectives are better aligned with firm performance than those of managers, managerial discretion is related negatively to firm performance, as traditional agency theory suggests. If, however, controlling parties’ objectives are more poorly aligned with firm performance than those of managers, managerial discretion is related positively to firm performance.

We conducted an empirical investigation of the relationship between managerial discretion and firm performance in China’s listed firms, where controlling parties and managers tend to have non-profit-maximizing objectives. Controlling parties in China’s listed firms are likely to have incentive problems for at least three reasons. First, these are partially privatized firms in which most of the largest shareholders are state entities. These large shareholders tend to give priority to social and political goals rather than to firm performance (Tenev et al. 2002, Tam 2002). Second, managers of China’s listed firms are under the control of not only state shareholders but also grassroots organizations of the Chinese Communist Party (CCP) (hereafter referred to as local party committees), the primary objective of which is to promote political goals (Opper et al., Qian 1995). Third, the ownership structure of these firms is highly concentrated, such that the largest shareholders usually enjoy control rights strong enough to allow them to dominate firms’ decision-making. Given the weak legal protection available for minority shareholders in China, the largest shareholders have not only the incentive but also the ability to redistribute wealth from the firms to themselves (Tenev et al. 2002, EIU 2002a, 2002b, Shanghai Stock Exchange 2001, Tam 2002).

On the other hand, managers of these firms are also likely to have incentive problems because their level of compensation is not linked to their firm’s performance. Furthermore, the

external mechanisms for monitoring managers (e.g., product market competition, a market for corporate control, lender monitoring) are relatively weak and ineffective (Tam 1999, Tenev et al. 2002, Tam 2002, Qian 1995). As a result, China's listed firms provide us with a valuable case that can be used to investigate the relationship between managerial discretion and firm performance when both managers and controlling parties have incentive problems.

We test the performance implication of managerial discretion among China's listed firms by employing data obtained from a survey conducted by the Shanghai Stock Exchange and Integrity Management Consulting Firm (hereafter, the survey is referred to as "SSES").<sup>1</sup> We offer evidence that managerial discretion among the listed firms has a positive effect on firm performance.

Agency theory hypothesizes that managerial discretion is related negatively to firm performance if managers use their discretion to serve their own objectives. By introducing controlling parties' incentive problems into agency theory, we show that managerial discretion can be related positively to firm performance even when managers are not immune to pursuing self-serving objectives at the expense of firm performance. Our study therefore adds to the existing literature on the relationship between managerial discretion and firm performance.

Our study also offers strategic management implications for dealing with managerial discretion in firms characterized by a separation of ownership and control. Our results suggest that the strategic management of managerial discretion is contingent on a comparison of controlling parties' objectives and those of managers. Although we know that managers may have self-serving objectives, there is no priori reason that restricting managerial discretion will better serve the goal of maximizing firm performance. When controlling parties also have

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<sup>1</sup> The survey is part of a three-year project conducted by the Shanghai Stock Exchange. The results of the project have been reported and published in "The Corporate Governance of China's Listed Firms" by the Shanghai Stock Exchange. The survey has also been used by Teney and Zhang (2002) and Opper et al. (2002).

self-serving objectives, increasing managerial discretion can be a useful way to partially protect the interests of outside investors and improve firm performance.

We are not the first to examine the issue of managerial discretion in situations where controlling parties have incentive problems. In their analysis of political control of firms' decision making in state-owned enterprises (SOEs), Boycko, Shleifer, and Vishny (1996) argue that transferring control rights from politicians to managers (i.e., increasing managerial discretion) can help improve firm performance, largely because managers are more concerned with firm performance than are politicians. Their study, however, provides no systematic evidence to support this hypothesis.

Thomsen and Pedersen (2000), on the other hand, show that the relationship between ownership concentration (as proxy for shareholder control over managers) and firm performance depends on the identity of large owners. They interpret this finding as evidence that different types of shareholders have different priorities and preferences for how to deal with managers' agency problems. While recognizing that "the tacit agency theoretical assumption of value-maximizing shareholders is incorrect" (p. 692), the study does not examine how the existence of non-profit-maximizing shareholders may affect the performance implications of managerial discretion. The purpose of our study is to fill this gap.

This paper is organized as follows. In section 2, we discuss the research background and state our hypothesis. The data and methods used to examine the performance implications of managerial discretion are described in section 3. Section 4 reports the empirical results. Section 5 is a conclusion.

## **II. Research Background and Hypothesis**

In this section, we provide an overview of our research background. We then examine the incentives of controlling parties and managers in China's listed firms and develop our hypothesis on the performance implication of managerial discretion for these firms.

## A. Managers' Incentive Problems and Performance Implication of Managerial Discretion

Agency theory assumes that managers have non-profit-maximizing objectives. Various studies analyzing managers' objectives make many different assumptions about these objectives. For example, Baumol (1959) assumes that managers have an incentive to maximize sales subject to the constraints of satisfactory profit, while Williamson (1963a, 1963b) assumes that managers have a positive preference for incurring staff expenses, acquiring bigger managerial emoluments, and increasing funds available for discretionary use. Some studies suggest that managers prefer a non-optimal capital structure because such a structure enables them to pursue personal goals such as protecting underdiversified human capital (e.g., Fama 1980), circumventing performance pressures associated with commitments to disgorge large amount of cash (Jensen 1986), and inflating the voting power of their equity stakes, thus reducing the possibility of a takeover (e.g., Harris and Raviv 1988, Stulz 1988). Others further argue that managers tend to adopt value-reducing diversification strategies to increase their indispensability to their firms (Shleifer and Vishny 1998) and to increase their compensation (Jensen and Murphy 1990).

Agency theory views managerial discretion as an *opportunity* for managers to serve their own objectives rather than the objectives of their controlling parties. The controlling parties may develop various strategies to prevent managers from using their decision-making discretion to pursue self-serving objectives at the expense of firm performance. These strategies would include coupling managers' compensation with firm performance (Jensen and Murphy 1990) and establishing monitoring and bonding mechanisms to limit opportunistic actions by managers (Fama and Jensen 1983). Such measures may discourage managers from pursuing their own goals even if they have the discretion to do so. Furthermore, it may be in managers' own best interest to maintain a certain level of firm performance because of "both the discipline and opportunities provided by markets for their

services, both within and outside the firm” (Fama 1980:289). Nevertheless, the core hypothesis within agency theory is that managerial discretion is negatively associated with firm performance if managers use their discretion to pursue self-serving objectives.

Many studies have examined the empirical relationship between managerial discretion and firm performance. Existing evidence about the relationship is inconclusive, however. Some studies support the negative performance implications of managerial discretion (e.g., Williamson 1963a, Palmer 1973, Baysinger and Butler 1985, Berger et al. 1997, Denis et al. 1997, Brush et al. 2000). Other studies find that managerial discretion is unrelated to firm performance (e.g., Chaganti et al. 1985, Demsetz and Lehn 1985, Zahra and Stanton 1988, Agrawal and Knoeber 1996). The absence of a relationship is interpreted as evidence that various controlling parties have made optimal use of various mechanisms to control managers’ agency problems and therefore is considered to be consistent with agency theory’s hypothesis. There are, however, some studies that find a positive association between managerial discretion and firm performance (e.g. Kesner 1987, Donaldson and Davis 1991). The positive association is viewed as evidence of agency theory’s limitations.

## B. Controlling Parties Incentive Problems, and Managerial Discretion

Agency theory assumes that controlling parties’ objective is to maximize profits but that managers have non-profit-maximizing objectives. However, parties that exercise control over managers may also have non-profit-maximizing objectives. The most obvious examples are state shareholders and politicians who seek to use firms to serve social and national objectives. In some cases, politicians use firms to correct market failures such as natural monopolies and externalities (Vickers and Yarrow 1989, Shleifer and Vishny 1994, Shleifer 1998). In other cases, they use firms to accelerate capital formation and technology transfer (Sacristan 1980), reduce income inequality (Willner 1996), and increase macroeconomic stability (Millward 1976). Furthermore, some scholars argue that state shareholders and

politicians have an incentive to serve their own political objectives rather than social or national goals. Shapiro and Willig (1990) suggest that a politician's objective function is a weighted average of social welfare and his/her political goals and that the relative weights placed on these two kinds of goals depend on the efficiency of the political market. Boycko et al. (1996) and Shleifer and Vishny (1994, 1998) examine the ways in which politicians use firms to provide employment for the purpose of obtaining political support. Krueger (1990) suggests that politicians tend to hire politically connected individuals rather than qualified individual. Jones (1985) describes numerous cases in which politicians in various countries use SOEs as vehicles to transfer wealth and favor from one group to another.

Controlling parties' incentive problems are not limited to using firms to serve social and political objectives. Even private large shareholders may have non-profit-maximizing objectives if their control rights allow them to expropriate other investors, including minority shareholders and creditors (Shleifer and Vishny 1997). Expropriation of other investors can take many forms (e.g., stealing profits, selling outputs and assets at below-market prices to other firms that are also owned by large shareholders, diverting investment opportunities) (La Porta et al. 2000). All these activities tend to damage firm performance. Controlling parties that use their control rights to pursue their own interests at the expense of other investors, much like shareholders and managers with traditional agency problems, are described as having agency problems (Wruck 1989, Morch et al. 1988, Thomsen and Pedersen 2000, Claessens et al. 1999).

The presence of incentive problems on the part of large shareholders does not imply that these shareholders necessarily have less of an incentive to prevent managers from adopting self-serving behaviors that may damage firm performance. This is because managers' self-serving behaviors reduce the amount of resources that large shareholders can capture with their cash flow rights or directly redistribute to themselves through various means of expropriation. Viewed from this perspective, large shareholders still have an

incentive to tie managers' interests to firm performance, even though the shareholders themselves have non-profit-maximizing objectives. Large shareholders, of course, have an incentive to ensure that managers do not attempt to block the shareholders' self-serving actions because of managers' concern about firm performance.

### C. Incentives of Controlling Parties and Managers in China's Listed Firms

#### *Incentive of the Largest Shareholders in China's Listed Firms*

According to China's Company Law, which was promulgated in 1993, China's listed firms are subject to two major types of control (Tenev et al. 2002). The most obvious and important type of control comes from shareholders. Theoretically, shareholders exercise their control over managers through the board of directors (BoD) (Opper et al. 2001). However, anecdotal evidence suggests that some firms' BoDs are actually controlled by managers rather than by shareholders (Tam 1999, 2002, Tenev et al. 2002). To more accurately assess the nature and the extent of shareholder control in the listed firms, we directly examine the incentives and the decision-making power of the largest shareholders, rather than of BoDs<sup>2</sup>.

The largest shareholders in China's listed firms are likely to have non-profit-maximizing objectives. Such shareholders may, first of all, use firms to serve social and political objectives. For example, they may use the firms to provide excessive employment in order to maintain social stability (Xu and Wang 1999, Bai et al. 2000). By 1999, 42 percent of the largest shareholders in China's listed firms were holders of state shares, and 57 percent were holders of legal person shares.<sup>3</sup> Among the largest shareholders holding legal person

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<sup>2</sup> According to China's Company Law, each shareholding firm must establish a board of supervisors consisting of representatives of shareholders and employees in appropriate proportions to supervise the activities of managers. The board of supervisors enjoys control rights that are defined only vaguely. Furthermore, existing studies agree that boards of supervisors are not the key decision-makers in China's listed firms. They are "more decorative than functional" and do not exert any real control over managers (Tenev et al. 2002:100). Therefore, we do not treat boards of supervisors as controlling parties in this study.

<sup>3</sup> There are four major types of shares in China's listed companies: state shares, legal persons shares, A-shares, and B-shares. State shares are held mainly by state asset management agencies or SOEs. Legal person shares are

shares, SSES reveals that, at the end of 1999, more than 90 percent were SOEs rather than private investors. In other words, nearly all of the largest shareholders are state entities, which are likely to give priority to social and political goals rather than to firm performance (Shelifer and Vishny 1994, 1998, Boycko et al. 1996, Tenev et al 2002).

These large shareholders also have both the incentive and the ability to benefit from the expropriation of outside investors. Shareholding in China's listed firms is highly concentrated. According to China's regulations, individual investors are not allowed to accumulate more than 0.5 percent of total shares. Institutional investors, comprising investment funds and insurance firms, have been allowed to invest in China's stock market only since 2000. It is estimated that official funds hold only around 2.3 per cent of the A-shares (OECD 2002, 439). On the other hand, only 5 percent of B-share holders are institutional investors (China Securities and Futures Statistical Yearbook 2000). By the end of 2001, the three largest shareholders of the firms listed on the Shanghai Stock Exchange held about 56.77 percent of total shares, with the average shareholding of the largest shareholders standing at 44.94 percent, the second largest at 8.56 percent, and the third largest at 3.27 percent. In fact, about 42.53 percent of the largest shareholders held more than 50 percent of shares. Given the dispersed shareholding of small shareholders and the weak legal protection available for minority shareholders in China, the largest shareholders in the listed firms have tremendous potential to dominate firms' decision-making and to expropriate other investors (Liu and Lu 2003, Bai et al. 2003, Tenev et al. 2002, Tam 2002, Shanghai Stock Exchange 2000).

The nature of the listing process in China further compounds the agency problems between controlling shareholders and outside investors. Most listed firms on China's stock exchanges are spinoffs from large SOEs and were selected for listing under a quota system.

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held by domestic institutions or firms. While A-shares are held mainly by domestic individual investors, B-shares are held exclusively by foreign investors and are traded against foreign currency. National individual investors, however, have also been allowed to invest in B-shares since February 2001. Foreign investors have been allowed to invest in the A-share market through the Qualified Foreign Institutional Investors Scheme since December 2, 2002.

As a result, most of the controlling shareholders of listed firms are actually parent groups, and the boundaries between the listed firms and the parent groups are “relatively new and often artificial” (Tenev et al. 2002:75). There is an implicit assumption between the listed firms and the parent groups that “listed companies will and should help a parent company if the need arises” (Tenev et al. 2002:101). A large number of case studies indicate that controlling shareholders treat listed firms as cash cows from which these shareholders attempt to reap personal benefit at the expense of other investors. Documented abuses by controlling shareholders include obtaining soft loans from listed firms; using listed firms as guarantors to borrow money from banks; buying and selling goods, services, and assets at unfair prices) (Liu and Lu 2003, Bai et al. 2003, Tenev et al. 2002, EIU 2002a, 2002b, Tam 2002, Smyth 2000, World Bank 1997).

#### *Incentives of Local Party Committees*

The second type of control over managers of China’s listed firms comes from local party committees, which have exercised political control over the firms since the founding of the People’s Republic of China. During the Cultural Revolution (1966-1976), the operation and management of firms were entirely dictated by local party committees, and the position of manager was essentially eliminated (You 1998). In late 1978, the leadership under Deng Xiaoping instigated a two-decade-long reform effort to transfer decision-making power from state and party bureaucrats to managers and shareholders. The promulgation of China’s Company Law in 1993 constituted an important step in the reform process. The law specifies the rights and duties of shareholders, BoDs, and managers in shareholding firms and thus provides these decision-makers with a legal foundation from which to prevent state and party bureaucrats from interfering with their decision-making (World Bank 1997). The law, however, did not entirely eradicate political control over managers. Concerning party activities, Art. 17 of the law states that “the activities of the local party committees of the CCP in a company shall be carried out in accordance with the Constitution of the CCP.” The

constitution of the CCP, however, does little to clarify party responsibilities within enterprises, as Art. 31 provides only a blanket statement that delegates the implementation of higher party decisions to local party committees at the firm level. What seems exceptionally important, however, is the fact that Art. 31, section 7, explicitly assigns local party committees the right to “supervise Party cadres and any other personnel to ensure that they strictly abide by the state laws and administrative disciplines, strictly observe the state’s financial and economic regulations and personnel system, and refrain from encroaching on the interests of the state, the collectives and the masses.” This provision in effect gives local party committees the right to supervise personnel in shareholding firms.

A salient characteristic of corporate governance within China’s shareholding firms, therefore, is the presence of local party committees at the top echelons of the firms, alongside shareholders. As local party committees’ primary duties are to promote political goals, it is likely that the committees do not seek to maximize profits (Opper et al. 2001, 2002, McGregor 2001). Nevertheless, most existing studies of local party committees’ involvement with China’s listed firms are descriptive in nature and based on generalizations about anecdotal evidence and selective case studies (McGregor 2001, Tam 1999). On the whole, these studies do not offer systematic evidence about how the involvement of local party committees in firms’ decision-making affects firms’ performance.

### *Incentives of Managers*

SSES reveals that managers’ main avenue of compensation is their salary. As most managers aspire to a civil service rank, salaries for different categories of managers are usually low and undifferentiated. Furthermore, stock-based incentives are weak, because managers usually hold an insignificant numbers of employee shares, and stock option have not yet developed (Tenev et al. 2002, Qian 1995). As a result, most of China’s listed firms lack compensation schemes that tie managers’ incentives to firm performance. Externally, managers of most listed firms are still shielded from competitive pressure to strive for profits.

In China, an active market for corporate control does not yet exist. There have been only a few episodes of takeover battles since the two exchanges were established. Moreover, many listed firms continue to enjoy some degree of monopolistic power in the still highly regulated product markets. Given the lack of appropriate compensation and external pressure, managers of listed firms have not only the incentive but also the ability to entrench themselves at the expense of firm performance (Shanghai Stock Exchange 2000, Tenev et al. 2002, Tam 2002, Shi and Weisert 2002, Qian 1995).

Salary, bonuses, and shares are only a few ways in which managers are rewarded. In a rent-seeking society like China's, on-the-job perks (e.g., better housing, use of cars, entertainment, restaurant meals, travel, diversion of assets, and business opportunities) associated with the position of manager in listed firms can be substantial (Qian 1995). To capture these benefits, managers must keep their jobs. The criteria for assessing managers are therefore important determinants of managers' incentives. Surprisingly, little systematic evidence is available about how managers of the listed firms are assessed. Some observers suggest that managers are unlikely to be evaluated on the basis of firm performance because of state and party bureaucrats' involvement in the performance-appraisal process (Tam 2002, 1999, Tenev et al. 2002, Qian 1995). Nevertheless, Groves, Hong, McMillan, and Naughton (1995) offer systematic evidence that even managers of China's SOEs have been fired for poor performance. To obtain some idea of how managers of listed firms are assessed, we collected data on managerial turnover in China's listed firms from 1998 through 2001 and then examined the way in which managerial turnover is related to firm performance. Table 1 reports the incidence of non-routine managerial turnover for all listed firms as well as for firms whose performance declined. In line with the literature on managerial turnover, we define managerial turnover as non-routine if a managerial turnover is not caused by sickness, death, or the age of a managers is at or above the normal retirement age of 65. We also exclude managerial turnover in which the managers previously held the titles of both BoD

chair and manager but retained the title of BoD chair after having been removed as manager. A listed firm is said to experience a performance decline if its ratio of pre-tax operating income to asset has been above its industry median for the previous two consecutive years but then drops to either below 25 or 10 percentiles. As shown in Table 1, the average percentage of non-routine managerial turnover during the period, without taking into consideration firm performance, for all of China's listed firms was about 27.13 percent. The incidence of non-routine turnover, however, increased significantly for firms whose performance declined significantly. For example, 36.84 percent and 75 percent of the managers of firms whose performance dropped to below 25 and 10 percentiles, respectively, were dismissed in 2001.<sup>4</sup>

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-----Insert table 1-----

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Our results therefore are consistent with the findings of Groves et al. (1995), who points out that managers in China are held accountable for poor performance. Although we do not have systematic evidence on how managers' internal promotions and outside opportunities are affected by their previous performance, we nevertheless expect that to maintain their on-the-job perks, managers must achieve a level of performance that is acceptable to their assessors.

#### D. Hypothesis

Our previous analysis of the incentives of the largest shareholders, local party committees, and managers in China's listed firms indicates that both managers and controlling parties have their own incentive problems. These problems can be partly reflected by firm performance. In 1999, China's overall economy grew at a rate of about 8 percent. Under such favorable macroeconomic conditions, only 60.56 percent of China's listed firms

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<sup>4</sup> We obtained data on managerial turnover from the Shanghai Wind Information Co., Ltd. (WIND), a private firm specialized in providing data for China's securities market since 1992. The information on reasons for

experienced a positive growth in profits, while the aggregation of profits for all the listed firms actually declined by 2 percentage points.

We expect managers' interests to rely more heavily on firm performance than do the interests of the largest shareholders and local party committees. Managers whose firms perform poorly will be fired and will thus lose all the benefits and rents that they can capture. Large shareholders and local party committees, however, have multiple objectives including their own interests, social and political objectives, and their parent groups' interests. Some of these objectives are in line with firm performance, but others may conflict with firm performance.<sup>5</sup> Furthermore, given the absence of an active takeover market and the lack of outside competition for membership in local party committees, the controlling parties are unlikely to lose their control rights (and therefore the associated benefits) if their firms experience performance declines. As a result, we expect that managers' incentives are better aligned with firm performance than are those of the controlling parties. We therefore offer the following hypothesis:

H1: Managerial discretion, relative to the largest shareholders and local party committees in China's listed firms, has a positive impact on the firm performance.

### **III. Data and Econometric Methodology**

This section provides a detailed discussion of our data source and econometric methodology. First, we introduce our data source and explain how we attempt to measure managerial discretion. Second, we describe the performance measures and the control variables included in our models. Finally, we specify the regression equation for estimation.

#### **A. Data Source of Decision-Making Power**

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managerial changes and on managers' ages were obtained from the Taiwan Economic Journal Mainland China Database.

<sup>5</sup> Bai (2000) developed a multitask theory of SOE reform whereby state shareholders are charged not only with the task of ensuring efficient production but also with the task of providing social welfare.

One question that arises from the testing of the impact of managerial discretion is how we measure managerial discretion. Most existing studies in finance literature use proxy variables rather than direct measures of managerial discretion. A frequently used approach is to adopt as proxies some measures of certain conditions that either allow or restrict managerial discretion. The most commonly adopted proxy variables are ownership variables; this use is based on the assumption that diffused ownership is a condition that affords managers the opportunity to pursue their own objectives (e.g., Demsetz and Lehn 1985, Morck et al. 1988). Others use different proxies, such as board composition and tenure of managers (e.g., Williamson 1963a, Berger et al. 1997, Denis et. al. 1997).

Although the use of proxy variables has the advantage of employing objective data, using proxy variables inevitably introduces noise, because the degree of managerial discretion usually depends on a host of conditions including environmental, organizational, and even psychological factors that cannot easily be captured by one or two proxy variables (Hambrick and Finkelstein 1987, Hambrick and Abrahamson 1995). Furthermore, conventional ownership variables may fail to portray the level of shareholder control over managers if (1) small shareholders fail to exercise their control rights and (2) managers are under the control of non-shareholders. In the first case, shareholders are likely to have control rights that exceed their rights as represented by their shareholding. In the second case, shareholders have to share their control rights with non-shareholders, and this tends to reduce shareholders' control rights relative to their shareholding. Furthermore, under the existence of non-shareholder control, managerial discretion is the extent to which managers are free from both shareholder and non-shareholder controls. Shareholding variables, which at best capture only shareholders' control, are unable to portray the level of managerial discretion.

Using a survey to obtain an assessment of the extent of managerial discretion, on the other hand, aims at measuring directly. This approach seeks to gather specific information only available to insiders in a firm's decision-making processes. In this study, we employed

survey data to assess the distribution of decision-making power in China's listed firms. Our survey includes a question that asked respondents (secretaries to BoDs) to rate the level of decision-making power of managers, the largest shareholders, local party committees, and boards of supervisors in 63 decisions on a five-point scale. Responses ranged from no involvement at all (score=1) to complete control (score=5). We used distribution of decision-making-power data to construct a measure of managerial discretion.

## B. Sample Size

Researchers distributed questionnaires to each of the 483 firms listed on the Shanghai Stock Exchange at the end of 1999. Of these firms, 257 returned the questionnaires (response rate: 53.54 percent). As the first step in checking the survey data and ensuring their quality, we compared the data on basic firm characteristics, including listing age and industries, provided by respondents with those provided by annual reports. Of the 257 returned questionnaires, we excluded 1 owing to the existence of inconsistent data. We excluded 6 more because the firms listed *only* by the B-share market and not by the main board A-share market. Among the remaining 250 respondents, 112, 113, and 113 provided a complete set of ratings on the decision-making power of the largest shareholders, local party committees, and managers (respectively) in all decisions. When we limit our sample to only firms that provided complete data on decision-making power, the number of firms in our sample falls to 90, or about 19 percent of the firms listed by the A-share market of the Shanghai Stock Exchange.

## C. Validity and Reliability of Data

We evaluate non-response biases by comparing the industries represented in our samples with the corresponding industrial structure of all the firms listed by the A-share market of the Shanghai Stock Exchange. As shown in Table 2, the firms listed by the Exchange are unevenly distributed across industries. At the end of 1999, 58.60 percent of the firms belonged to the manufacturing industry, 10.83 percent belonged to the wholesale and

retail industry, and 8.28 percent were conglomerates. The top three industries account for 77.71 percent of all the listed firms. The distribution of firms in our sample is very similar to the distributions of population firms. Within our sample, 58.89 percent of firms belong to the manufacturing industry and 13.33 percent belong to the wholesale and retail industry. Our sample includes observations for only 8 of the 12 industries represented on the Exchange. The 4 unrepresented industries are agriculture, banking and insurance, mining and quarrying, and media. However, the number of firms belonging to these 4 industries is relatively small (with percentages in *ALL<sub>99</sub>* at less than 1.91 percent). Therefore, our sample appears to comprise a reasonably accurate representation of the overall industrial structure of the firms listed by the Shanghai Stock Exchange, suggesting that the sample may not suffer from non-response bias.

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[Insert Table 2 about here]

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We attempted to use respondents' assessment of the decision-making power of the major decision-makers in 63 decisions to capture the decision discretion of local party committees. The list of the decisions and the average decision-making power of the major decision-makers in the firms (including managers, the largest shareholders, and local party committees) is provided in Appendix A. The decisions cover a wide range, including decisions on issues relating to finance and investment, appointment and dismissal of key personnel, performance appraisal, organizational change, strategic planning, and external relationships, among others. The comprehensive coverage suggests that the lack of content validity might not be a problem for our measure.

We assess the reliability of our data by testing the internal consistency of the ratings for each decision-maker. Results indicate that our data is highly consistent, with Cronbach's alpha greater than 96 percent (the results are presented in Appendix A).

Our data on decision-making power are provided by BoD secretaries. In the management structure of China's listed firms, the position of BoD secretary is similar to the position of managing director; such an individual is expected to be the most knowledgeable about a listed firm. Although we cannot entirely rule out the possibility that respondents' biases exist, systematic biases that may affect our results are unlikely to be a problem. This is because it is unlikely that respondents could have perceived the specific linkage between managerial discretion and firm performance on the questionnaire, which contains 74 questions covering nearly every aspect of the listed firms' corporate governance structure.

#### D. Measures of Managerial Discretion

We attempt to capture the performance implications of managerial discretion in two steps. First, based on the survey data, we construct for each decision-maker an index of decision-making power, as rated by respondents. The average decision-making power of managers (MI), the largest shareholders (SI), and local party committees (PI) in 63 decisions are calculated as follows:

$$MI_i = \frac{\sum_{j=1}^n S_{ij}}{n} \quad SI_i = \frac{\sum_{j=1}^n S_{ij}}{n} \quad PI_i = \frac{\sum_{j=1}^n S_{ij}}{n}$$

where  $S_{ij}$  is the level of involvement of the decision-makers  $i$  in decision  $j$ , rated on a five-point scale ranging from no involvement at all (score=1) to complete control (score=5) in 63 decisions ( $n=63$ ). When MI, SI, and PI are constructed, we treat all decisions as equally important and thus assign them equal weightings.

We use the ratio of managers' decision-making power to the total decision-making power of the largest shareholders and the local party committees as the measure of managerial discretion (MD):

$$MD_i = \frac{MI_i}{SI_i + PI_i}$$

MD in essence is a measure of the relative decision-making power between managers and controlling parties. A high value of MD implies a higher level of decision-making power on the part of managers relative to that of controlling parties and therefore implies greater latitude for managers to pursue their own objectives rather than the goals of the controlling parties. If managers' incentives are better aligned with firm performance than are those of controlling parties, MD will be positively associated with firm performance.

#### E. Performance Measurement

The performances of the listed companies are compared using three measures: return on assets (ROA), return on sales (ROS), and growth of sales (GOS). While ROA and ROS measures the firms' profitability, GOS measures the firms' growth.

Some researchers may be sceptical about the quality of Chinese firms' accounting data, given China's embryonic accounting standards. The use of market-based performance measures may, however, present even more problems. China's stock market is no different than any other emerging market in that it is plagued by many speculative activities. To illustrate, at the end of 1999, more than 99 percent of the participants in the Shanghai Stock Market consisted of small individual investors rather than institutional investors. In addition, the turnover velocity (defined as the total transaction volume/total number of tradable shares) of stocks reached as high as 421.55 percent; that is, each stock changed hands 4.2 times per year, on average. In fact, China's stock market has been described as a "casino" because of the rampant speculative activities that take place within it (Wilhelm 2001). For that reason, we choose not to use the market prices of stocks to construct performance measures. The accounting data we use for the construction of our performance measures was obtained from the Shanghai Wind Information Co., Ltd. (WIND). To further ensure data accuracy and consistency, we double-checked our data against the financial data published in the annual reports of the listed companies.

## F. Other Control Variables

The main purpose of this study is to estimate the performance implications of managerial discretion in China's listed firms. However, some factors can jointly affect the level of managerial discretion and firm performance and thus may induce a spurious correlation between them. Based on various economic arguments, we introduce five sets of control variables in this study. Except for the industry code that is obtained from *China Securities and Futures Statistical Yearbook 2000*, data for all control variables come from WIND.

### *Market Conditions*

Firms in our sample come from various industries at various stages of the product life cycle and are subject to different degrees of competition and regulation. Different market conditions provide firms with different opportunities to capture profit. Such differing conditions also leave different amounts of room for varying degrees of managerial discretion (Hambrick and Finkelstein 1987, Hambrick and Abrahamson 1995). We therefore introduce the variable of industrial dummies ( $INDUSTRY_i$ ) in our study.

### *Firm Size*

Firm size is another basic characteristic that may affect both level of managerial discretion and firm performance of listed companies. On the one hand, large firms may have scale economies and better access to financial resources, which could improve firm performance (Fama and French 1995). Xu and Wang (1999) and Qi et al. (2000) document that the financial performance of China's listed firms is positively related to firm size. On the other hand, one might expect large firms to be associated with a higher degree of managerial discretion because it is assumed that managers have incentives for empire building (Baumol 1959, Williamson 1963). In this study, we follow Qi et al. (2000) to use the logarithm of the book value of assets (hereafter "ASSET") as a proxy to capture firm size.

### *Capital Structure*

We also take into account the possible effects of capital structure. Xu and Wang (1999) and Qi et al (2000) find that the debt-to-equity ratio of China's listed firms is negatively related to firm performance. Much of the capital structure research using the principal-agency approach also demonstrates that there is a relationship between managerial discretion and capital structure (Fama 1980, Stiglitz 1985, Jensen 1986, Harris and Raviv 1988, Stulz 1988, Berger et al. 1997). We therefore introduce the debt-to-equity ratio (hereafter "DER") as a control variable.

### *State Shareholding*

The largest shareholders in China's listed firms are holders of either state shares or legal person shares. Qi et al (2000) and Xu and Wang (1999) find that the performance of China's listed firms is related negatively to state shares but positively to legal person shares.<sup>6</sup> As these two types of shareholders may have different incentive to monitor managers and may thus be associated with different levels of managerial discretion in the listed firms, we introduce a dummy variable indicating the presence of state shares to capture possible confounding effects.

### *Lagged Performance Measures*

We also include lagged performance measures as control variables because managerial discretion may be affected by previous firm performance. Managers in a poorly performing firm may experience a loss in decision-making latitude owing to an increase in shareholder monitoring (Denis and Kruse 2000).

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<sup>6</sup> The finding that the proportion of legal person shares is positively associated with firm performance does not imply that the control rights of the legal person shareholders are related positively to firm performance. When there is a departure from the rule of one-share-one vote, Claessens et al. (1999) offer evidence that concentration of cash-flow rights in the hands of large-block holders is positively associated with corporate valuation, but concentration of these block holders' control rights is negatively associated with corporate valuation.

## G. Regression Models

We employ the following model to examine the performance implications of managerial discretion:

$$P = \mathbf{a} + \sum_{i=1}^7 \mathbf{I}_i \text{INDUSTRY}_i + \mathbf{b}_1 \text{ASSET} + \mathbf{b}_2 \text{DER} + \mathbf{b}_3 \text{DSTATE} + \mathbf{b}_4 P_L + \mathbf{b}_5 \text{MD} + \mathbf{e} \quad (1)$$

where P denotes the performance measure proxy as either ROA, ROS, or GOS.  $P_L$  is the corresponding performance measures lagged by one year. MD is the relative decision-making power between managers and controlling parties.  $\hat{a}$ ,  $\hat{e}_i$ ,  $\hat{a}_1$ ,  $\hat{a}_2$ ,  $\hat{a}_3$ ,  $\hat{a}_4$ ,  $\hat{a}_5$  are the coefficients for estimation. Our hypothesis suggests that  $\hat{a}_5$  is significantly positive.

## IV. Results

### A. Descriptive Statistics and Sample Data

Table 3 shows the descriptive statistics and Pearson correlation matrix. ROA and ROS of our sample firms were 4.2 percent and 9.1 percent, respectively. Both of these percentages are lower than their corresponding levels in the preceding year (4.7 percent and 14.2 percent, respectively). The growth of sales was 9.1 percent, which was higher than the growth of sales in 1998 (-9.7 percent).

MD is 0.859, indicating that managers' decision-making power is on the average less than that of controlling parties. MD is related negatively to ROA and ROS. No other simple correlation is found between managerial discretion and other variables included in our model.

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----- [Insert table 3 here ]-----

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### B. Regression Results

Table 4 presents the estimated performance implication of managerial discretion in China's listed firms. The coefficients are estimated by the ordinary least square (OLS) technique. The coefficients of DER are negative in all regressions. Our results are consistent with those of Qi et al. (2000) as well as with those of Xu and Wang (1999). We, however, do not find a positive size effect in our model.

The focus of this model is the performance implications of managerial discretion. Table 4 indicates that the coefficients of MD are positive in all regressions, with statistical significance at 1 percent in ROA and ROS regressions and 5 percent in GOS regression. This suggests that the performance of the listed firms tends to improve when managers have more latitude to pursue their own objectives. Our hypothesis that managerial discretion is related positively to firm performance is therefore supported.<sup>7</sup>

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----- Insert table 4 -----

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## **V. Conclusion**

The relationship between managerial discretion and firm performance is a much-studied topic in agency theory. Most existing studies focus mainly on managers' incentive problems, while controlling parties' incentive problems have received little attention (Thomsen and Pedersen 2000). In this study, we introduce controlling parties' incentive problems and examine the relationship between managerial discretion and firm performance when both managers and controlling parties have incentive problems. Under these

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<sup>7</sup> One may argue that the positive association between MD and performance reflects the utilization of greater amount of managerial expertises rather than differences in incentives between managers and controlling parties. It is true that a higher level of MD implies a greater degree of involvement on the part of managers in decision-making and therefore possibly greater use of their professional knowledge. Nevertheless, they would not make productive use of their expertise to improve firm performance if their self-interests were not somehow tied to firm performance.

circumstances, the relationship between managerial discretion and firm performance depends on a comparison of managers' objectives and those of controlling parties.

We conducted an empirical analysis of the relationship between managerial discretion and firm performance in China's listed firms where both controlling parties and managers have incentive problems but managers' incentives are likely to be better aligned with firm performance than controlling parties' incentives. We offer evidence that managerial discretion has a positive effect on firm performance. We show that managerial discretion can be related positively to firm performance even when managers have self-serving objectives. Our study therefore provides a useful and new addition to existing studies on the performance implications of managerial discretion in agency theory literature.

Our study has important strategic managerial implications. Our results suggest that the strategic management of managerial discretion is contingent on a comparison of controlling parties' objectives and those of managers. Although we know that managers may have self-serving objectives, there is no priori reason that restricting managerial discretion will better serve the goal of maximizing firm performance. If controlling parties also have incentive problems, increasing managerial discretion may be a useful way of partially protecting the interests of minority investors and improving firm performance.

In addition, our study contributes to the debate on the performance implications of managerial discretion in the strategic management literature. Currently, there are two divergent views (Lane, Cannella, and Lubatkin 1999, Denis, Denis, and Sarin 1999, Dalton, Daily, Ellstrand, and Johnson 1998). The first view is based on traditional agency theory, which assumes that managers have an incentive to adopt self-serving behaviors and that managerial discretion is thus detrimental to firm performance. The second view is based on the stewardship theory of managers, which assumes that managers "are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholder

returns” (Donaldson and Davis 1994:159, Davis et al. 1997). Managerial discretion therefore is viewed as “an opportunity for value-enhancing entrepreneurship” (Lane et al. 1999:1079). At first glance, our results seem to support the stewardship theory. However, managers in China’s listed firms managers are not immune to pursuing self-serving objectives at the expense of firm performance. Their agency problems have been documented by many case studies (e.g. Tam 1999, 2002, Tenev et al.2002) and reflected by the firms’ poor performance. Our study therefore suggests that the absence of incentive problems on the part of managers is not a necessary condition for a positive association between managerial discretion and firm performance. Given the existence of incentive problems on the part of controlling parties, self-serving managers may still be good stewards if their interests are relatively better aligned with profit maximization than are those of controlling parties.

Our results suggest that the incentives of managers in China’s listed firms are better aligned with firm performance than the incentives of controlling parties, which are by and large state and political entities. This provides some empirical evidence to support the hypothesis of Boycko et al. (1996) that managers are more concerned with profits than are politicians. Furthermore, our findings echo the findings of some other studies of managers’ roles in transitional economies. Berglof (1995) found that managers in many transitional economies have not attempted to undertake large-scale asset stripping, even though they have gained substantial control over firms’ decision-making. Rather, they have attempted to reduce “their work force substantially and closed down loss-making activities” (p. 64). Based on a review of case studies on the corporate governance of firms, Brada and Singh (1999) argue that “the concern about increased managerial autonomy in transition economies seems ... to be somewhat misplaced.... [T]he type of shareholder activities proposed by many critics of corporate governance in transition economies would seem to replace the petty tutelage of managers by bureaucrats with petty tutelage by shareholders. The latter system is unlikely to yield results better than did the former.” (p. 13).

The controlling shareholders in China's listed firms are mainly state-owned entities. These shareholders may expropriate outside investors in ways that are different from those employed by private shareholders. Therefore, caution must be exercised when generalizing our findings to private controlling shareholders. Nevertheless, our study is still relevant to the growing literature on the agency problems of controlling shareholders. Our study at least suggests the possibility that the existence of agency problems between controlling shareholders and outside investors may change the performance implications of managerial discretion. Given the existence of incentive problems on the part of controlling shareholders, managerial discretion may not be necessarily detrimental to firm performance.

Our study not only has academic value but also provides some practical strategic implications for China's listed firms. Our results imply that transferring decision-making rights from the largest shareholders and local party committees to managers could help improve firm performance. Nevertheless, this is only a second-best solution given the existence of the distorted internal corporate governance structure in China and the weak legal protection available for minority shareholders. In the long run, both controlling parties' and managers' incentives problems must be directly addressed. Fully privatizing the listed firms and providing better protection for minority shareholders through reforms in corporate governance and legal systems are the ultimate keys to improving the performance of China's listed firms (La Porta et al. 2000).

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**Table 1. Managerial Turnover in China's Listed Firms with Performance Decline**

Year	1998	1999	2000	2001
<b>ALL</b>				
No. of Firms	819	916	1052	1122
No. of Non-Routine Turnover	254	269	258	265
Percentage of Non-Routine Turnover	31.01%	29.37%	24.52%	23.62%
<b>P50P50N25</b>				
No. of Firms with Performance Decline	10	18	19	27
No. of Non-Routine Turnover	4	7	7	10
Percentage of Non-Routine Turnover	40.00%	38.89%	36.84%	37.04%
<b>P50P50N10</b>				
No. of Firms with Performance Decline	4	4	4	6
No. of Non-Routine Turnover	3	2	3	4
Percentage of Non-Routine Turnover	75.00%	50.00%	75.00%	66.67%

**P50P50N25:** Firms whose ratios of pre-tax operating income to tax exceeded the industry median for the previous two consecutive years but then dropped to below 25 percentile. [[“percent” instead of “percentile”?]]

**P50P50N10:** Firms whose ratios of pre-tax operating income to tax exceeded the industry median for the previous two consecutive years but then dropped to below 10 percentile. [[“percent” instead of “percentile”?]]

**Table 3. Descriptive Statistics and Pearson Correlation Matrix (N=90)**

Variables	MeanSample99	S.D.Sample99	1	2	3	4	5	6	7	8	9
1 Return on Asset (ROA)	0.042	0.048									
2 Return on Sales (ROS)	0.091	0.240	0.648**								
3 Growth of Sales (GOS)	0.051	0.407	0.333**	0.395*							
4 Return on Asset <sub>Year-1</sub>	0.047	0.051	0.640**	0.293*	0.260*						
5 Return on Sales <sub>Year-1</sub>	0.142	0.219	0.247*	0.235*	0.089	0.646**					
6 Growth of Sales <sub>Year-1</sub>	-0.097	0.592	0.282*	0.187	0.126	0.174	-0.272*				
7 Debt to Equity Ratio (DER)	1.288	1.879	-0.317**	-0.163	-0.203	-0.292**	-0.134	-0.025			
8 Logarithm of Asset (ASSET)	20.819	0.900	-0.133	0.058	0.073	-0.035	0.066	-0.035	0.430**		
9 Existence of State Shares (DSTATE)	0.722	0.450	0.095	0.051	0.047	0.001	-0.031	-0.069	0.127	0.063	
10 MI/ PI +SI (MD)	0.857	0.221	0.251*	0.211*	-0.004	0.029	-0.084	-0.001	0.002	-0.107	-0.057

PI = Decision-Making Power of Party Committee

MI = Decision-Making Power of Manager

SI = Decision-Making Power of Largest Shareholder

\*\*P < 0.01; \*P < 0.05

Table 2. Comparing the Industrial Distribution between Sample Firms and All China's Listed Firms. (N=90)

Industries	SAMPLE <sub>99</sub>	ALL <sub>99</sub>
Agriculture	0 (0.00%)	9 (1.91%)
Mining/ Quarrying	0 (0.00%)	3 (0.64%)
Manufacturing	53 (58.89%)	276 (58.60%)
Production and Supply of Electric Power, Gas, and Water	4 (4.44%)	16 (3.40%)
Construction	1 (1.11%)	10 (2.12%)
Transportation, Storage, and Postal	6 (6.67%)	26 (5.52%)
Wholesale and Retail	12 (13.33%)	51 (10.83%)
Finance and Insurance	0 (0.00%)	4 (0.85%)
Real Estate	3 (3.33%)	14 (2.97%)
Social Services	3 (3.33%)	20 (4.25%)
Media	0 (0.00%)	3 (0.64%)
Conglomerate	8 (8.89%)	39 (8.28%)
No. of Firms	90 (100%)	471 (100%)

Table 4. OLS Regression Analysis of Performance Implications of Managerial Discretion in China's Listed Firms

	ROA Model1	ROS Model2	GOS Model3
(Constant)	0.000 (0.103)	-0.658 (0.652)	-2.233* (1.271)
Industrial Dummy (INDUSTRY)	YES	YES	YES
Debt-to-Equity Ratio (DER)	-0.004* (0.002)	-0.032** (0.015)	-0.065** (0.027)
Logarithm of Asset (ASSET)	-0.002 (0.005)	0.026 (0.031)	0.099 (0.059)
Existence of State Shares (PSTATE)	0.014 (0.009)	0.066 (0.056)	0.158 (0.110)
MI / PI+SI (MD)	0.055*** (0.018)	0.290*** (0.111)	0.565** (0.230)
Return on Asset $_{Year-1}$	0.548*** (0.080)		
Return on Sales $_{Year-1}$		0.122 (0.121)	
Growth of Sales $_{Year-1}$			0.096 (0.094)
No. of Firms	90	90	77
Adjusted R Square	0.449	0.132	0.119
F	7.041	2.125	1.859

The entries in the table are the standardized  $\beta$  with standard errors in parentheses.

ROA = Return on Asset

ROS = Return on Sale

GOS = Growth of Sale

PI = Decision-Making Power of Party Committee

MI = Decision-Making Power of Manager

SI = Decision Making Power of Largest-Shareholder

\*\*\*P < 0.01; \*\*P < 0.05; \*P < 0.10

## Appendix I. Types of Decision and Reliability Test

NO. Type	L. Shareholder	Manager	Party
1 Call of Shareholder Meeting	3.056	2.144	1.411
2 Agenda Setting in Shareholder Meeting	2.989	2.156	1.367
3 Call of Board Meeting	2.711	2.322	1.389
4 Agenda Setting in Board Meeting	2.578	2.400	1.422
5 Call of Supervisory Committee Meeting	2.133	1.689	1.511
6 Agenda Setting in Supervisory Committee Meeting	1.944	1.678	1.500
7 Call of Manager's Office Meeting	1.689	4.578	1.767
8 Agenda Setting in Manager's Office Meeting	1.678	4.589	1.767
9 Selection of Representatives Attending Manager's Office Meeting	1.489	4.567	1.656
10 Making Amendments to Company's Charter	2.600	2.167	1.433
11 Organizational Change	2.111	3.511	2.000
12 Creation and Abolition of Functional Departments	1.722	3.989	1.989
13 Selection of Functional Department Manager	1.633	4.389	2.144
14 Performance Appraisal of Functional Departments	1.511	4.411	2.022
15 Creation and Abolition of Business Departments	1.567	4.378	1.889
16 Selection of Business Department Managers	1.533	4.411	2.133
17 Performance Appraisal of Business Department	1.467	4.389	2.000
18 Creation and Abolition of Branch	1.811	3.789	1.767
19 Selection of Branch Manager	1.689	4.256	2.044
20 Performance Appraisal of Branch	1.600	4.300	1.878
21 Creation and Abolition of Subsidiaries	1.844	3.589	1.800
22 Selection of Subsidiary Manager	1.622	4.056	2.056
23 Performance Appraisal of Subsidiaries	1.544	4.167	1.911
24 Election and Dismissal of Chairman of Board of Directors	3.156	1.400	1.589
25 Performance Appraisal of and Remuneration Enjoyed by Board Chairman	2.711	1.444	1.589
26 Election and Dismissal of Board Members	2.944	1.433	1.544
27 Performance Appraisal of and Remuneration Enjoyed by Board Members	2.456	1.467	1.578
28 Election and Dismissal of Board Secretary	2.300	1.844	1.600
29 Performance Appraisal of and Remuneration Enjoyed by Board Secretary	2.056	2.067	1.622
30 Selection of Supervisory Committee Members	2.689	1.544	1.744
31 Performance Appraisal of and Remuneration Enjoyed by Supervisory Committee Members	2.400	1.600	1.689
32 Selection and Dismissal of Manager	2.533	1.856	1.844
33 Performance Appraisal of and Remuneration Enjoyed by Manager	2.211	1.967	1.767
34 Selection and Dismissal of Vice-Manager	2.111	3.267	1.978
35 Performance Appraisal of and Remuneration Enjoyed by Vice-Manager	1.944	3.156	1.889
36 Change in Shareholding Structure	2.878	2.211	1.356
37 Change in Debt/Equity Ratio	2.600	2.567	1.300
38 Dividend Plan	2.700	2.411	1.256
39 Share Placement and New Issue	2.722	2.500	1.278
40 New Investment in Technology	2.256	3.289	1.367
41 New Investment in Infrastructure	2.256	3.200	1.367
42 Financial Investment	2.078	3.067	1.322
43 Investment in Other Stock Companies	2.278	2.989	1.344
44 Sale of Assets	2.256	2.944	1.367
45 Loans for Fixed Asset Investment	1.967	3.400	1.344
46 Loans for Liquidity Fund	1.844	3.689	1.311
47 Loans through Mortgaging of Asset	2.111	3.011	1.356
48 Guarantee for Other Enterprises' Large-Scale Loans	2.122	2.889	1.333
49 Amount of External Donation	1.856	3.011	1.578
50 External Donation Plan	1.800	3.178	1.667
51 Contracting of Large-Scale Construction Projects	1.811	3.478	1.467
52 Merging with Other Enterprises	2.500	2.956	1.467
53 Being Merged By Other Enterprises	2.822	2.767	1.589
54 Formulation of Long-Term Development Plan	2.322	3.300	1.633
55 Formulation of Strategic Plan	2.289	3.333	1.611
56 Establishment of Long-Term Relationship with Other Enterprises	1.956	3.656	1.556
57 Change of Direction; Entry into New Industry and Market	2.367	3.333	1.567
58 Selection of Accounting (Auditing) Firm	1.933	2.589	1.322
59 Selection of Law Firm	1.856	2.833	1.333
60 Selection of Financial Consultant	1.722	3.033	1.344
61 Selection of Management Consultant	1.756	3.322	1.367
62 Training and Education for Board Members and Higher Management	1.778	2.933	1.678
63 Training and Education for Middle Management	1.567	4.233	1.822
Average of Total Decision-Making Power	2.134	3.033	1.613
Alpha	<b>0.983</b>	<b>0.959</b>	<b>0.986</b>

