Corporate Governance Research on Listed Firms in China: Institutions, Governance and Accountability

T. J. Wong
Chinese University of Hong Kong, China
tjwong@cuhk.edu.hk

the essence of knowledge
Boston — Delft

Foundations and Trends® in Accounting

Published, sold and distributed by:
now Publishers Inc.
PO Box 1024
Hanover, MA 02339
United States
Tel. +1-781-985-4510
www.nowpublishers.com
sales@nowpublishers.com

Outside North America:
now Publishers Inc.
PO Box 179
2600 AD Delft
The Netherlands
Tel. +31-6-51115274

The preferred citation for this publication is

T. J. Wong. *Corporate Governance Research on Listed Firms in China: Institutions, Governance and Accountability.* Foundations and Trends® in Accounting, vol. 9, no. 4, pp. 259–326, 2014.

This Foundations and Trends® issue was typeset in LaTeX using a class file designed by Neal Parikh. Printed on acid-free paper.

ISBN: 978-1-68083-099-6

Editorial Scope

Topics

Foundations and Trends® in Accounting publishes survey and tutorial articles in the following topics:

- Auditing
- Corporate governance
- Cost management
- Disclosure
- Event studies/Market efficiency studies
- Executive compensation
- Financial reporting
- Financial statement analysis and equity valuation
- Management control
- Performance measurement
- Taxation

Information for Librarians

Foundations and Trends® in Accounting, 2014, Volume 9, 4 issues. ISSN paper version 1554-0642. ISSN online version 1554-0650. Also available as a combined paper and online subscription.

Foundations and Trends® in Accounting
Vol. 9, No. 4 (2014) 259–326

DOI: 10.1561/1400000039

Corporate Governance Research on Listed Firms in China: Institutions, Governance and Accountability

T. J. Wong
Chinese University of Hong Kong, China
tjwong@cuhk.edu.hk

Contents

1 Introduction **260**

2 Institutional Background **268**

2.1 State control and ownership of listed firms 268

2.2 SOE management and government bureaucracy 274

2.3 Law, regulations, and administrative governance 276

2.4 Culture and norms 277

3 Institutions, Governance, and Accountability **279**

3.1 How do institutions shape the corporate governance of Chinese listed firms? 279

3.2 The effect of government ownership on performance . . . 279

3.3 SOEs' management compensation and turnover 284

3.4 State ownership, accounting transparency, and auditor choice 286

4 New Emerging Topics **293**

4.1 New orientation 295

4.2 Incentives of politicians and the role of the bureaucracy . . 298

4.3 The role of social and political networks 304

4.4 The role of the media and financial and information intermediaries in corporate governance 310

4.5 Corporate governance issues of non-SOEs 312
4.6 Challenges in applying Anglo-American-based accounting standards to a relationship-based governance system 314

5 Conclusion **318**

Acknowledgements **319**

References **320**

Abstract

The objective of this monograph is to review prior studies and propose new research directions for the corporate governance of Chinese listed firms. The focus of this monograph is to investigate the underlying relation between China's institutional environment and its listed firms' corporate governance, and to show how formal and informal governance mechanisms actually work within these firms. A top-down institutional framework is adopted to integrate prior research and guide us in identifying first-order factors that shape the corporate governance practice in China. Following this institutional framework, I propose a number of research directions that study the formal and informal governance approaches unique to China's environment.

T. J. Wong. *Corporate Governance Research on Listed Firms in China: Institutions, Governance and Accountability*. Foundations and Trends® in Accounting, vol. 9, no. 4, pp. 259–326, 2014.

DOI: 10.1561/1400000039.

1

Introduction

China has experienced a phenomenal growth in of the gross domestic product (GDP) at an average annual rate of 10% for the past 20 years. In October 2015, China had the second largest GDP in the world at current prices and was ranked first in the world in Purchasing Power Parity terms, according to the IMF Economic Outlook Report. Together with Hong Kong, Shanghai and Shenzhen combined, China's stock market was ranked third in the world in 2014, only after NYSE and Nasdaq. Despite the rapid growth in the number of firms and market capitalization in the domestic stock markets, the fledging market is plagued with a number corporate governance challenges facing the listed firms, including opaque accounting, expropriation by controlling shareholders, and political intervention by the government.

These challenges are in conflict with the original intention of the Chinese government to list the state-owned enterprises (SOEs) in Hong Kong and the domestic stock markets in Shanghai and Shenzhen, and to reform the SOEs through efficiently allocating capitals to these firms and improve their corporate governance by using Anglo-American style governance mechanisms such as instating board of directors, listing regulations, company laws, accounting and auditing standards, and information and financial intermediaries. Allen et al. [2015] argue that these governance issues are part of the key contributing factors, and explain that the stock price performance of the firms listed in China's domestic markets has failed to reflect the stellar performance of the country's GDP in the past 20 years. Thus, research that can shed light on the underlying factors that explain a firm's choices in corporate governance design and whether there are alternative corporate governance approaches that can substitute or complement the Anglo-American model would be invaluable to its SOE reform and its stock markets' capital allocation efficiency.

The objective of this monograph is to review prior studies and propose new research directions on the corporate governance of Chinese listed firms. The focus is on investigating the underlying relation between China's institutional environment and its listed firms' corporate governance and study how formal and informal governance mechanisms actually work within these firms. A top-down institutional framework is adopted to integrate prior research and guide us in identifying first-order factors that shape the corporate governance practice in China. Following this institutional framework, I propose a number of research directions that study the formal and informal governance approaches unique to China's environment.[1]

The top down approach allows us to trace the chain of effects from institutions at the country level to the corporate governance mechanisms practiced at the firm level. Identifying the institutional factors and understanding the paths through which these institutions impact corporate governance is an essential first step for researchers. The reason for a firm in China to adopt a governance system that is different from that of the United States (U.S.) is not necessarily because the managers of the firm behave opportunistically, it may be that such a

[1] In this review, I have primarily selected papers from top U.S. accounting and finance journals that are relevant to China's corporate governance research and the top-down institutional framework. A large body of corporate governance and accounting papers published in China's academic journals are excluded in this paper. A review of these governance and accounting papers can be found in Li and Sun [2009].

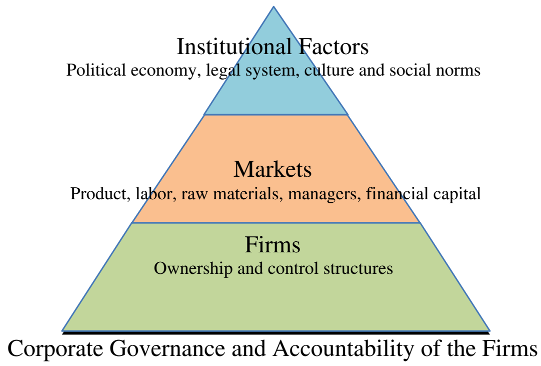

Figure 1.1: Layers of factors that shape corporate governance.

system is optimal to the institutional environment in which the firm is operating.

As shown in Figure 1.1, the corporate governance mechanisms adopted by a firm are determined by key institutional factors, which are at the top of the pyramid, and layers of intermediate factors below the apex. The bottom layer of the pyramid, which has the most direct impact on the corporate governance of a firm, is the corporate and ownership structures of the firm. Compared to U.S. firms, a typical Chinese listed firm is not diffusely owned, but controlled by a large shareholder such as the state, family, or an entrepreneur. In addition, the listed firm often belongs to a corporate group that is under the control of the same large shareholder. The group typically comprises of firms that are vertically integrated or belonging to a diversified portfolio of industries or both. In most cases, the group of firms is structured in a stock pyramid, with the large shareholder controlling the holding company, which in turn, holds shares of another group company and so on. Figure 1.2 illustrates how a listed firm in China is ultimately controlled by the large shareholder at the top of a stock pyramid. Past research has shown that firms' corporate and ownership structures can have a significant impact on their corporate governance, firm performance, and accounting properties [Fama and Jensen, 1983, Morck et al., 1988, La Porta et al., 1999, Fan and Wong, 2002].

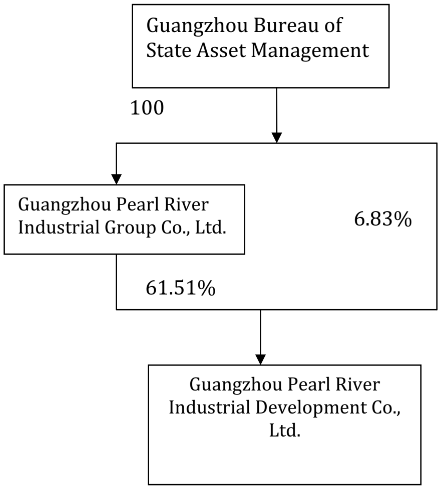

Figure 1.2: A listed company controlled by a local government through a two-layer pyramid.
Source: This figure was reproduced from Fan et al. [2013].
Description: Guangzhou Pearl River Industrial Development Co., Ltd., a listed company, is controlled by Guangzhou Pearl River Industrial Group Co., Ltd., its parent company, with 61.51% ownership. This parent state-owned firm is ultimately controlled by the Guangzhou Bureau of State Asset Management with 100% ownership. Thus, Guangzhou Pearl River Industrial Development Co., Ltd. is ultimately controlled by the government asset management bureau via a two-layer stock pyramid.

The underdevelopment of market institutions is one of the reasons why Chinese listed firms have a high concentration of ownership and/or belong to a corporate group that is either vertically integrated or diversified into various industries. In China, access to natural and financial resources is heavily controlled by the state. Corporate groups are formed because in the absence of private markets for these scarce resources, such structure could create internal markets for accessing and allocating these resources. Large shareholders such as a local government or an entrepreneur with strong political connections can access these state-controlled resources and channel them to members of the corporate group via an internal market. The group can form internal labor markets for member firms when the market for talents is underdeveloped, and achieve a vertical integration that secures the contractual relationships of suppliers and customers, which are otherwise difficult to maintain; especially when the market and legal institutions for many products and services are not yet established (See La Porta et al. [1999], Claessens et al. [2000], and Khanna and Yafeh [2005] for prior research on stock pyramids and corporate groups).

Ultimately, it is the country's institutions that shape the development of markets, which in turn, determines the corporate and ownership of the listed firms. According to the property rights literature, the three key institutional factors in a country that have a significant effect on markets, corporate and ownership structures, and corporate governance are political economy, law and social norms.[2] As a communist state adopting market socialism, the state's influence on the economy is still ubiquitous. As argued earlier, the markets for natural resources, managerial talents and financial capital are not well developed because access to these resources are still heavily controlled by the state. Even in some markets where the state has given up control, the transactions are carried out not at arms-length but through private networks. One important reason is that the legal system is not well established in China. Contracting parties therefore use their social networks to enforce contracts, rather than relying on the courts [Granovetter, 1985]. The dependence on social networks, termed *guanxi* in China, for business transactions is especially prevalent in China because its society is traditionally structured in webs of personal ties. Instead of using formal and universal rules and regulations that govern individual behaviors, members in a social group rely on rituals and mutual obligations that are informal and situation specific [Fei et al., 1992, Faure, 2006]. Therefore, the weak legal system and the traditional practice of *guanxi*-based transactions will further constrain business transactions from being at arms-length, further slowing down the market development.

These country institutional factors sometimes have direct effects on the lower tiers of the pyramid in Figure 1.1. For example, the

[2] The body of property rights literature provides a general framework for analyzing the determinants of corporate ownership structures. This literature was pioneered by Coase [1960], Demsetz [1964], Alchian [1965, 1977], Cheung [1970, 1983]. Interested readers are referred to Eggertsson [1990] for a survey of the literature.

development of legal institutions can shape a firm's ownership structure directly. As argued by La Porta et al. [1999], firms that operate in economies with weak investor protection tend to have high ownership concentration because investors that fear expropriation by corporate insiders will avoid buying shares of such companies, and vice versa. Similarly, the political economy and social norms in China also shape its firms' ownership structure. As China is still transitioning from a state-controlled economy to a market-based economy, many of the listed state firms are still under majority control by the state. Even for entrepreneurial firms, establishing political ties that allow them to access scarce resources would be essential for the firms' growth or even survival. To facilitate rent-seeking activities with the government, which require the ability to build clandestine and long-term relationship with the politicians, entrepreneurs maintain a high concentration of ownership and even form stock pyramids [Fan and Wong, 2002].

Using this institutional framework for analyzing China's corporate governance offers a number of advantages. By identifying China's institutional features that determine its firms' corporate governance, we can gain a better understanding of the differences in governance practice between China and more developed economies such as the U.S. This allows policy setters and researchers to observe the reasons why one size does not always fit all. That is, not all U.S. governance mechanisms are appropriate in China due to the differences in the institutional environment. An undesirable governance arrangement in the U.S. may well be optimal in China. Also, many agency conflicts and governance challenges in China cannot be fixed with simple solutions such as the appointment of a few independent directors, adopting new accounting standards, or introducing pay-for-performance compensation schemes. Many of the problems are deeply rooted in the institutions that cannot be remedied by quick-fix solutions.

Another benefit of using the institutional perspective to study China is that it points us to possible alternative governance systems that are suitable for its environment. One key institutional difference of listed SOEs compared to the U.S., is that the government still retains control in the appointment of senior executives, who are government bureaucrats rather than professional managers. Another important distinction from the U.S. is that *guanxi* is often used as an informal governance mechanism. In this monograph, I propose to examine how the bureaucratic management system, compared to the professional managerial market in the U.S., serves its corporate governance role in the listed SOEs. I also argue that more efforts should be devoted to understanding what roles social networks play in the corporate governance and transfer of information of Chinese listed firms. As will be discussed in Section 2, since there are institutional constraints that prevent the formation of formal governance systems in China, *guanxi* will continue to be a crucial informal substitute. Stakeholders such as business partners, suppliers, customers, creditors, and investors will extensively use network ties to engage in business transactions with the firms. Policy setters should get a better understanding of the values of these network ties and not to be too quick to restrict the usage of such informal contracting and governance mechanisms.

Finally, the corporate governance research of Chinese listed firms offers researchers a rare opportunity to study how a country's institutions can fundamentally change the way firms establish their governance and accounting systems. For instance, the government's retention in the ownership control rights and the rights to appoint senior executives of the listed firms leads to serious agency conflicts between the government as the controlling shareholder and the politicians and bureaucrats who have management control over the firms. These conflicts allow us to examine the direct effect of politicians' incentives on firm behaviors. Other institutional features that have first order effects on the firms are China's legal system and social norms. These institutional factors shape the way firms contract, the formation of markets in which the firms operate and the ownership and corporate structures of the listed firms. This, in turn, will affect the firms' corporate governance and accounting systems. By applying this institutional framework to the China setting, we can identify fundamental conditions or constraints, which are embedded in China's institutions, that cause its governance practice to be different from that of the U.S. and other developed economies.

Also, by carefully mapping the relations between these institutional factors and firms' corporate governance, we can expand our theoretical understanding of the endogenous relations between the firms' operating environment and their governance practice. Having the knowledge of these latent factors will enable us to identify first-order effects and omitted variables in corporate governance research in China. In contrast, without this institutional perspective, our research models will guide us towards inappropriate governance solutions by focusing on the wrong fundamental factors. Also, not considering the right set of underlying determinants of corporate governance will lead to endogeneity or correlated omitted variable problems in the analysis.

This institutional approach to researching China offers new insights in corporate governance research that uses cross-country data or focuses on a single economy. The unique institutional conditions and constraints identified in China are likely to be weaker in more developed economies and stronger in similar emerging economies. Cross-country research can examine whether and how the fundamental institutional factors identified in China also apply in other emerging economies, whereas a different set of institutional features are shaping corporate governance in developed economies. Likewise, the findings of this research could guide cross-country studies in identifying and comparing formal and informal governance mechanisms practiced in certain countries, and analyzing how they differ from those in other countries because of their institutional differences. Although the institutional features and informal governance mechanisms documented in China are not dominant factors in the developed economies, they could play an important role in certain industries or during a particular stage in the life cycle of the firms within those economies. The corporate governance research discussed in this monograph could potentially provide new insights on these research areas.

The remainder of the monograph is organized as follows. Section 2 provides a discussion of the key unique institutional features in China. Section 3 reviews prior research on the effects of government ownership and control on firm performance, managerial turnover and compensation, and accounting. I propose a number of research directions in Section 4, and conclude in Section 5.

References

J. Aharony, C.-W. J. Lee, and T. J. Wong. Financial packaging of IPO firms in China. *Journal of Accounting Research*, 38(1):103–126, 2000.

A. A. Alchian. Some economics of property rights. *Il Politico*, 30:816–829, 1965.

A. A. Alchian. *Economic Forces at Work*. Liberty press, Indianapolis, 1977.

A. A. Alchian and Harold Demsetz. Production, information costs, and economic organization. *The American Economic Review*, 62(5):777–795, 1972.

F. Allen, J. Qian, and M. Qian. Law, finance, and economic growth in China. *Journal of Financial Economics*, 77(1):57–116, 2005.

F. Allen, J. Qian, S. Shan, and J. Zhu. Explaining the disconnection between China's economic growth and stock market performance. Working paper. Imperial College of London and University of Pennsylvania, 2015.

M. Ayyagari, A. Demirgüç-Kunt, and V. Maksimovic. Formal versus informal finance: Evidence from China. *Review of Financial Studies*, 23(8):3048–3097, 2010.

R. Ball, S. P. Kothari, and A. Robin. The effect of international institutional factors on properties of accounting earnings. *Journal of Accounting and Economics*, 29(1):1–51, 2000a.

R. Ball, A. Robin, and J. Shuang Wu. Accounting standards, the institutional environment and issuer incentives: Effect on timely loss recognition in China. *Asia-Pacific Journal of Accounting & Economics*, 7(2):71–96, 2000b.

H. Berkman, R. A. Cole, and L. J. Fu. Political connections and minority-shareholder protection: Evidence from securities-market regulation in China. *Journal of Financial and Quantitative Analysis*, 45(6):1391–1417, 2011.

R. S. Burt. *Structural holes: The social structure of competition.* Harvard University Press, 2009.

G. Chen, M. Firth, Y. Xin, and L. Xu. Control transfers, privatization, and corporate performance: Efficiency gains in China's listed companies. *Journal of Financial and Quantitative Analysis*, 43(1):161–190, 2008.

K. C. W. Chen and H. Yuan. Earnings management and capital resource allocation: Evidence from China's accounting-based regulation of rights issues. *The Accounting Review*, 79(3):645–665, 2004.

Q. Chen, X. Chen, K. Schipper, Y. Xu, and J. Xue. The sensitivity of corporate cash holdings to corporate governance. *Review of Financial Studies*, 25(12):3610–3644, 2012.

Z. Chen, Y. Guan, and B. Ke. Are stock option grants to directors of state-controlled Chinese firms listed in Hong Kong genuine compensation? *The Accounting Review*, 88(5):1547–1574, 2013.

S. Cheung. The structure of a contract and the theory of a non-exclusive resource. *Journal of Law and Economics*, 13(1):49–70, 1970.

S. Cheung. The contractual nature of the firm. *Journal of Law and Economics*, 26(1):1–21, 1983.

S. Claessens, S. Djankov, and L. Lang. The separation of ownership and control in East Asian corporations. *Journal of financial Economics*, 58(1): 81–112, 2000.

R. H. Coase. The problem of social cost. *Journal of Law and Economics*, 3: 1–44, 1960.

M. L. DeFond, T. J. Wong, and S. Li. The impact of improved auditor independence on audit market concentration in China. *Journal of Accounting and Economics*, 28(3):269–305, 1999.

H. Demsetz. The exchange and enforcement of property rights. *Journal of Law and Economics*, 7:11–26, 1964.

F. Du, G. Tang, and S. M. Young. Influence activities and favoritism in subjective performance evaluation: Evidence from chinese state-owned enterprises. *The Accounting Review*, 87(5):1555–1588, 2012.

Þ. Eggertsson. *Economic behavior and institutions: Principles of Neoinstitutional Economics.* Cambridge University Press, 1990.

E. F. Fama and M. C. Jensen. Separation of ownership and control. *Journal of Law and Economics*, 26(2):301–325, 1983.

J. P. H. Fan and T. J. Wong. Corporate ownership structure and the informativeness of accounting earnings in East Asia. *Journal of Accounting and Economics*, 33(3):401–425, 2002.

J. P. H. Fan, T. J. Wong, and T. Zhang. Politically connected CEOs, corporate governance, and Post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, 84(2):330–357, 2007.

J. P. H. Fan, T. J. Wong, and T. Zhang. Institutions and organizational structure: The case of state-owned corporate pyramids. *Journal of Law, Economics, and Organization*, 29(6):1217–1252, 2013.

L. Fang, J. Lerner, and Z. Wu. Intellectual property rights protection, owneship and innovation: Evidence from China. Working paper. Harvard Business School, 2015.

D. Faure. *China and capitalism: A history of business enterprise in modern China, Vol. 1.* Hong Kong University Press, 2006.

X. Fei, G. G. Hamilton, and Z. Wang. *From the soil, the foundations of Chinese society: a translation of Fei Xiaotong's Xiangtu Zhongguo, with an introduction and epilogue.* University of California Press, 1992.

M. Firth, C. Lin, and H. Zou. Friend or foe? the role of state and mutual fund ownership in the split share structure reform in China. *Journal of Financial and Quantitative Analysis*, 45(3):685–706, 2010.

M. Firth, C. Lin, P. Liu, and Y. Xuan. The client is king: Do mutual fund relationships bias analyst recommendations? *Journal of Accounting Research*, 51(1):165–200, 2013.

F. Fukuyama. *The origins of political order: from prehuman times to the French Revolution.* Profile Books, 2011.

X. Gao, T. J. Wong, L. Xia, and G. Yu. Friends with close ties: Asset or liability? evidence from the investment decisions of mutual funds in China. Working paper. The Chinese University of Hong Kong and Harvard Business School, 2014.

T. B. Gold. After comradeship: Personal relations in China since the cultural revolution. *The China Quarterly*, 104:657–675, 1985.

M. Granovetter. Economic action and social structure: The problem of embeddedness. *American Journal of Sociology*, 91(3):481–510, 1985.

M. Granovetter. The impact of social structure on economic outcomes. *Journal of Economic Perspectives*, 19(1):33–50, 2005.

Z. Gu, Z. Li, and Y. G. Yang. Monitors or predators: The influence of institutional investors on sell-side analysts. *The Accounting Review*, 88(1):137–169, 2012.

F. A. Gul, J.-B. Kim, and A. A. Qiu. Ownership concentration, foreign shareholding, audit quality, and stock price synchronicity: Evidence from China. *Journal of Financial Economics*, 95(3):425–442, 2010.

D. Guthrie. The declining significance of guanxi in China's economic transition. *The China Quarterly*, 154:254–282, 1998.

I. M. Haw, D. Qi, D. Wu, and W. Wu. Market consequences of earnings management in response to security regulations in China. *Contemporary Accounting Research*, 22(1):95–140, 2005.

X. He, T. J. Wong, and D. Young. Challenges for implementation of fair value accounting in emerging markets: evidence from China. *Contemporary Accounting Research*, 29(2):538–562, 2012.

M. Hung, T. J. Wong, and T. Zhang. Political considerations in the decision of Chinese SOEs to list in Hong Kong. *Journal of Accounting and Economics*, 53(1):435–449, 2012.

M. Hung, T. J. Wong, and F. Zhang. The value of political ties versus market credibility: Evidence from corporate scandals in China. *Contemporary Accounting Research*, 32(4):1641–1675, 2015.

K. Hwang. Face and favor: The Chinese power game. *American Journal of Sociology*, 92(4):944–974, 1987.

M. C. Jensen and W. H. Meckling. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3 (4):305–360, 1976.

M. C. Jensen and W. H. Meckling. Rights and production functions: An application to labor-managed firms and codetermination. *Journal of business*, 52(4):469–506, 1979.

M. Jian and T. J. Wong. Propping through related party transactions. *Review of Accounting Studies*, 15(1):70–105, 2010.

G. Jiang, C. M. C. Lee, and H. Yue. Tunneling through intercorporate loans: The China experience. *Journal of Financial Economics*, 98(1):1–20, 2010.

J. M. Karpoff and E. M. Rice. Organizational form, share transferability, and firm performance: Evidence from the ANCSA corporations. *Journal of Financial Economics*, 24(1):69–105, 1989.

T. Kato and C. Long. Executive turnover and firm performance in China. *The American Economic Review*, 96(2):363–367, 2006.

B. Ke, O. Rui, and W. Yu. Hong Kong stock listing and the sensitivity of managerial compensation to firm performance in state-controlled Chinese firms. *Review of Accounting Studies*, 17(1):166–188, 2012.

T. Khanna and Y. Yafeh. Business groups and risk sharing around the world. *The Journal of Business*, 78(1):301–340, 2005.

R. King, J. Piotroski T. J. Wong, and T. Zhang. Mixing business with politics: The value of business and political elites to chinese firms. CUHK and Stanford University working paper, 2014.

S. P. Kothari, K. Ramanna, and D. J. Skinner. Implications for GAAP from an analysis of positive research in accounting. *Journal of Accounting and Economics*, 50(2):246–286, 2010.

R. La Porta, F. Lopez de Silanes, and A. Shleifer. Corporate ownership around the world. *The Journal of Finance*, 54(2):471–517, 1999.

M. A. Layton. Is private securities litigation essential for the development of China's stock markets. *NYU Law Review*, 83:1948, 2008.

Z. Li and Z. Sun. *Institutions, governance and accounting — empirical accounting research based on China's institutions.* (Chinese version) Gezhi Press, Shanghai Joint Publishing House and Shanghai People's Publishing House, 2009.

Z. Li, T. J. Wong, and G. Yu. Do analysts with close ties improve the firms' information environment? evidence from a relationship-based economy. Working paper. Chinese University of Hong Kong and Harvard Business School, 2014.

L. Liao, B. Liu, and H. Wang. China's secondary privatization: Perspectives from the split-share structure reform. *Journal of Financial Economics*, 113 (3):500–518, 2014.

R. Morck, A. Shleifer, and R. W. Vishny. Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics*, 20:293–315, 1988.

R. Morck, B. Yeung, and W. Yu. The information content of stock markets: Why do emerging markets have synchronous stock price movements? *Journal of Financial Economics*, 58(1–2):215–260, 2000.

J. D. Piotroski and T. J. Wong. Institutions and information environment of Chinese listed firms. In J. F. Fan and R. Morck, editors, *Capitalizing China*. University of Chicago Press, 2012.

J. D. Piotroski and T. Zhang. Politicians and the IPO decision: The impact of impending political promotions on IPO activity in China. *Journal of Financial Economics*, 111(1):111–136, 2014.

J. D. Piotroski, T. J. Wong, and T. Zhang. Political incentives to suppress negative information: Evidence from Chinese listed firms. *Journal of Accounting Research*, 53(2):405–459, 2015a.

J. D. Piotroski, T. J. Wong, and T. Zhang. Credibility of corporate news coverage in china: Impact of commercialization and conglomeration reforms. Working paper. The Chinese University of Hong Kong and Stanford University, 2015b.

K. Pistor and C. Xu. Governing emerging stock markets: Legal vs administrative governance. *Corporate Governance: An International Review*, 13 (1):5–10, 2005a.

K. Pistor and C. Xu. Governing stock markets in transition economies: Lessons from China. *American Law and Economics Review*, 7(1):184–210, 2005b.

Y. Qian and C. Xu. The M-form hierarchy and China's economic reform. *European Economic Review*, 37(2):541–548, 1993.

B. Rothstein. Understanding the quality of government in China: the cadre administration hypothesis. Working paper. University of Gothenburg, 2013.

P. Sapienza, L. Zingales, and L. Guiso. Does culture affect economic outcomes. Working paper No. w11999. National Bureau of Economic Research, 2006.

V. Shih. Factions matter: Personal networks and the distribution of bank loans in China. *Journal of Contemporary China*, 13(38):3–19, 2004.

V. Shih, C. Adolph, and M. Liu. Getting ahead in the communist party: Explaining the advancement of central committee members in China. *American Political Science Review*, 106(01):166–187, 2012.

A. Shleifer and R. W. Vishny. *The grabbing hand: Government pathologies and their cures.* Harvard University Press, 2002.

E. S. Steinfeld. *Forging reform in China: The fate of state-owned industry.* Cambridge University Press, 1999.

Q. Sun and W. H. S. Tong. China share issue privatization: The extent of its success. *Journal of Financial Economics*, 70(2):183–222, 2003.

G. Tullock. *The politics of bureaucracy.* Public Affairs Press, 1965.

Q. Wang, T. J. Wong, and L. Xia. State ownership, the institutional environment, and auditor choice: Evidence from China. *Journal of Accounting and Economics*, 46(1):112–134, 2008.

R. L. Watts and J. L. Zimmerman. *Positive accounting theory.* Prentice-Hall, Inc, 1986.

Z. Wei, F. Xie, and S. Zhang. Ownership structure and firm value in China's privatized firms: 1991–2001. *Journal of Financial and Quantitative Analysis*, 40(01):87–108, 2005.

C. Xu. The fundamental institutions of China's reforms and development. *Journal of Economic Literature*, 49(4):1076–1151, 2011.

M. M. Yang. *Gifts, favors, and banquets: The art of social relationships in China*. Cornell University Press, 1994.

Z. Yang. Do political connections add value to audit firms? evidence from IPO audits in China. *Contemporary Accounting Research*, 30(3):891–921, 2013.