China's Secondary Privatization: Perspectives from the Split-Share Structure Reform

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- Review comprehensively the Split-share Structure Reform (SSR)
- Evaluate the reform in terms of improving firm performance and corporate governance.
- Investigate the driving forces behind its success, particularly as a privatization effort.

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- No work has carefully evaluated the reform.
- The SSR provides a great opportunity to study privatization.

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- The split-share structure was established.

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- Extremely under-developed corporate bond market

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- Long bearish stock market during 2002-2004, in contrast to 11% annual compounding GDP growth.

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  - market-based compensation mechanism—for each firm, non-tradable shareholders negotiated directly *consideration* paid to tradable shareholders.
  - compulsory the 12-month lockup of non-tradable shares after the implementation of the SSR.
- Opened up gate for China's secondary privatization.

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- Reliable financial and governance data available before and after the reform.
- Almost all firms involved, less selection and sample biases, if any.

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  - Performance: output, profitability, employment, solvency, and operating efficiency.
  - Governance: related-party transactions, corporate lending to large shareholders, the Herfindahl index of top 10 shareholders' shareholding, and managerial shareholding percentage.
  - Contrast 3 years before and after the reform.

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  - Governance improvement may need more substantial ownership changes.

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  - $IMP^{privatization} = \Delta Perform^{SOE} - \Delta Perform^{Non-SOE\ benchmark}$
  - divide the non-SOEs into 5x5 portfolios by size and industry and compute the median performance change of each portfolio, $\Delta Perform^{Non-SOE\ benchmark}$

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- Concluding remarks: the market negotiation mechanism predicts positively the success of privatization. (the link?)

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- Market mechanism is more effective than top-down administrative orders in privatization.

Data and empirical design

- Data:
  - Sources: CSMAR crossed checked with WIND
  - All firms finished the SSR by the end of 2007, excluding inactive, financial firms and those with unreliable accounting information
  - 1023 firms: 633 SOEs and 399 non-SOEs.
- Empirical challenges:
  - China changed general accounting principles effective in 2007, affecting how assets, inventories, investment and other incomes are scoped and calculated—we use operating revenue and operating profit-related measures.
  - 2007-2009 financial crisis causes market-based performance measures unreliable—we focus on firm financial performance.