Issues & Studies© 44, no. 3 (September 2008): 43-70.

Rights Issues in China as Evidence for the Existence of Two Types of Agency Problems

Bi-Huei Tsai

This paper identifies the existence of two kinds of agency problem by focusing on rights issues by Chinese firms. It begins by examining the context in which state-designated managers are strongly encouraged by the government to provide funds for its use, often at the expense of their companies' interests. The statistics presented in this paper further show how Chinese managers transfer these cash funds, raised from their public shareholders, via rights issues, to the state as cash dividends. An empirical examination of 459 rights issues by Chinese firms from 1999 to 2004 shows how Chinese managers have inflated their earnings prior to rights issues in order to gain regulatory permission and thus process the cash transfers more smoothly. This is evidence of the first type of agency problem: managers behaving in a way that is against the interests of their shareholders. In addition, during rights issues, existing shareholders can purchase new shares at lower prices and as a result there is a substantial drop in both the firm's share price and its returns. Wealth reallocation from the nation to subscribed shareholders occurs during this period, which implies that state-designated managers disregard this obligation to safeguard national assets. This practice is a sign of the second type of agency problem: Chinese state-designated managers violating the national interest for the sake of their own self-interest.

Keywords: **China; market economy; public; rights issues.**

Bi-Huei Tsai (蔡璧徽) (Ph.D., National Taiwan University, 1993) is currently assistant professor in the Department of Management Science, College of Management, National Chiao Tung University, Hsinchu, Taiwan. She can be reached at <Joy@mail.nctu.edu.tw>.

©Institute of International Relations, National Chengchi University, Taipei, Taiwan (ROC).

* * *

The Chinese market has become more and more important on a global level as it undergoes a transformation from socialism to a free economy. According to Chinese government statistics, Chinese capital markets have been rising in recent years. From 1991 to 2005, the annual market value of Chinese stocks on the Shenzhen (深圳) Stock Exchange grew from 8 billion *yuan* to 933 billion *yuan*, and those in Shanghai (上海) grew in value from 250 billion *yuan* to 2,309 billion *yuan*. Over the same period, the total annual amount of foreign loans and investment in China grew from 88 billion *yuan* to 504 billion *yuan*. All the evidence indicates that the Chinese markets are expanding dramatically and that foreign capital is continuously flowing into them. Chinese capital markets are some of the most significant in the world. Since managers do not have ownership of listed firms in China, it is important for us to determine whether or not Chinese managers harm the interests of outside shareholders by serving their own interests. Furthermore, because the state held on average a 39.46 percent stake in Chinese firms between 1999 and 2004, the government in China has a much greater influence over firms than it does in developed countries. Thus, in this paper, firms listed in China between 1999 and 2004 are defined as "state-dominated firms." In these circumstances, it is critical to investigate whether or not managers violate their obligations to protect national assets.

According to the agency theory proposed by Jensen and Meckling,[1] the separation of ownership and management creates conflicts of interest between the principals (shareholders) and agents (managers) that is the root cause of principal-agent problems. As managers do not hold all the ownership, they have strong incentives to impair or exploit outside shareholders in order to serve their own self-interest. Hence, agency problems occur between managers and outside shareholders. The related literature

[1]Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Cost, and Ownership Structure," *Journal of Financial Economics* 3, no. 4 (October 1976): 305-60.

C.E.P.S.

further shows how companies in Western countries apply monitoring mechanisms to mitigate agency problems. These monitoring mechanisms consist of boards of directors, auditors, takeovers, institutional investors, and so on. Institutional investors[2] and boards of directors[3] collect information about company operations and prevent corporate strategies from harming shareholders. In addition, organizations may also establish control systems and employ independent auditors to reduce agency costs.[4] Furthermore, banks also protect their loans by ensuring that managers make the required repayments.[5] Active merger or takeover activities in the stock market also put pressure on managers to perform well.[6] The monitoring function performed by institutional investors, boards of directors, banks, and potential mergers is a critical factor in forcing managers in developed countries to issue accurate financial statements. Decisions concerning financial activities can be made based on these statements in order to maximize profit. In short, accurate accounting and accurate decision-making by managers are the two key criteria for the successful operation of firms in developed countries.

China is in the process of transforming itself from a socialist to a free economy, and in doing this it has directly adopted regulations, market standards, and trading systems from the developed world. However, as Clarke[7]

---

[2]K. J. Martijn Cremers, Vinay B. Nair, and Chenyang Wei, "Governance Mechanisms and Bond Prices," *Review of Financial Studies* 20, no. 5 (September 2007): 1359-88.

[3]Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, D.C.: Brookings Institution Press, 1995); and Theodore Eisenberg, Stefan Sundgren, and Martin T. Wells, "Larger Board Size and Decreasing Firm Value in Small Firms," *Journal of Financial Economics* 48, no. 1 (April 1998): 35-54.

[4]Kevan L. Jensen and Jeff L. Payne, "Management Trade-offs of Internal Control and External Auditor Expertise," *Auditing: A Journal of Practice & Theory* 22, no. 2 (September 2003): 99-119; and Kevan L. Jensen and Jeff L. Payne, "Audit Procurement: Managing Audit Quality and Audit Fees in Response to Agency Costs," ibid. 24, no. 2 (November 2005): 27-48.

[5]Jensen and Meckling, "Theory of the Firm," 313-19.

[6]Fernandez Carlos and Arrondo Ruben, "Alternative Internal Controls as Substitutes of the Board of Directors," *Corporate Governance: An International Review* 13, no. 6 (November 2005): 856-66; and Andrei Shleifer and Robert W. Vishny, "Large Shareholders and Corporate Control," *Journal of Political Economy* 94, no. 3 (June 1986): 461-88.

[7]Donald C. Clarke, "Corporate Governance in China: An Overview," *China Economic Review* 14, no. 4 (2003): 494-507.

and Zhang[8] have pointed out, corporate governance in Chinese firms is inferior to that in their counterparts in developed countries. Chinese firms still need to improve the corporate supervision of managerial efficiency and financial statements. Some researchers have argued that Chinese auditors, as a profession, do not perform to a standard that would ensure their independence.[9] Specifically, many studies indicate the negative impact of soft budget constraints (預算軟約束) on the effectiveness of bank debt covenants in China.[10] Soft budget constraints help stressed firms to avoid liquidation and thus they also reduce managerial efforts to maximize profits for outside shareholders and debtors. Zheng Shaozu (鄭紹祖) also points to the poor performance of Chinese boards of directors.[11] Moreover, the internal controls of Chinese firms are not as sound as those in developed countries. Since so few market mechanisms exist in China which can prevent agency problems, it is necessary to investigate how agency problems emerge and develop in Chinese firms. This paper will present important evidence to assist in developing an understanding of agency problems in China.

In addition to the agency problems that arise in traditional corporate models, Shleifer and Vishny indicate that further conflicts arise between firms and politicians through partial government control of commercial-

---

[8]Le-Yin Zhang, "Market Socialism Revisited: The Case of Chinese State-Owned Enterprises," *Issues & Studies* 42, no. 3 (September 2006): 1-46.

[9]Shi Peiyong and Wang Jianxin, "Analyzing the Factors That Influence CPA Audit Independence and the Relevant Improving Measures," *Shandong shangye zhiye jishu xueyuan xuebao* (Journal of Shandong Institute of Commerce and Technology) 7, no. 4 (August 2007): 25-27; and Wang Zhihua, "Analysis of the Professional Ethics of the Certified Public Accountants (CPA)," *Keji qingbao kaifa yu jingji* (Sci-Tech Information Development & Economy), no. 23 (2007): 147-48.

[10]Zhu Hongjun, He Xianjie, and Chen Xinyuan, "Financial Development, Soft Budget Constraints, and Firm Investment," *Kuaiji yanjiu* (Accounting Research), no. 10 (2006): 64-70; and Liu Wanming and Li Xuelian, "Denationalization Reform of the World Banking, Property Rights Structure, Externalities, and the Soft Budget Constraint: An Explanatory Framework Based upon the Property Rights Theory of New Institutional Economics," *Guoji jinrong yanjiu* (Studies of International Finance), no. 9 (2007): 11-19.

[11]Zheng Shaozu, "Probe into Interior Control Environments in State-Owned Enterprises," *Shanxi caizheng shuiwu zhuanke xuexiao xuebao* (Journal of Shanxi Finance and Tax College) 9, no. 4 (August 2007): 27-29.

C.E.P.S.

ized state-dominated enterprises.[12] They conclude that state-dominated enterprises are highly inefficient as a result of political pressure from the politicians who control them. For example, most state-dominated enterprises are encouraged by politicians seeking votes to employ more staff than they need, so that a small number of people benefit by being employed at the expense of the rest of the population. In addition, the state-assigned managers may act in the interests of the politicians who control them, and this may result in them not acting in the interests of the nation (all the citizens). From 1999 to 2004, the state held on average a 39.46 percent stake in Chinese firms, so the government had a substantial influence over them. Fan, Wong, and Zhang have shown that Chinese listed firms are inclined to appoint politically-connected chief executive officers (CEOs) who try to solve the problems of local unemployment.[13] A CEO located in an area of high unemployment will be required to recruit extra staff to comply with the government policy to increase employment, and as a result the firm will perform poorly after initial public offerings (IPOs). According to the cited literature, the government is able to exercise its control of state-dominated firms through its assigned managers who tend to comply with the government's wishes in order to maintain their positions. Hence, the agency problem involving state-assigned managers and the national interest seldom occurs in developed countries, but is prevalent in China. It is doubtful that managers of state-dominated firms protect the wealth of the nation. Here, I shall investigate whether or not Chinese managers make their choices in order to please government leaders rather than giving due consideration to the interests of the firm and its shareholders.

The studies carried out by Jensen and Meckling[14] and Shleifer and Vishny[15] indicate that both kinds of agency problem are likely to occur in

---

[12]Andrei Shleifer and Robert W. Vishny, "Politicians and Firms," *Quarterly Journal of Economics* 109, no. 4 (November 1994): 995-1025.

[13]Joseph P. H. Fan, T. J. Wong, and Tianyu Zhang, "Politically Connected CEOs, Corporate Governance, and Post-IPO Performance of China's Newly Partially Privatized Firms," *Journal of Financial Economics* 84, no. 2 (May 2007): 330-57.

[14]Jensen and Meckling, "Theory of the Firm," 313-19.

[15]Shleifer and Vishny, "Politicians and Firms," 995-98.

C.E.P.S.

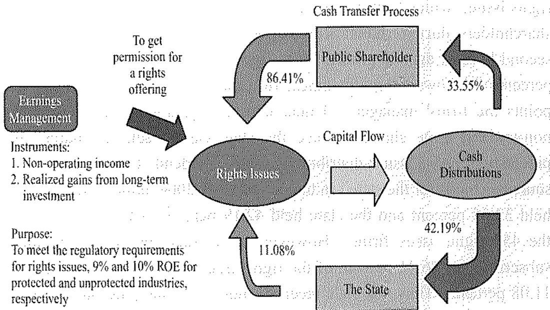
Chinese firms. However, these studies were conducted using modeling analysis. More empirical work is needed on what agency problems are found in Chinese firms and how they occur. This paper will examine data on the rights issue activities of Chinese firms to see how the two kinds of critical agency problem are related to rights issues. The first type of agency problem arises when Chinese managers mislead existing and potential shareholders through manipulated accounting reports in order to meet the regulatory requirements for rights offerings. The second type, between private shareholders of firms and the national interest, is a result of violations by state-assigned managers of their obligation to safeguard national assets. A more detailed discussion of the two types of agency problem follows below.

There is evidence that some Chinese managers seriously deceive capital markets through the manipulation of earnings presented in financial statements in order to meet the regulatory requirements for rights issues. Since 1999 the China Securities Regulatory Commission (CSRC, Notice No. 12) has required unprotected and protected firms to have an average ROE (return on equity) above 10 percent and 9 percent, respectively, for three consecutive years prior to a rights offering; therefore, managers have a strong incentive to inflate earnings to meet these regulatory benchmarks. The process of manipulation which managers use to discretely increase their firms' incomes in accounting reports is a part of "earnings management."[16] Since manipulated figures in financial statements can mislead investors in their evaluation of a firm, there is a real need to establish the existence of this practice, as well as to determine its extent (see figure 1).

[16]See, e.g.: Patricia M. Dechow, "Accounting Earnings and Cash Flows as Measures of Firm Performance: The Role of Accounting Accruals," *Journal of Accounting and Economics* 18, no. 1 (July 1994): 3-42; Mark L. Defond and James Jiambalvo, "Debt Covenant Violation and Manipulation of Accruals," ibid. 17, nos. 1-2 (January 1994): 145-76; Paul M. Healy, "The Effect of Bonus Schemes on Accounting Decisions," ibid. 7, nos. 1-3 (April 1985): 85-107; Robert S. Kaplan, "Evidence on the Effect of Bonus Schemes on Accounting Procedure and Accrual Decisions," ibid., 109-13; and Paul M. Healy and James M. Wahlen, "A Review of the Earnings Management Literature and Its Implications for Standard Setting," *Accounting Horizon* 13, no. 4 (December 1999): 365-83.

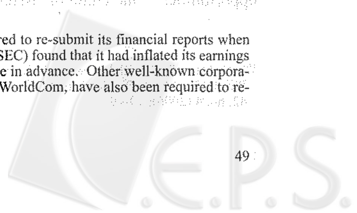
I.E.P.S.

Figure 1
Earnings Management and Cash Transfer Process of Rights Issue Firms



In financial statements, ROE is defined as the net income deflated by the equity. Net income incorporates non-operating income which is mainly comprised of realized gains from long-term investments. As non-operating income increases, so do net income and ROE. In such circumstances, managers are likely to use non-operating income or realized gains to meet the regulatory requirements for rights issues. If this were to occur in developed countries, the companies involved would risk having to re-submit their financial reports should they be found out by their national securities and exchange commission (SEC) or its equivalent.[17] In China, however, the CSRC seldom uncovers such fraudulent financial reporting. Therefore, it is critical to determine if Chinese managers employ more straightforward methods, such as using non-operating income or realized gains from long-term investments, to meet rights issue requirements due to the lower

[17]For example, the Xerox Corporation was required to re-submit its financial reports when the U.S Securities and Exchange Commission (SEC) found that it had inflated its earnings by inappropriately recognizing operating income in advance. Other well-known corporations, such as IBM, Bristol-Myers Squibb, and WorldCom, have also been required to re-submit.



risk of having to re-submit financial reports.

There is also political interference in strategic decisions concerning rights issues, which leads to a transfer of wealth from the nation to private shareholders during rights issue periods. This process represents the second kind of agency problem (see figure 1). As the state holds 39.46 percent of the ownership of Chinese firms, the government frequently appoints the firms' managers. Under current regulations, the state holds non-tradable state shares. Since the state cannot sell its shares, the proceeds of rights issues distributed as cash dividends form an important source of funds for the state. In the period 1999-2004, public shareholders held 33.55 percent and the state held 42.19 percent of the ownership of the 459 rights issue firms. However, on average, public shareholders subscribed for 86.41 percent of the rights issues and the state subscribed 11.08 percent. Thus, the state received more cash and paid out less than public shareholders during rights issues (see figure 1). Using the revenue from rights offerings to pay cash dividends is equivalent to asking public shareholders to pay money to the holder of non-tradable shares (the state). The coexistence of rights offerings and cash distributions in Chinese firms is analogous to a cash transfer from public shareholders to the state, and it is therefore impossible to increase the value of a firm through a rights issue.

According to conventional financial theory, firms with the potential to grow execute rights issues and retain their profits in order to take advantage of potentially lucrative investment opportunities.[18] Also according to this theory, such firms avoid the simultaneous execution of rights issues and cash distributions. However, the empirical data seem to indicate that Chinese firms engage in rights offers and cash dividend distributions at almost the same time. This practice goes against conventional financing theory, because the motivation for rights issues among Chinese firms is to transfer cash from the public to the state, rather than to support investment opportunities. One common assumption concerning managerial behavior

[18]E.g., Mustafa Kemal Yilmaz and Guzhzan Guly, "Dividend Policies and Price-Volume Reactions to Cash Dividends on the Stock Market," *Emerging Markets Finance and Trade* 42, no. 4 (2006): 19-49.

in developed countries is that managers make equity financing choices to maximize the value of their firm, namely, the wealth of all the shareholders; however, this assumption is not valid in the Chinese case. Chinese managers impair shareholder interests in order to achieve political targets and to keep their positions. This is an example of the first kind of agency problem derived from the conflict of interest between outside shareholders and managers.

In particular, Chinese firms make use of a subscription price that is much lower than the market price to encourage the existing public shareholders to participate in a rights issue. Existing shareholders are qualified to obtain rights issue shares at prices much lower than market prices, while other people are not. Thus, existing shareholders prefer rights issue shares because such shares are more profitable. However, right issue actions dilute the share value of Chinese firms and thus lower the value of state shares. Evidence from the 459 rights issues (1999-2004) used in this study seems to indicate that the national interest, which belongs to all its citizens, is sacrificed in order to benefit three groups of individuals: politicians, state-appointed managers, and existing public shareholders. This behavior on the part of state-appointed managers violates their responsibility to protect national assets and represents the second kind of agency problem. Now, this paper needs to investigate market responses during rights issues and to find evidence for wealth reallocations from national assets to existing public shareholders in China.

The Background of Political Interference in Chinese Firms

China is in transition from a socialist system to a free economy, but its firms are still mostly owned by the state and other legal entities, and the government frequently appoints managers to these firms. There may be more incentives for such state-appointed managers to act in the best interests of the state rather than in the interests of the other existing and potential shareholders. Watanabe has pointed out that the ultimate controller (the state-appointed manager) in Chinese firms might have interests which

Table 1
Distribution of Cash Dividend Payout Ratio*

Year	Frequency	Median	Mean	Minimum	Maximum	Standard deviation
1995	199	49.89	48.97	3.36	95.86	23.17
1996	179	48.50	48.54	7.83	98.49	20.40
1997	168	48.92	50.14	5.66	97.92	22.95
1998	220	48.54	50.09	3.63	99.93	24.90
1999	236	47.89	49.35	2.55	99.89	25.38
2000	287	45.34	46.87	4.02	97.29	22.55
2001	656	42.87	45.08	3.88	99.90	22.21
2002	669	42.88	44.62	2.68	99.76	22.02
2003	591	48.78	50.19	4.63	99.50	23.34
2004	601	42.58	46.36	1.64	99.67	24.02

*Cash dividend payout ratio is defined as the cash dividend deflated by net income.

conflict with those of the company and its small shareholders.[19] In such a situation, it would be very difficult for the controller to make decisions that maximize corporate value. Under current regulations, the state holds non-tradable shares. In contrast to public shares, non-tradable shares can only be bought and sold through private placement and with special approval from the government. They cannot be traded directly in capital markets. In these circumstances, it is reasonable to expect that the state might receive cash from the state shares through frequent cash dividends. On average, cash dividend payout ratios exceeded 44 percent annually between 1995 and 2004, and 123 of the total number of cash dividend distributions accounted for 90 percent of the net income (see table 1). From this it can be concluded that Chinese firms prefer to distribute cash dividends.

[19]Mariko Watanabe, "Holding Company Risk in China: A Final Step of State-Owned Enterprises Reform and an Emerging Problem of Corporate Governance," *China Economic Review* 13, no. 4 (2002): 373-81.

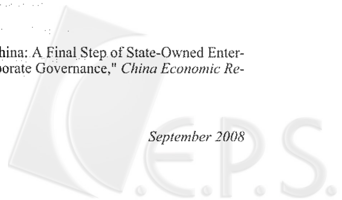


Table 2
Distribution of Subscribed Shareholder Proportion among 459 Rights Issues from 1999 to 2004

Variable	Mean	Standard deviation	Minimum	Maximum
State	0.1108	0.1601	0	0.7500
Public	0.8642	0.1747	0.2500	1.0000
Institutions	0.0251	0.0900	0	0.6563

Source: *Taiwan Economic Journal* (*TEJ*) database.

In order for the Chinese firms to be able to provide the cash outflow for cash dividend payments, these firms may execute rights issues to raise additional capital. From 1999 to 2004, there were 459 rights issues to existing shareholders among firms listed in the A-share markets. Of the firms involved in the rights issues, 267 paid out cash dividends in the same year as the rights offering, 222 firms did so in the previous year, and 155 had done so two years earlier. There were 294 firms that distributed cash dividends in the first year after the rights issue, 296 that did so in the second subsequent year, and 223 in the third subsequent year after the rights issue. Altogether, the cash dividends distributed in the year of the rights issue and the subsequent two years accounted for 52.97 percent of the offering proceeds on average. From these statistics, it can be seen that the coexistence of rights offerings and cash dividends is prevalent in Chinese firms.

To encourage tradable shareholders to subscribe to new shares from rights issues, Chinese firms allow existing shareholders to obtain rights issue shares at, on average, 53.50 percent of the market price. This discount explains why public shareholders are eager to subscribe.

State shares accounted for about 11.08 percent of the 459 rights issues and public shares accounted for 86.41 percent. Although state shareholders held 42.19 percent of the ownership of the 459 rights issue firms, they only subscribed to 11.08 percent of the rights issue shares and they did not participate at all in 208 of the 459 rights issues. Even though public shareholders accounted for only 33.51 percent of ownership, they subscribed to more than 86.41 percent of the rights issues (see table 2). Lee and Xiao

Table 3
Example of Wealth Reallocation in Chinese Firms through Rights Issues

Prior to rights issue	Value	Ownership
Firm value	1,000 (10×100 shares=1,000)	
Share value (value per share)	10 (1,000÷100 outstanding share)	
State	500 (5×100 shares=500)	50/100=50%
Public	500 (5×100 shares=500)	50/100=50%
Subsequent to rights issue		
Firm value	1,500 (10×100+5×100=1,500)	
Share value (value per share)	7.5 (1,500÷200 outstanding share)	
State	375 (7.5×50 shares=375)	50/200=25%
Public	1,125 (7.5×150 shares=1,125)	150/200=75%

also find that non-tradable state shareholders subscribe to a much smaller percentage of shares allocated to them in rights offerings than do public shareholders.[20] The use by managers of cash receipts from rights offerings to pay cash dividends is equivalent to them asking existing shareholders to buy non-tradable state shares.

Consequently, wealth transfer occurs when the state gives up its subscription and the public subscribes to most of the available shares. Take the example of Firm X. Before the rights issue, there are 100 outstanding shares for Firm X and the stock price per share is 10 dollars. The state and the public holds 50 shares each, so the market value of both the state shares and the public shares is 500 dollars. The situation changes when Firm X executes a rights issue for 100 shares at 5 dollars per share. The firm's value increases to 1,500 dollars. The state does not take up its subscription, while the public shareholders do. As a result, the balance in holdings changes: the state now holds 50 shares (375 dollars market value) and the public holds 150 shares (1,125 dollars, market value) (see table 3). In addition, the share value (value per share) of Firm X is likely to go down

[20]Chi-wen Jevons Lee and Xing Xiao, "Tunneling Dividend," Working paper, 2004. http://166.111.96.192:8080/cfrn/getPaper.do? id=805.

C.E.P.S.

from 10 to 7.5 dollars subsequent to the rights issue since the lower offer price of the rights issue has diluted its share value.

From the data presented it can be seen that with rights issues and cash distributions under the Chinese system, wealth is transferred (in the form of shares) from the state to the public shareholders, while cash (in the form of dividends) moves in the opposite direction at almost the same time. Clearly, this phenomenon contradicts conventional financial practice which emphasizes that firms experiencing a period of growth execute rights issues and retain earnings to use in potentially lucrative investment opportunities. Rights issues are the direct result of managers seeking to maintain their positions and this practice continues unchecked due to deficiencies in monitoring, rather than being the outcome of a firm's policy of value-maximization. It seems that Chinese politicians treat state-dominated firms as political tools despite their obligations to maximize, or at least to safeguard, the national wealth.

Hypothesis Development

The main aim of this paper is to determine whether or not Chinese firms utilize non-operating income in order to obtain approval for rights issues. It also seeks to ascertain if rights offerings dilute the market price, resulting in the transfer of wealth from the state to existing shareholders who participate in rights issues.

Earnings Management before Rights Issues

Previous studies have defined "earnings management" as managers using income-increasing accounting numbers to inflate earnings.[21] Other

[21]See, e.g.: Dechow, "Accounting Earnings and Cash Flows as Measures of Firm Performance," 3-4; Defond and Jiambalvo, "Debt Covenant Violation and Manipulation of Accruals," 145-46; Healy, "The Effect of Bonus Schemes on Accounting Decisions," 85-86; Kaplan, "Evidence on the Effect of Bonus Schemes on Accounting Procedure and Accrual Decisions," 109-10; and Healy and Wahlen, "A Review of the Earnings Management Literature and Its Implications for Standard Setting," 365-66.

papers have specifically studied the practice of earnings management in Chinese state-dominated enterprises before public listings or the issuing of new equity.[22] The China Securities Regulatory Commission has set clear rules for rights issues to existing shareholders in order to control the allocation of key resources to listed firms. Since 1999, the government has required unprotected firms to have an average ROE above 10 percent and protected firms to have an average ROE of 9 percent for three consecutive years prior to an offering (CSRC Notice No. 12, 1999). In order to get permission for rights issues, managers may inflate earnings to meet the regulatory requirements.

Previous studies have found that discretionary accruals are the generally accepted instrument for earnings management in developed countries.[23] However, discretionary accruals will suffer reversal and it is difficult for them to recur in consecutive years. Since Chinese firms are required to meet the conditions for three consecutive years before a rights issue, their managers are more likely to select non-reversible items such as non-operating income to inflate earnings. Chen and Yuan found that Chinese firms have made use of non-operating income to meet the requirements for an IPO.[24] This paper now offers the following hypothesis:

---

[22]See, e.g.: Joseph Aharony, Chi-wen Jevons Lee, and Tak Jun Wong, "Financial Packaging of IPO Firms in China," *Journal of Accounting Research* 38, no. 1 (1999): 103-26; Ming Jian and T. J. Wong, "Earnings Management and Tunneling through Related Party Transactions: Evidence from Chinese Corporate Groups" (Working paper, Hong Kong University of Science and Technology, 2004); Charles J. P. Chen, Shimin Chen, and Xijia Su, "Profitability Regulation, Earnings Management, and Modified Audit Opinions: Evidence from China," *Auditing: A Journal of Practice & Theory* 20, no. 2 (2001): 9-30; and In-Mu Haw, Daqing Qi, Donghui Wu, and Woody Wu, "Market Consequences of Earnings Management in Response to Security Regulations in China," *Contemporary Accounting Research* 22, no. 1 (Spring 2005): 95-140.

[23]Messod D. Beneish and Mark E. Vargus, "Insider Trading, Earnings Quality, and Accrual Mispricing," *The Accounting Review* 77, no. 4 (October 2002): 755-91; Jan Barton and Paul J. Simko, "The Balance Sheet as an Earnings Management Constraint," ibid., no. s1 (2002): 1-27; Dawn A. Matsumoto, "Management's Incentives to Avoid Negative Earning Surprises," ibid., no. 3 (July 2002): 483-514; and Eli Bartov and Partha Mohanram, "Private Information, Earnings Manipulations, and Executive Stock-Option Exercises," ibid. 79, no. 4 (October 2004): 889-920.

[24]Kevin C. W. Chen and Hongqi Yuan, "Earnings Management and Capital Resource Allocation: Evidence from China's Accounting-Based Regulation of Rights Issues," *The Accounting Review* 79, no. 3 (July 2004): 645-65.

C.E.P.S.

H_1: *The non-operating income of firms is greater prior to rights issues.*

Effects of Regulatory Requirements on Pre-Issue Earnings Management

Burgstahler and Dichev found that accounting figures have discontinuous distributions around the regulatory thresholds.[25] Degeorge, Patel, and Zeckhauser explained discontinuous distributions as caused by earnings inflation around the regulatory thresholds.[26] Yu, Du, and Sun further indicated that non-smoothness occurred around the 10 percent and 6 percent thresholds in Chinese rights issue firms during the period 1999-2000.[27] Under CSRC regulations, the requirements for rights issues are less strict for firms in protected industries (petrochemicals, energy, and raw materials) than for those in unprotected industries. Because of these different thresholds, there has been a greater tendency for unprotected firms to manage earnings through non-operating items than for protected firms to do so. This paper presents the hypothesis:

H_2: *The pre-issue non-operating income of firms in unprotected industries is greater than that for firms in protected industries.*

Market Response during Rights Issue Period

According to conventional financial theory, firms experiencing a period of growth execute rights issues and retain earnings to take advantage of potentially lucrative investment opportunities. According to Grinblatt, Masulis, and Titman's "signaling hypothesis" (or retained earnings hypothesis),[28] firms which know of future investment opportunities prefer to

[25]David C. Burgstahler and Ilia Dichev, "Earnings Management to Avoid Earnings Decreases and Losses," *Journal of Accounting and Economics* 24, no. 1 (December 1997): 99-126.

[26]Francois Degeorge, Jayendu S. Patel, and Richard J. Zeckhauser, "Earnings Management to Exceed Thresholds," *Journal of Business* 72, no. 1 (January 1999): 1-33.

[27]Qiao Yu, Bin Du, and Qian Sun, "Earnings Management at Rights Issue Thresholds: Evidence from China," *Journal of Banking and Finance* 30, no. 12 (December 2006): 3453-68.

[28]Mark S. Grinblatt, Ronald W. Masulis, and Sheridan Titman, "The Valuation Effect of Stock Splits and Stock Dividends," *Journal of Financial Economics* 13, no. 4 (December 1984): 461-90.

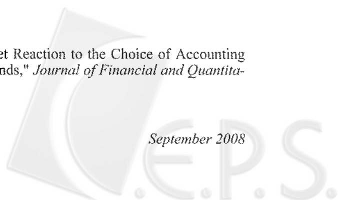
convey positive signals through stock dividends.[29] Growing firms of this kind in developed countries do not distribute cash dividends. One common assumption concerning managerial behavior in developed countries is that it is motivated by a desire to maximize the value of the firm. However, it is argued that this may not be the case in Chinese firms. Chinese firms which engage in rights offerings still distribute cash dividends rather than retaining cash for reinvestment. Since existing shareholders obtain rights issue shares at a cost much lower than the market price, the average cost of all their shares decreases (see table 3). However, even though the market price becomes lower after the rights issue, the existing shareholders will still be willing to sell their stocks because of the lower purchase price of their existing shares. In addition, other investors take into account the reduced share value after a rights offering and are only willing to purchase the stock at lower than market price. From this it can be seen that investors react negatively during rights issue periods as the following hypothesis indicates:

H_3: *Excess returns are negative for Chinese firms around rights issue days.*

Empirical Method and Research Findings

This study looks at 459 rights issues to existing shareholders of A-shares in Chinese firms from 1999 to 2004. The data on the rights issues, cash dividends, financial statement components, and ownership were mainly taken from the *Taiwan Economic Journal* (*TEJ*) database. Because there are no rights issues in B-shares to existing shareholders, these are not included. This paper also excludes rights issues to new shareholders and IPO because of their different regulatory requirements. Furthermore, some firms have been excluded due to the lack of financial

[29]Graeme Rankine and Earl K. Stice, "The Market Reaction to the Choice of Accounting Method for Stock Splits and Large Stock Dividends," *Journal of Financial and Quantitative Analysis* 32, no. 2 (June 1997): 161-82.



or ownership data.[30] Of the 459 rights issue cases, 237 are listed on the Shanghai Stock Exchange and 222 on the Shenzhen Stock Exchange (see table 4). Because this study focuses on earnings management in the three years prior to the 459 rights issues, 1,377 firm-year observations need to be analyzed. To compare the earnings management of the rights issue firms with those of the non-rights issue firms, this paper has employed 5,493 non-rights issue firm-year observations from 1996 to 2004 in the A-share market.

Earnings Management before Rights Issues

To investigate earnings management as proposed in hypothesis H_1, this study examines whether or not non-operating income items are obviously high during the three years prior to the offerings. The sample is divided into two sub-samples, rights issues and non-rights issues. The 1,377 observations during the three years prior to the 459 rights issues are chosen as rights issue sub-samples. The non-rights issue sub-sample includes the 5,493 non-rights issue firm-year observations from 1996 to 2004. Analysis of variance (ANOVA) and F statistics are used to compare the following items in the two sub-samples:

$CR_{i,t}$ = change of cash flow from operating activities (cash flow from operating activities at year t minus cash flow from operating activities at year t-1) deflated by market value for the ith firm at year t (%).

$NOI_{i,t}$ = non-operating income deflated by market value for the ith firm at year t (%).

$LTI_{i,t}$ = realized gains (loss) from long-term investments deflated by market value for the ith firm at year t (%).

[30]From 1999 to 2004, 437 firms made a total of 459 rights issues to existing shareholders, with 22 of them making two rights issues.

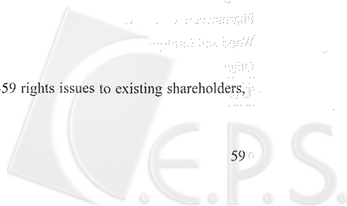


Table 4
Sample Distribution by Exchange, Year, and Industry

Panel A: Sample distribution of companies by exchange and year

	1999	2000	2001	2002	2003	2004	Total
Shanghai Stock Exchange	60	86	58	10	14	9	237
Shenzhen Stock Exchange	60	83	45	11	11	12	222
Total	120	169	103	21	25	21	459

Panel B: Sample distribution of companies by exchange and industry

	Shanghai Stock Exchange	Shenzhen Stock Exchange	Total number of companies
Water, gas, and electricity	13	9	22
Oil and plastics	24	40	64
Machinery and equipment	26	36	62
Retailing	30	15	45
Real estate	5	7	12
Social service	4	9	13
Mining	1	5	6
Finance, banking, and insurance	1	0	1
Metal and nonmetal	17	26	43
Information and technology	19	6	25
Construction	4	4	8
Food and beverage	12	13	25
Textile/apparel	10	6	16
Paper and printing	6	2	8
Mass communication and culture	1	1	2
Agriculture, forestry, fisheries, and farming	4	7	11
Haulage and warehousing	10	9	19
Electronics	10	4	14
Conglomerates	21	12	33
Pharmaceutical and biological	18	10	28
Wood and furniture	0	1	1
Other	1	0	1
Total	237	222	459

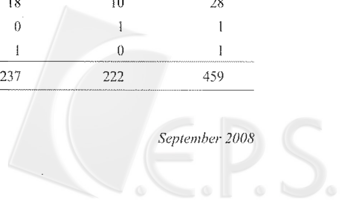


Table 5
ANOVA Test Results for Rights Issue and Non-Rights Issue Groups

Variables	Non-rights issue firms *Means* (N = 5,493)	Rights issue firms *Means* (N = 1,377)	F statistics
$NOI_{i,t}$	0.4174	1.0523	55.7000***
$LTI_{i,t}$	0.3345	0.9131	48.2970***
$CR_{i,t}$	1.4438	1.0262	7.1730***

*Significant at the 10% level; **significant at the 5% level; ***significant at the 1% level.

Non-operating income $NOI_{i,t}$ is one of the instruments used in earnings manipulation by Chinese firms. Realized gains from long-term investments $LTI_{i,t}$ are also chosen as an alternative proxy for non-operating items because these gains account for 84.81 percent of the non-operating income in this study. If firms use non-operating income $NOI_{i,t}$ and realized gains from long-term investments $LTI_{i,t}$ to increase net income prior to rights offerings, a pattern of higher non-operating income $NOI_{i,t}$ and realized gains from long-term investments $LTI_{i,t}$ will be observed.

Net cash flow change from operating activities deflated by market value is employed in the comparison of the above earnings management indicators with the non-discretionary indicator $CR_{i,t}$. According to Dechow the cash flow from operating activities is not as easily manipulated as earnings management indicators;[31] therefore, this paper uses the former as the benchmark in determining if the pre-issue earnings management indicators ($NOI_{i,t}$ and $LTI_{i,t}$) for the rights issue sub-sample are higher than for the non-rights issue sub-sample while the cash flow indicators $CR_{i,t}$ remain unchanged.

The two earnings management indicators were found to be as expected (see table 5). The average ratio of non-operating incomes is 1.0523 for the rights issue sub-sample, and only 0.4174 for the non-rights issue sub-sample. The average ratio of the realized gains from long-term in-

[31]Dechow, "Accounting Earnings and Cash Flows as Measures of Firm Performance," 3-4.

C.E.P.S.

vestments is 0.9131 for the rights issue sub-sample, and 0.3345 for the non-rights issue sub-sample. Furthermore, the results of the ANOVA tests reveal that the average ratios of non-operating incomes $NOI_{i,t}$ and realized gains from long-term investments $LTI_{i,t}$ are significantly greater for the rights issue sub-sample than they are for the non-rights issue sub-sample at 0.01 significant levels. The findings strongly suggest that Chinese firms make use of excess non-operating income and excess realized gains from long-term investments to meet the regulatory requirements for rights issues. As "non-operating income" and "realized gains from long-term investments" are two items listed in financial reports, an investor can easily see through this kind of earnings management. The results above offer a more developed perspective on the nature of this "tweaking": specifically its comparative simplicity and directness when compared to similar practices in devéloped countries.

In contrast, the other remaining variable, the net cash flow ratio $CR_{i,t}$, has an average which is significantly higher for the non-rights issue sub-sample than for the rights issue sub-sample. Cash flow from operation and non-operating income are two important components of ROE. In practice, managers can easily dress up earnings with non-operating items, but they cannot manipulate cash flows. Because managers cannot manipulate cash flows, rights issue firms perform worse than non-rights issue firms in terms of cash flow from operations. However, rights issue firms are able to inflate their earnings by means of non-operating income or realized gains from long-term investments in order to meet the regulatory requirements. As a result, non-operating income and realized gains from long-term investments (a major component of non-operating income) appear substantially larger in the three years prior to the rights offering. In short, these results provide robust support for hypothesis H_1.

Furthermore, the indicators $NOI_{i,t}$ and $LTI_{i,t}$ in unprotected industries are 1.1096 and 0.9842 respectively, greater than those in protected industries (0.9306 and 0.7783, respectively). Consistent with hypothesis H_2, the ANOVA tests reveal that the two indicators $NOI_{i,t}$ and $LTI_{i,t}$ are significantly greater in unprotected industries at 0.05 significant levels (see table 6). This suggests that unprotected firms are more inclined to

C.E.P.S.

Table 6
ANOVA Test Results for Unprotected and Protected Industries

Variables	Unprotected industries *Means* (N = 936)	Protected industries *Means* (N = 1,377)	F statistics
$NOI_{i,t}$	1.1096	0.9306	5.3530**
$LTI_{i,t}$	0.9842	0.7783	6.5720***
$CR_{i,t}$	1.0937	0.8831	1.7690

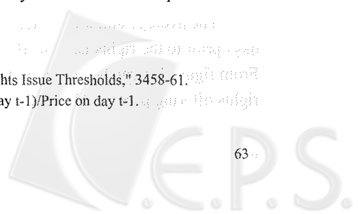
*Significant at the 10% level; **significant at the 5% level; ***significant at the 1% level.

use surplus non-operating income to manipulate earnings in order to satisfy the stricter thresholds for rights offerings. Yu, Du, and Sun have found that frequencies above the 10 percent ROE threshold are fairly high as rights issue firms need to satisfy this requirement. By contrast, financially distressed firms are required to maintain ROE above zero in order to avoid delisting and as a result frequencies above the zero ROE threshold are also very high.[32] Even though the thresholds in their study are not the same as those in this paper, the implications of the findings of both studies are consistent. The poor quality of financial reporting in China tends to confuse investors and deprive them of the clear and accurate information needed to make decisions. In this one can see the first type of agency problem identified above: managers behaving in a way that is against the interests of their shareholders.

Market Responses during Rights Issue Periods

To examine the drop in share prices during rights issue periods, this study employs the market model to analyze the related cumulative abnormal returns (CARs). As rate of return is defined as the price change ratio,[33] a negative rate of return is caused by a decline in share price. This

[32]Yu, Du, and Sun, "Earnings Management at Rights Issue Thresholds," 3458-61.
[33]Daily rate of return = (Price on day t-Price on day t-1)/Price on day t-1.



paper uses rates of return to indicate share price decreases during rights offerings.

The rights issue date is set as day 0 for each rights issue. Negative days represent days prior to the rights issue date and positive days represent days subsequent to the rights issue date. The estimation interval is the period from day –270 to day –21 and the forecast interval is the period from day –20 to day 20. For each firm i, the market model parameters, $\hat{\alpha}_i$ and $\hat{\beta}_i$, are estimated by regressing each firm's stock returns on the market returns over the estimation period (250 days in length, ending 21 days before the event day) as represented in equation (1):

$$R_{i,t} = \alpha_i + \beta_i R_{m,t} + e_{i,t} \quad (1)$$

where $R_{i,t}$ and $R_{m,t}$ are the rates of return on day t for the ith rights issue and the Chinese market indices, respectively. First, $\hat{\alpha}_i$ and, $\hat{\beta}_i$ in equation (1) are estimated using the data during the estimation interval, so equation (1) is used to determine the expected returns in the forecast interval. Then, the abnormal returns are calculated as the actual minus expected returns in equation (2):

$$AR_{i,t} = R_{i,t} - (\hat{\alpha}_i + \hat{\beta}_i R_{m,t}) \quad (2)$$

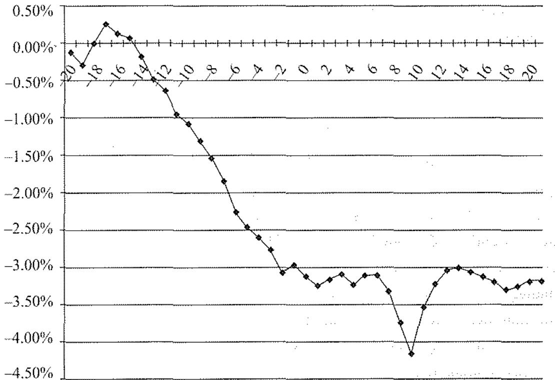
In equation (2), the abnormal return on day t ($AR_{i,t}$) is computed by comparing the actual return on day t $R_{i,t}$ with the predicted return ($\hat{\alpha}_i + \hat{\beta}_i R_{m,t}$). Next, the cumulative abnormal returns (CARs) from the 20 days prior to the rights issue to day T_2 ($T_2 = -20, -19, ..., 19, 20$) can be expressed as equation (3):

$$CAR(-20, T_2) = \sum_{\tau=-20}^{T_2} AR_{i,t} \quad (3)$$

The average abnormal returns are negative during the period from 14 days prior to the rights issue to 10 days after the rights issue (see figure 2). From figure 2 it can be seen that the CAR is in constant decline during the rights offering period. This implies that market investors expect a dilution

C.E.P.S.

Figure 2
Cumulative Abnormal Returns (CARs) during Rights Issue Periods



of share values since the subscription price of rights issues are much lower than the stock price prior to rights offerings. Hence, investors react negatively to rights issue events. This is consistent with hypothesis H_3.

From the observed drop in share prices, it seems that the market value of the state's holdings decreases dramatically due to the substantial drop in share prices. Meanwhile, the existing public shareholders hold more shares, having subscribed to the 86.41 percent of rights issue shares at a cost much lower than the market price, as mentioned above. The total market value of the shares bought by the existing shareholders increases more than the amount paid for them. As a result of the rights issue process, wealth is transferred from the state to existing public shareholders who represent a very small proportion of the people. In theory, the state should take care of all of its citizens equally. However, only existing shareholders are eligible to purchase rights issues at a significantly discounted price and other citizens have no opportunity to take advantage of such a discount.

C.E.P.S.

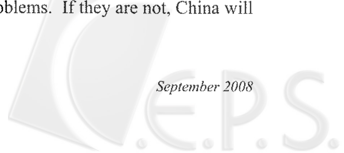
The state-dominated managers therefore violate their obligation to protect national assets, which should belong to all citizens and not to an elite group. This supports the existence of the second type of agency problem: a state-designated manager violating national interests for the sake of self-interest.

Conclusions

The purpose of this paper is to investigate the existence of the two types of critical agency problems which have emerged due to the fact that China has not developed a strong set of monitoring mechanisms similar to those found in developed countries. The first type of agency problem involves a conflict of interest between shareholders and the state-designated managers. The second type involves a conflict between the interests of the state-designated manager and the national interest.

The investigation of the first type of agency problem focuses on how Chinese managers mislead existing and potential shareholders through the manipulation of accounting reports in order to meet the regulatory requirements for rights offerings. In conclusion, based on the evidence collected, it is claimed that Chinese firms not only manipulate earnings but do so in more straightforward ways than do firms in developed countries on account of the nature of CSRC regulations and the existence of weak monitoring devices.

Indeed, most of the time, Chinese firms do not behave in the same way as large firms in fully developed capitalist economies; however, Chinese listed firms are required to employ the same control systems and boards of directors as their counterparts in developed countries. In addition, the government requires listed firms to employ auditors to evaluate published financial reports. That is to say, the market standards, regulations, and trading systems have been and are still adopted from the developed countries. Therefore, it is important to determine whether the market standards of developed countries are suitable for China in terms of preventing the occurrence of agency problems. If they are not, China will need to develop its own standards.



The second type of agency problem is a result of state-assigned managers violating their obligation to safeguard national assets. It is found that Chinese state-assigned managers use the proceeds of rights issues, mostly from public shareholders (on average 86.41 percent), to distribute cash dividends, almost half of which go to the state (on average 42.19 percent). Due to the fact that the subscribed price for rights issues is much lower than the market price, the share value is diluted. The empirical results of this study confirm that the market reacts negatively to this share value dilution. The total market value of state holdings thus decreases during rights issues. On the other hand, the public shareholders obtain additional shares at lower cost, so their total holding value increases after rights issues. As a result of this process, the market value of the additional shares bought by public shareholders increases more than the amount paid for them, while the market value of the state's holdings dramatically decreases. In summary, this seems to support the view that state-assigned managers transfer wealth from the nation (all citizens) to a small group (subscribed public shareholders) during the rights issue process, which is a violation of their obligation to protect the national assets.

Bibliography

Aharony, Joseph, Chi-wen Jevons Lee, and Tak Jun Wong. 1999. "Financial Packaging of IPO Firms in China." *Journal of Accounting Research* 38, no. 1: 103-26.

Barton, Jan, and Paul J. Simko. 2002. "The Balance Sheet as an Earnings Management Constraint." *The Accounting Review* 77, no. s1:1-27.

Bartov, Eli, and Partha Mohanram. 2004. "Private Information, Earnings Manipulations, and Executive Stock-Option Exercises." *The Accounting Review* 79, no. 4 (October): 889-920.

Beneish, Messod D., and Mark E. Vargus. 2002. "Insider Trading, Earnings Quality, and Accrual Mispricing." *The Accounting Review* 77, no. 4 (October): 755-91.

Blair, Margaret M. 1995. *Ownership and Control: Rethinking Corporate Govern-*

ance for the Twenty-First Century. Washington, D.C.: Brookings Institution Press.

Burgstahler, David C., and Ilia Dichev. 1997. "Earnings Management to Avoid Earnings Decreases and Losses." *Journal of Accounting and Economics* 24, no. 1 (December): 99-126.

Carlos, Fernandez, and Arrondo Ruben. 2005. "Alternative Internal Controls as Substitutes of the Board of Directors." *Corporate Governance: An International Review* 13, no. 6 (November): 856-66.

Chen, Charles J. P., Shimin Chen, and Xijia Su. 2001. "Profitability Regulation, Earnings Management, and Modified Audit Opinions: Evidence from China." *Auditing: A Journal of Practice & Theory* 20, no. 2:9-30.

Chen, Kevin C. W., and Hongqi Yuan. 2004. "Earnings Management and Capital Resource Allocation: Evidence from China's Accounting-Based Regulation of Rights Issues." *The Accounting Review* 79, no. 3 (July): 645-65.

Clarke, Donald C. 2003. "Corporate Governance in China: An Overview." *China Economic Review* 14, no. 4:494-507.

Cremers, K. J. Martijn, Vinay B. Nair, and Chenyang Wei. 2007. "Governance Mechanisms and Bond Prices." *Review of Financial Studies* 20, no. 5 (September): 1359-88.

Dechow, Patricia M. 1994. "Accounting Earnings and Cash Flows as Measures of Firm Performance: The Role of Accounting Accruals." *Journal of Accounting and Economics* 18, no. 1 (July): 3-42.

Defond, Mark L., and James Jiambalvo. 1994. "Debt Covenant Violation and Manipulation of Accruals." *Journal of Accounting and Economics* 17, nos. 1-2 (January): 145-76.

Degeorge, Francois, Jayendu S. Patel, and Richard J. Zeckhauser. 1999. "Earnings Management to Exceed Thresholds: Evidence from China." *Journal of Business* 72, no. 1 (January): 1-33.

Eisenberg, Theodore, Stefan Sundgren, and Martin T. Wells. 1998. "Larger Board Size and Decreasing Firm Value in Small Firms." *Journal of Financial Economics* 48, no. 1 (April): 35-54.

Fan, Joseph P. H., T. J. Wong, and Tianyu Zhang. 2007. "Politically Connected CEOs, Corporate Governance, and Post-IPO Performance of China's Newly Partially Privatized Firms." *Journal of Financial Economics* 84, no. 2 (May): 330-57.

C.E.P.S.

Grinblatt, Mark S., Ronald W. Masulis, and Sheridan Titman. 1984. "The Valuation Effect of Stock Splits and Stock Dividends." *Journal of Financial Economics* 13, no. 4 (December): 461-90.

Haw, In-Mu, Daqing Qi, Donghui Wu, and Woody Wu. 2005. "Market Consequences of Earnings Management in Response to Security Regulations in China." *Contemporary Accounting Research* 22, no. 1 (Spring): 95-140.

Healy, Paul M. 1985. "The Effect of Bonus Schemes on Accounting Decisions." *Journal of Accounting and Economics* 7, nos. 1-3 (April): 85-107.

______, and James M. Wahlen. 1999. "A Review of the Earnings Management Literature and Its Implications for Standard Setting." *Accounting Horizon* 13, no. 4 (December): 365-83.

Jensen, Kevan L., and Jeff L. Payne. 2003. "Management Trade-offs of Internal Control and External Auditor Expertise." *Auditing: A Journal of Practice & Theory* 22, no 2 (September): 99-119.

Jensen, Kevan L., and Jeff L. Payne. 2005. "Audit Procurement: Managing Audit Quality and Audit Fees in Response to Agency Costs." *Auditing: A Journal of Practice & Theory* 24, no 2 (November): 27-48.

Jensen, Michael C., and William H. Meckling. 1976. "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure." *Journal of Financial Economics* 3, no. 4 (October): 305-60.

Jian, Ming, and T. J. Wong. 2004. "Earnings Management and Tunneling through Related Party Transactions: Evidence from Chinese Corporate Groups." Working paper, Hong Kong University of Science and Technology.

Kaplan, Robert S. 1985. "Evidence on the Effect of Bonus Schemes on Accounting Procedure and Accrual Decisions." *Journal of Accounting and Economics* 7, nos. 1-3 (April): 109-13.

Lee, Chi-wen Jevons, and Xiao Xing (蕭星). 2004. "Tunneling Dividend." Working paper, 2004. http://166.111.96.192:8080/cfrn/getPaper.do? id=805.

Liu, Wanming (劉萬明), and Li Xuelian (李雪蓮). 2007. "Denationalization Reform of the World Banking, Property Rights Structure, Externalities, and the Soft Budget Constraint: An Explanatory Framework Based upon the Property Rights Theory of New Institutional Economics." *Guoji jinrong yanjiu* (國際金融研究, Studies of International Finance), no. 9:11-19.

Matsumoto, Dawn A. 2002. "Management's Incentives to Avoid Negative Earning Surprises." *The Accounting Review* 77, no. 3 (July): 483-514.

Rankine, Graeme, and Earl K. Stice. 1997. "The Market Reaction to the Choice of Accounting Method for Stock Splits and Large Stock Dividends." *Journal of Financial and Quantitative Analysis* 32, no. 2 (June): 161-82.

Shi, Peiyong (史沛勇), and Wang Jianxin (王建新). 2007. "Analyzing the Factors That Influence CPA Audit Independence and the Relevant Improving Measures." *Shandong shangye zhiye jishu xueyuan xuebao* (山東商業職業技術學院學報, Journal of Shandong Institute of Commerce and Technology) 7, no. 4 (August): 25-27.

Shleifer, Andrei, and Robert W. Vishny. 1986. "Large Shareholders and Corporate Control." *Journal of Political Economy* 94, no. 3 (June): 461-88.

Shleifer, Andrei, and Robert W. Vishny. 1994. "Politicians and Firms." *Quarterly Journal of Economics* 109, no. 4 (November): 995-1025.

Wang, Zhihua (王志華). 2007. "Analysis of the Professional Ethics of the Certified Public Accountants (CPA)." *Keji qingbao kaifa yu jingji* (科技情報開發與經濟, Sci-Tech Information Development & Economy), no. 23:147-48.

Watanabe, Mariko. 2002. "Holding Company Risk in China: A Final Step of State-Owned Enterprises Reform and an Emerging Problem of Corporate Governance." *China Economic Review* 13, no. 4:373-81.

Yilmaz, Mustafa Kemal, and Guzhzan Guly. 2006. "Dividend Policies and Price-Volume Reactions to Cash Dividends on the Stock Market." *Emerging Markets Finance and Trade* 42, no. 4:19-49.

Yu, Qiao, Bin Du, and Qian Sun. 2006. "Earnings Management at Rights Issue Thresholds: Evidence from China." *Journal of Banking and Finance* 30, no. 12 (December): 3453-68.

Zhang, Le-Yin (張樂因). 2006. "Market Socialism Revisited: The Case of Chinese State-Owned Enterprises." *Issues & Studies* 42, no. 3 (September): 1-46.

Zheng, Shaozu (鄭紹祖). 2007. "Probe into Interior Control Environments in State-Owned Enterprises." *Shanxi caizheng shuiwu zhuanke xuexiao xuebao* (山西財政稅務專科學校學報, Journal of Shanxi Finance and Tax College) 9, no. 4 (August): 27-29.

Zhu, Hongjun (朱紅軍), He Xianjie (何賢杰), and Chen Xinyuan (陳信元). 2006. "Financial Development, Soft Budget Constraints, and Firm Investment." *Kuaiji yanjiu* (會計研究, Accounting Research), no. 10:64-70.