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Research on Relationship between Control Transfer, Ownership Structure and Company's Performance: Evidence from Domestic Listed Companies

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Abstract

Control transfer is a major measure taken by companies to improve the performance. However, it still remains inconclusive that performance will be effectively enhanced after control transfer. Based on agreement transfer, it uses factor analysis method and analyzes performance indicators in sequent five years from 2006 to 2008 with the samples of Chinese stock markets. The results showed that, the performance of listed companies will be increased after the transfer of control rights, but it is only a short-term effect; as to the company's ownership structure, ownership concentration has a positive effect to firm performance, and the proportion of state-owned shares does not show a positive impact to it. Company's performance and market value will be enhanced with the resource optimization and resource integration. Finally, it is necessary for company and the whole market to strengthen and standardize control transfer behaviors and optimize equity structure in order to improve the market construction of control transfer system.

Keywords: control transfer, ownership structure, company performance, factor analysis

1. Introduction

The control transfer as a kind of mergers and acquisitions behavior of listed companies is a market-oriented model of the economic structure and enterprise structure adjustment. In the context of the growing of merger and acquisition activity**,** this model in the merger and reorganization proportion is becoming bigger, the transfer mode is increasingly diversified, and the transfer process is also increasingly standardized. Therefore, researching the problem of the control transfer of the listed companies will be one of the hot theoretical and practical topics of foreign and domestic capital market.

With the development of the market economy in our country, the mergers and acquisitions activities are also increasing. The State Council in March 2012, approved and transmitted the notice by the National Development and Reform Commission "On deepening the reform of economic system in 2012 focused on the opinions of the work", once again clearly required continue to advance the joint-stock reform of the system of the state-owned enterprises, and perfected the state-owned capital management budget and revenue sharing system. Under the background of the property right reform of state-owned enterprises, the government begins to allow to dilute the control right through the way of transferring the shares of the listed company to other investors, so as to improve the performance of the listed companies, which makes the control transfer as a type of acquisition and reorganization of the listed companies events emerge endlessly.

Then, through the control transfer, whether it can really effectively improve the performance, increase the economic value of the company, so as to achieve the optimal allocation of the social resources or not? Whether the proportion of shareholding structure adjustment significantly affects the company's operating performance? Based on empirical analysis of China's Shanghai and Shenzhen listed companies, this article discusses the relationship between the changes in the shareholding structure of listed companies, and cooperate performance before and after control transfer in order to perfect the property right reform of the state-owned enterprises, provide reference for improving the overall efficiency of the capital market in our country.

2. Literature Review

In allusion to the impact on the performance of the company based on the control transfer of merger and acquisition behavior, scholars have launched a lot of researches, the conclusions are not consistent. Some scholars believe that the merger and acquisition activity improves the performance of the company, for example, Bradley et al found that after the control transfer, the amplification of the shareholder's income at different time range are different, but the lowest growth rate is not less than 19%, which states that the shareholder value has significantly increased after the merger (Bradley et al., 1988). Kaplan's empirical research results show that after the implementation of the management buy-out activity, the business income, net cash flow and other financial indicators than before the acquisition have increased to a great extent, which confirmed the positive effect of the merger and acquisition activity on the corporate performance and shareholder wealth (Kaplan, 1989). But some other scholars have a negative view on the merger and acquisition activity role**,** they think that the company performance does not rise but fall instead after the control transfer, such as Bhagat et al found that the cumulative excess return ratio of the listed company is falling from 29.3% in the fifth day before the merger and acquisition event to 0.65% in the fifth day after the merger and acquisition event, the falling range is amazing (Bhagat et al., 2001). In addition, the results of the Magenheim and Mueller's match inspection and the conclusions of the research by Agrawal et al. all indicate that the corporate operating performance after acquisition and reorganization is worse instead (Agrawal et al., 2012; Coffee Jr et al., 1988). Otherwise the case studies on the mergers and acquisitions of twenty Chinese listed companies in Taiwan by Yeh and Hoshino also show that the acquiring company has an obvious decline in profitability after the merger and acquisition (Yeh & Hoshino, 2000). Still some other scholars believe that the effects of the control transfer of mergers and acquisitions on corporate performance in fact is not significant, as Ravenscraft etc use the operating earnings before interest and taxes and the total assets, the cash flow and the sales income these two ratios to compare with the operating performance of the target company and the control samples in the same industry, concluded that the target company's operating performance before and after the acquisitions is neither improved nor worse (Ravenscraft & Scherer, 1987). The main reason causing these different findings is the difference of the study period and the sample selection. In addition, the difference of the different research methods is also one of the reasons forming different conclusions.

There is no unanimous conclusion about the relationship between ownership structure and firm performance. Some scholars believe that between the two there are positive correlations: Claessens's study about Czech Republic, as well as Claessens, Djankov, Fan and Lang's study about the shareholding structure of the companies in the East Asian region, shows these countries and regions' ownership structure of is highly concentrated, and positively correlated with the enterprise value (Claessens et al., 2002; Claessens et al., 1997). Pedersen and Thomsen inspect 435 large companies of 12 European countries and find that the company ownership concentration has significant positive correlation with their return on equity (Pedersen & Thomsen, 1999). Lins has the same conclusion from his study of thousands of companies in Germany, Japan and the United Kingdom (Lins & Servaes, 1999). But some scholars believe that there is no significant relationship between ownership structure and firm performance: Demsetz and Lehn inspect 511 large U.S. companies and found that ownership concentration is not related to business performance indicators and accounting indicators (Demsetz & Lehn, 1985). McConnel & Servaes select 1,093 companies in 1976 and 1,173 companies in 1986 in the United States and find that proportions of the large shareholders is not related to the value of Tobin's Q, but they believe that the institutional ownership performs functions with that (McConnell & Servaes, 1990). Other researchers also question whether there is a link between ownership structure and firm performance. Cho examines the relationship of inside ownership, investment and corporate value, he find that ownership structure does not affect the value of the company. He concludes that it is the investment which affects the value of the company, and in turn, affects the ownership structure in the end (Cho, 1998). Davies, Hillier and McColgan use the data of 752 companies in the United Kingdom in 1996 and 1997 respectively to examine the relationship between management ownership and firm value (Tobin's Q) and find that both are bimodal curve (double the hump curve) (Davies et al., 2005).

As can be seen from the studies above, there is no unified point of view whether control transfer has a positive impact, a negative impact or has no impact on firm performance. As to the research methods, scholars like to choose market performance and use the methodology of event study to analyze, they pay more attention to analysis the changes of sample stocks returns before and after the transfer incidents. Event study require an effective capital market, the market should be unbiased with the influences of other factors in the study period. However, the development of China's securities market cannot meet the requirement of event study at present. Therefore, this paper will use accounting method which based on financial indicators. In order to get more

objective conclusions, we select data of listed companies from stock markets of Shanghai and Shenzhen in China as samples to analysis the effect of control transfer to firm performance.

3. Research Hypothesis

The listed company performance reflects the competitive position and competition situation of listed companies in the market. Influenced by a certain system background, the control transfer of China's listed companies not only has the general characteristics of acquisition and reorganization, but also has the distinctive Chinese characteristics. On the basis of western acquisition and reorganization theories, in combination with the practical situation of control transfer market in China, this paper puts forward the following analysis and assumptions.

The basic motivation of the behavior of corporate merger and acquisition is to seek the promotion and development of the enterprise. The traditional western acquisition and reorganization theories think that the behavior of acquisition and reorganization has the advantages of enlarging the scale of production and operation, improving the industry strategic position of the enterprise, gaining advanced manufacturing technology and management, enhancing the brand influence, and helping implement the diversified strategy. The acquisition and reorganization event in China also has its special system background. Firstly, the mergers and acquisitions of state-owned enterprises are mainly dominated by the government. Their purpose is to reverse the loss of enterprise, to reduce the burden of national finance and government management. Secondly, with the continuous development of Chinese capital market, in the control right market besides state-owned enterprises account for a certain proportion, private enterprises and foreign capital also gradually increase. The subjects of mergers and acquisitions begin to tend to diversification, which is beneficial to promote the separation of government and enterprises, make the enterprise move towards the market truly, optimize the allocation of resources, and improve the corporate productivity. Therefore, whether from the perspective of the foreign acquisition and reorganization theory or from the special system background of China, it can be seen that the controlling shareholders have strong willingness to improve the company's operating performance. Based on the above analysis, this paper puts forward hypothesis H1.

H1: The business performance of listed company whose control right transferred will be significantly improved and promoted.

The purpose of merger and acquisition is to adjust and supple the resources, so as to attain the best economic scale, and to achieve the optimal allocation of resources. After the control transfer occurs, all the resources of company will face the integration in large range, and because of the personnel and resources' adjustment could not immediately reach the designated position, which needs a transition period, so the effect of control transfer on corporate performance may have a lag in time, even shows the signs of decline. Thus, it puts forward hypothesis H2.

H2: At the initial stage of the control transfer, the improvement of the company's operating performances not obvious.

Shareholding structure has an important impact on the company's operating decisions, thereby affecting the operating performance after control transfer. After the 'stock right splitting reform' in China (2005), the ratio of state-owned shares has significantly decreased, while a substantial growth in the ratio of corporate shares appeared, and the ratio of circulating/tradable shares remained stable. With a special ownership structure of listed companies in China, the institution for supervision and administration of state-owned assets, an agent of the state shares, cannot exert an active supervision and regulation on the state-owned shareholdings, which result in an absence of the state ownership in the business and a difficulty in making proper evaluation and effective supervision on managers. Therefore, we raise our third hypothesis H3.

H3: The proportion of state-owned shareholding cannot play a positive role on the corporate performance in control transfer.

Due to the current development status of China's capital market, the proportion of corporate shares and tradable shares (A shares) are both relatively low. In addition, since little cash dividends existing listed companies, corporate shareholders may have irrational behaviors departure from the value of the company objectives for pursuing their selfish goals. On the other hand, tradable shareholders tend to pursue short-term arbitrage purposes, and showed less interests on the cooperate performance resulting from control transfer, which means they have strong speculations. Therefore, we rise our forth hypothesis H4.

H4: The proportion of corporate shares and tradable shares (A shares) do not significantly affect the cooperate performance in control transfer.

The small shareholders of the company are usually very scattered. Due to the presence of monitoring costs, it is difficult for small shareholders to exert any effective supervision and control on the decision of company's merger and acquisition (M & A). Large shareholders desired more to supervise the managers to maximize enterprise value when making M & A decisions. Therefore, when other cases are in similar situations, the ownership concentration or the presence of large shareholders is conducive to the effective supervision of the control transfer behavior, and thus help to improve corporate performance. Therefore, we raise our fifth hypothesis H5.

H5: The proportion of the largest shareholder and the top five shareholders, the degree of ownership concentration can generate significant positive impact on the cooperate performance in control transfer.

4. Research Design

4.1 Time Window

China Securities Regulatory Commission announced to launch the pilot reform of equity division in 2005. Equity division reform had basically been completed by the end of 2007, after that the control transfer's behavior of listed companies in our country shows different characteristics compared with the previous stage. It also has a higher degree of marketization. Because the Tai'an CSMAR financial database can provide the latest integrated until 2011 financial data, this article chooses the listed companies whose control right are transferred in the sequent there years from 2006 to 2008 as the research objects to conduct study, thereby to make it more practical significance and effectiveness. This paper chooses the sequent five years from the year before control transfer to the third year after control transfer as the time window of the performance changes before and after the control transfer. T_{-1} represents the year before control transfer, T_0 represents the control transfer year, T_1 represents the year after control transfer, T_2 represents the second year after control transfer, and T_3 represents the third year after control transfer (shown in table 1).

Table 1. Inspection period of samples

Year	Inspection Period
2006	T_{-1} -2005; T_0 -2006; T_1 - 2007; T_2 -2008; T_3 - 2009
2007	T_{-1} -2006; T_0 -2007; T_1 -2008; T_2 -2009; T_3 -2010
2008	T_{-1} -2007; T_0 -2008; T_1 -2009; T_2 -2010; T_3 -2011

4.2 Sample Selection and Data Sources

In order to avert some abnormal data to impact the result, according to the following conditions to eliminate and filter the samples:

(1) The Sample is these companies that the first largest shareholder changed (Eliminate only the first largest shareholder is changed, but the actual controller has not changed), and approved by the State-owned Assets Supervision and Administration Commission or complete the control transfer in the same year. The transfer means is negotiating transfer (transfer with compensation), not including these forms of judicial rulings, auction or free transfer.

(2) The Sample Firms have listed a year ago before the event of control transfer (The sample is included in the year which the equity transfer day is located in).

(3) To eliminate these companies that the first large shareholder changed again within three years after control transfer.

(4) To eliminate these companies that after the transfer control, the industry classification is changed within the time window. This method can reduce to some extent the influence of these control transfer events for the purpose of cross-industry backdoor listings on the research results.

(5) To eliminate these companies, reducing the effects caused by their financial condition or other condition being abnormal on the research results.

(6) Excluding the financial listed companies, this category of listed companies is different from others in other industries; its financial statements have a certain degree of particularity, so it should be eliminated.

After screening, this paper finally chooses 61 listed companies as research samples. Research data is from the Tai'an CSMAR financial database, and the statistical analysis software is SPSS17.0.

4.3 Research Model

As the sum of proportion of state-owned shares, proportion of corporate shares and the proportion of tradable shares (A shares) is near 1, multicollinearity would exist when doing regression analysis in the same equation. So we separate the state-owned shares and the corporate shares and estimate two below-given systems of simultaneous equations:

$$FP = \beta_0 + \beta_1 GJG + \beta_2 LTG + \beta_3 TOP5 + \beta_4 Herf_5 + X_1 SIZE + \varepsilon \quad (1)$$

$$FP = \beta_0 + \beta_1 FRG + \beta_2 F_1 + \beta_3 Herf_5 + X_1 SIZE + \varepsilon \quad (2)$$

where the approximation of ERS is the measure of firm performance. We use data in table 2 as explanatory variables. In order to examine the influence precisely, we introduce firm size as control variables.

Table 2. Explanatory variables

Variable Symbol	Variable's Meaning
FP	Firm Performance (ERS)
F1	Share proportion of the largest shareholder
TOP5	Share proportion of the top five largest shareholders
GJG	Proportion of state-owned shares
FRG	Proportion of corporate shares
LTG	Proportion of tradable shares (A shares)
Herf5	Ownership concentration

5. Empirical Analysis

5.1 Control Transfer and Firm Performance

The paper selected four typical indexes of company operations such as debt paying ability, profit ability, development ability and cash operation ability as analysis variables. We evaluate the performances of control transferred listed companies by analyzing the variation trend of the mean value of the four typical indexes during the time window. The four economic indexes are asset-liability ratio (X1), return on equity (X2), total assets growth rate (X3) and operating cash flow per share (X4); Table 3 provides descriptive statistics for the sample firms within the time window.

Table 3. Descriptive statistics

Time Window	T_{-1}	T_0	T_1	T_2	T_3
Index	Mean	Mean	Mean	Mean	Mean
X1	.2297	.2993	.5507	.2556	.1728
X2	-.1655	.0947	.0647	.0770	.1088
X3	.3090	1.1154	.5014	11.8727	7.8707
X4	.2807	.2734	.3311	.2967	.1962

Figure 1 shows the variation trends of the mean values of the indexes within the time window after data normalization.

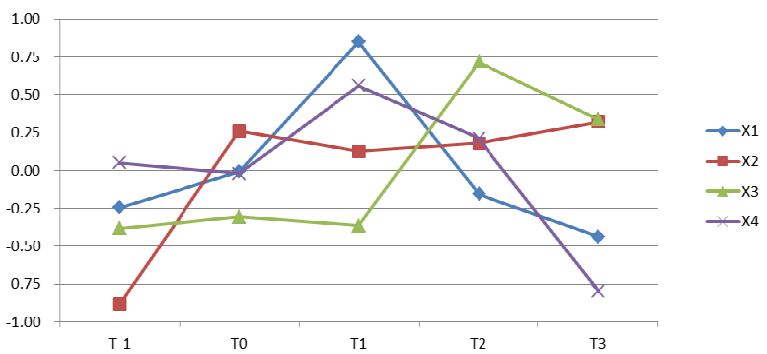

Figure 1. Variation trends of normalized mean values of selected indexes within time window

As illustrated in Figure 1, the selected indicators showed gradually increasing trends within the study period, which indicated that the corporate performance of listed companies would be improved after control transfer. Thus the control transfer indeed bring some positive impacts on the company's corporate performance, therefore, the hypothesis H1 was confirmed. However, although these indicators performed upward trends at the early stage, they showed decreasing trends later on. In summary, there is a certain break-in period right after the control transfer and the influence of control transfer would appear gradually. Furthermore, such influence is generally short-term, which does not have a long-term continuity.

The firm performance rises at the beginning, and then reduces during a short time period. This paper argues that it may be caused by these following factors. First of all, the acquisition and reorganization theory and the theory of control right market both are based on effective market environment, while the effectiveness of China's capital market is still relatively weak. The degree of marketization of control transfer market is lower and there is an "only one big share" phenomenon in most equity structure of listed companies. After the control transfer of listed companies, these problems have not been fundamentally improved. Secondly, the negotiated acquisition is the main way of control transfer of listed companies in our country at present, under which background, the control transfer of listed companies may aims to deal the interests of both sides, rather than improve enterprise value. When selecting the samples, this paper as far as possible to eliminate the control transfer events of cross-industry backdoor listing, but cannot completely avoid the problem of back-door listing in the same industry. In the process of pursuing "shell resource", many acquirers do not make the transfer of control right effective, to help the listed company out of trouble. On the contrary, output the interests from the listed companies to the strong stock holder. Thirdly, the impact of government intervention in the control transfer process will increase the uncertainty of company's operating performance after control transfer. Although the related studies about merger and acquisition theory and control right market theory think that the transfer of corporate control right can effectively improve corporate performance, but considering the special system background and current situation of the capital market in China, in a short period the control transfer may be difficult to ensure the continuous improvement of corporate performance. Therefore, also need to further strengthen the supervision and improvement to the listed companies and the control right transfer market in our country.

5.2 Ownership Structure and Firm Performance

Table 4 provides descriptive statistics for the sample firms within the time window.

Table 4. Descriptive statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
F1	61	.0843	.7303	.341225	.1570012
TOP5	61	.2054	.8054	.488832	.1557444
GJG	61	.0000	.6592	.157001	.2189564
FRG	61	.0000	.6674	.179313	.2060105
LTG	61	.2729	1.0000	.626693	.2245050
Herf5	61	34.1530	41.6242	37.617484	1.5571526
Firm Size	61	20.3136	22.8216	21.344662	.7453316
ERS	61	-.2702	1.0400	.242934	.3456738

It can be seen from table 4 that the average proportion of state-owned shares is 15.7% while the minimum and maximum is 65.92% and 0, respectively. The average proportion of corporate shares is 17.93% while the maximum is 66.74%. The average proportion of tradable shares (A shares) is the largest among the three, about 62.67%. The mean value of largest shareholder of listed companies reaches 34.12%, and the maximum value is 73.03%. Compared with the other shareholders, the largest shareholder shows strong control ability. The top five largest shareholders' ratio is between 20.54% and 80.54%.

Table 5 present regression analysis results for the relationship between firm performance (ERS) and variables of ownership structure.

Table 5. Regression analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.858	1.126	--	-3.426	.001
	GJG	-.443	.200	-.281	-2.221	.031
	LTG	.172	.227	.112	.759	.451
	TOP5	1.439	.343	.648	4.195	.000
	Herf5	.129	.043	.582	3.033	.004
	Firm Size	.385	.078	.831	4.919	.000
2	(Constant)	-3.422	1.183	--	-2.893	.005
	FRG	.177	.201	.105	.880	.383
	F1	.563	.292	.256	1.925	.059
	Herf5	.094	.043	.423	2.168	.035
	Firm Size	.327	.084	.705	3.876	.000

The regression analysis reveals that the proportion of state-owned shares of corporate performance which shows negative influence at the level of 5% cannot play a positive role on the corporate performance in control transfer. H3 is confirmed. The significant coefficients of the proportion of tradable shares (A shares) is 0.451, indicates that it has no relationship with firm performance after control transfer events; although the result of proportion of corporate shares shows some positive influence, but it is not significant, so H4 is confirmed. Both of the share proportion of the top five largest shareholders and the ownership concentration show significant positive impacts on firm performance, the significant coefficients are 0.000 and 0.004, respectively. As to the share proportion of the largest shareholder, the result is 0.059, indicating no significant relationship. H5 is partly confirmed.

To find the reasons for these phenomena, we believe that the shareholder structure of listed companies in China is confined by the organization system of the state, which causes a high proportion of state-owned shares and low proportions of corporate shares and tradable shares. In this context, the M & A activities are often non-market corporate behaviors; the target of government intervention, often accompanied with the government's policy objectives, is not objected to maximize the enterprise value. In addition, in the M & A process, preferential policies provided by the government cannot always meliorate the company's operating system and the competitiveness of companies is not actually improved. Since the corporate shares of listed companies cannot be freely circulated in the stock market, the dividend payout is the main way for their profits; however, the low proportion of corporate shareholders will lead to some irrational behavior to pursue their selfish goals and departure from the company's value target. After the share reform, the proportion of tradable shares has improved dramatically, and it will take some adaptation stage until it really plays an effective role.

6. Conclusion

In this article, we use China's Shanghai and Shenzhen listed companies as research objects, and did empirical analysis on ownership structure and the change of performance of listed companies before and after the control transfer. The following conclusions were obtained from the empirical analysis:

(1) After the control transfer, the performance of companies will be significantly improved, namely the control transfer event will exert a positive impact on corporate performance.

(2) The impact of control transfer on corporate performance has a break-in period before existence, and it is not of persistence.

(3) A decline in the proportion of state-owned shares will cause a corresponding increase in the company's operating performance after control transfer. The improvement of five largest shareholding ratio and ownership concentration will exert positive effect in enhancing the performance of listed companies.

(4) To prolong the active effect of control transfer, further regulation of the behavior of control transfer is required in China, as well as optimization on the ownership structure and improvement in market building of control transfer.

In summary, a long-term run-in period of management and industrial adaption occurs in the operation and management of listed companies after the control transfer. The existence of such a period may not decline the corporate performance or affect the effectiveness of the control transfer. With the gradual optimization and integration of company's resources, the performance of the company and its market value will be enhanced.

However, the persistence of these positive effects is based on further regulation on the market of control transfer in China.

In addition, optimization of the ownership structure has become one of the keys to solve the governance problem of listed companies. View from the shareholding structure of the list companies which have already completed the 'stock right splitting reform' in China, we can see that the phenomenon of single-large shareholder continue to exist, which means the largest shareholder is still keeping in the controlling position. The existence of this phenomenon has a certain rationality, which meets the development of China's capital market at this stage. However, due to the dominance of largest shareholder, the medium and small shareholders lost their voting rights, and the non-tradable shareholdings result in a lack of competition mechanism in control transfer. Listed companies need to consider a further optimization on the ownership structure, and gradually diversify and rationalize the shareholding structure, in order to weaken the dominate control of the largest shareholder in listed companies. A competitive form of the company's control and balances among the subjects of property right are also required.

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