ISSN : 0974 - 7435 Volume 10 Issue 6

BioTechnology
An Indian Journal

FULL PAPER

BTAIJ, 10(6), 2014 [1654-1659]

Study on the relationship between corporate governance structure and enterprise competitive advantage: The case of wenzhou's private listed company

Shan Duan[1], Yan Wang[2]*

[1]School of Public Affairs, Zhejiang University, Zhejiang Academy of Science and Technology for Development, Hangzhou 310027, Zhejiang, (CHINA)

[2]School of Public Finance and Public Affairs Administration, Zhejiang University of Finance and Economics, Hangzhou 310018, Zhejiang, (CHINA)

E-mail: 88100182 @qq.com

ABSTRACT

The governance of private listed companies has emerged to be a significant issue influencing China's regional economy. However, the existing private enterprises are facing a number of problems ranging from difficulties in separation of ownership and management, unreasonable ownership structure, rigid management layer, to the weak function of supervisory board. By conducting empirical analysis, we find that ownership concentration and CEO-chairman duality are positively associated with corporate performance in a significant way while there is no strong negative association between ratio of independent directors and corporate performance. In addition, the contribution of managerial ownership and supervisory board size to corporate performance is not remarkable. The results therefore indicate approaches for private listed companies to improve corporate performance with regard to these factors concerning internal governance structure.

KEYWORDS

Corporate governance;
Enterprise competitive advantage;
Corporate performance.

INTRODUCTION

Currently, private enterprises are playing an increasingly important role in promoting economic growth, emerging as a new force in China's capital market. And many of them go public after long-term efforts of operation. However, they are facing a number of problems in their course of transforming from traditional family corporate to the company with modern management concepts. The corporate governance structure which determines the smooth operation of the company, especially on corporate performance is composed of many factors like ownership structure and management mechanism. As has been studied by many scholars, a sound corporate governance structure will contribute to establishment of corporate value and improvement of corporate governance which has a decisive role on company performance. This paper takes Wenzhou's private listed companies as object, exploring the relationship between their governance structure and corporate performance. Based on the previous studies on corporate governance of listed company, we examine factors influencing corporate governance structure of Wenzhou's private listed companies and propose hypothesis on their relation with corporate performance. By setting up influencing variables related to corporate governance structure, the paper conducts an empirical test using descriptive statistical analysis and linear regression, and obtains results of how these influencing factors affect performance of Wenzhou's private listed company. The empirical conclusion on the other hand is conducive to proposing measures to improve corporate competitive advantages.

In the context that non-public ownership economies are strongly encouraged, supported and guided nowadays, along with the boom of private enterprises, studies on private listed companies and corporate governance structure are richer and more thorough. Despite the vast literature on corporate governance structure, little attention has been paid to a comprehensive analysis of its influencing factors. Instead of focusing on one single influencing factor, this paper systematically takes four aspects into consideration including shareholding structure, board governance, managerial incentives and supervisory board size. Besides, Wenzhou's private listed enterprises with prominent features will provide references for further study of listed companies in other regions.

THEORETICAL EVIDENCE OF RELATIONSHIP BETWEEN CORPORATE GOVERNANCE STRUCTURE AND CORPORATE PERFORMANCE

Literature review

In a long-term study of governance of private listed enterprises, many scholars have achieved diverse theoretical results from a variety of perspectives. Berle and Means[3] proposed the Principal-Agency Theory which advocates the separation of ownership and management. This has served to be the logical start of modern corporate governance. Jensen and Mekcling[7], representatives of Convergence of Interest Hypothesis, believed that manager can help promote company performance by holding a large proportion of shares in hand. Moreover, Freeman[5], an theorist of Stakeholder Theory argued that the management activities aimed to meet and balance interests of all stakeholders.

A number of theorists have highlighted the role of ownership concentration in affecting corporate performance. Vishny[1] for example, suggested the positive impact of ownership concentration on the improvement of corporate performance. He noted that major shareholders could be motivated to supervise the management layer with large equity concentrated in them, thus reducing manager's self-interest behaviors and opportunistic behaviors and improving company performance in the end. Contrary to his result, Demsetz[6] believed that ownership concentration had no systematic connections with company performance from results of regression analysis which showed no significant positive correlation with operating margin as the measure of performance and shareholding ratio of the top ten shareholders as equity concentration.

As for board governance, Donaldson[4] based on the Modern Stewardship Theory proposed the hypothesis of CEO-chairman duality model. And Boyd[2] also supported the view that in some cases the general manager can be a good steward of company assets, largely enriching the Stewardship Theory.

In terms of managerial ownership, Shleifer and Vishny[1] found that the relationship between manager ownership and performance cannot be described as a simple and dominant one. Their research findings suggested that when share-holding rate of the board was below 5%, there's positive correlation between shareholding ratio and performance; when the number swang between 5% and 20%, it turned out to be negative correlation; and when shareholding of the board accounting for over 25%, the positive correlation result was back. However, Jensen's Shleifer[7] linear regression analysis on the incentive effect of executive compensation, share option inspiration, insider holding and other motivation approaches showed that managerial ownership can motivate managers to work, reduce their expense in-office and decrease the agent costs, thus improving company performance. Domestic studies at the same time suggested weak correlation between stock rights incentive and performance.

The current research

This study deeply analyzes indicators related to corporate governance structure of Wenzhou's private listed companies. We explore the correlation between corporate governance structure and corporate performance of Wenzhou's private listed companies by mainly adapting the ordinary least squares of regression analysis methods. Based on previous findings, the paper develops an analyzing model to explore relationship between Wenzhou's private listed companies and corporate performance from four aspects including ownership structure, board of governance, supervisory board size and executive incentives. With regard to identifying influencing variables, we take ownership concentration analyze ownership structure; CEO-chairman duality and ratio of independent directors to analyze board governance; number of supervisors to analyze supervisory board size and proportion of managerial ownership to analyze executive incentives. Besides, we take company scale and capital structure as control variables with total assets and asset liability rate as their indicators respectively (Figure 1).

The aim of this research is to examine the relationship between corporate governance structure and corporate performance. This research tests the following hypotheses:

Hypothesis 1

We expected that ownership concentration of Wenzhou's private listed company is positively correlated with corporate performance.

Hypothesis 2

We hypothesized that the relationship between CEO-chairman duality of Wenzhou's private listed company and corporate performance is positive.

Hypothesis 3

We expected that ratio of independent directors is positively associated with corporate performance.

Hypothesis 4

We expected that the relationship between managerial ownership of Wenzhou's private listed company and corporate performance is positive.

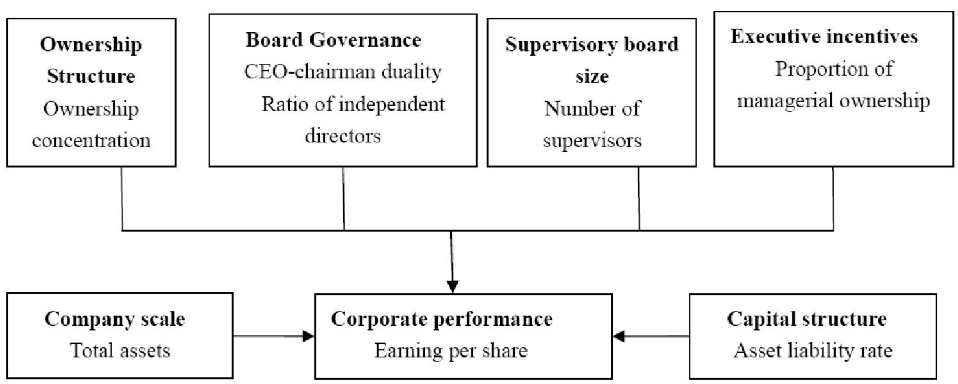

Figure 1 : Research model

The executive incentive mechanism manages to coordinate interest balance between shareholders and the manager through a set of related mechanisms. The expectancy theory[8] which suggested that employees' motivation for work depended on their expectancy for ability in fulfilling job, and their expected reward from work, which is performance-rewards expectation. As to corporate managers, with large proportion of shares, they have effort-performance and performance-rewards expectations, resulting in corporate performance improvement.

Hypothesis 5

We expected that supervisory board size of Wenzhou's private listed company is positively correlated with corporate performance.

EMPIRICAL RESEARCH ON THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE STRUCTURE AND CORPORATE PERFORMANCE

Illustrations on data source

Considering the small number of Wenzhou's listed companies, the paper concludes all 24 private companies listed on Shenzhen Stock Exchange and Shanghai Stock Exchange before the year of 2013 with related data collecting from the China Stock Market & Accounting Research Database. In order to ensure the credibility of sample data, the paper excludes companies as following: all ST and PT companies; companies whose return on equity are below zero; companies with negative net assets and net return; and companies with incomplete data and undisclosed. After data screening, we get sample data with capacity of 22 companies.

Measurement of variable

Independent variable

With regard to corporate governance structure, a number of factors including ownership structure, board governance, managerial incentives and supervisory board size contribute to influencing company performance in different degrees. Based on these four dimensions, the paper selects five factors: ownership concentration, CEO-chairman duality, and ratio of independent directors, managerial ownership, and supervisory board size as independent variables. In the end, the paper attempts to put forward suggestions on company performance improvement by studying relationship between these factors and performance in the case of Wenzhou's private listed companies.

Dependent variable

Currently, several indicators can be used to reflect company performance, for example, the earning per share, net asset value per share, return on equity, operating margin, fixed price-earning ratio and so on. However, given the frequency of indicator used and the availability of material, the paper takes earning per share as explanatory variable for the reason that it is a significant indicator that can comprehensively reflect profitability of company and measure stock investment value. As a core indicator, it can guide external investment by affecting investors' assessment of corporate value. In theory, the higher is earning per share, the stronger can the company make profit. The paper chooses fully diluted earning per share.

Control variable

The paper introduces total assets and asset liability rate as control variables so as to control effect of factors like scale of company and capital structure on company performance. Generally speaking, company with a large scale and rich assets boasts a good reputation, which is conducive to attract external funding, thus improving company performance in the end. On the other hand, the asset liability rate has a direct connection with the risks that company may encounter, ending in the influence of company performance.

Empirical findings

To test the hypothesis, the paper sets the model as linear model and applied SPSS 17.0 to conduct regression analysis. For the results from model analysis,

TABLE 1 : Correlation coefficient analysis

	1	2	3	4	5	6	7	8
1.Ownership concentration								
2.CEO-chairman duality	0.398							
	0.067							
3.Ratio of independent directors	-0.115	-0.253						
	0.611	0.255						
4.Managerial ownership	-0.294	-0.039	-0.178					
	0.184	0.863	0.429					
5.Supervisory board size	-0.323	-0.491*	-0.091	-0.012				
	0.142	0.02	0.688	0.957				
6.Eps	0.671**	0.392	-0.184	-0.051	-0.195			
	0.001	0.071	0.414	0.821	0.386			
7.Total asset	0.142	-0.111	0.127	-0.101	-0.161	0.003		
	0.529	0.624	0.573	0.654	0.475	0.99		
8.Asset liability rate	-0.387	-0.261	0.067	-0.264	0.503*	-0.286	0.450*	
	0.075	0.242	0.766	0.236	0.017	0.197	0.036	

Note: *.Positive correlation at 0.01 (bilateral); **.Positive correlation at 0.05 (bilateral).

FULL PAPER

TABLE 2 : Results from regression analysis

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	SD	Beta		
1	Independent variable	-0.678	1.026		-0.661	0.518
	Ownership concentration	0.016	0.005	0.679	3.273	0.005
	CEO-chairman duality	0.055	0.197	0.176	0.786	0.043
	Ratio of independent directors	-0.003	0.026	-0.024	-0.122	0.904
	Supervisory board size	0	0.01	-0.152	-0.793	0.039
	Proportion of managerial ownership	0.032	0.062	0.111	0.515	0.614
	Total assets	0	0	0.126	0.407	0.69
	Asset liability rate	0.003	0.009	0.138	0.353	0.73

A dependent variable:eps

please refer to TABLE1 and TABLE2.

The above table shows that: (1) The correlation coefficient of the variables is comparably small with the absolute value no more than 0.5. And only supervisory board size and CEO-chairman duality show significant correlation when the significance level is 0.1%. The contribution of other variables, however, is not significant, which means the weak correlation of ownership concentration, CEO-chairman duality, ratio of independent directors and the proportion of managerial ownership, so the multi-collinearity among the variables are unobvious.(3) The relationship between supervisory board size and the explanatory variables and control variable is nonsignificantly negative.(4) The correlation coefficient between control variable and explanatory variables is small and not significant. The correlation between two control variables namely total assets and asset-liability ratio is weak with coefficient as 0.450.

CONCLUSION AND DISCUSSIONS

As shown in table, (1) Non-standard coefficient between ownership concentration and corporate performance is 0.016 with sig. less than 0.05. This finding suggests that the higher is the ownership concentration of Wenzhou's private listed company, the bigger effect it exerts on promotion of corporate performance. In other words, with equity moderately held by a minority of shareholders, major shareholders are motivated to strengthen supervision over the management while also enhancing the mutual checks and balances between major shareholders, seeking for the maximization of stockholders' interest. (2) As for CEO-chairman duality, the result is 0.055 with sig. 0.043 when the significant level is below 0.05, indicating that dual role of chairman of Wenzhou's listed company contributes to the improvement of performance. (3) The regression coefficient is -0.003 between ratio of independent directors and company performance, with sig. 0.904. It shows negative correlation between ratio of independent directors of Wenzhou's private listed companies and its performance, yet the contribution is not significant. (4) The Non-standard coefficient between managerial ownership and performance is extremely small. However, given the fact that the standardized coefficient is -0.153, the correlation coefficient is -0.0513 and sig.is 0.039, the managerial ownership significantly contributes to company performance in a negative way, which is inconsistent with the hypothesis.(5) The correlation coefficient between size of supervisors and performance is 0.032 and sig. is 0.614. It reveals positive yet not significant correlation between Wenzhou's private listed company and performance.(6) Determination coefficient for control variables as asset-liability ratio and total asset are 0.000 and 0.003 respectively with its sig. being 0.69 and 0.73, an evidence of weak effects on corporate performance.

Combined with results of the regression analysis, we see that among five dependent factors, only ownership concentration and dual role of chairman significantly contribute to company performance in a positive way, and the supervisory board size shows positive but not significant correlation, while the ratio of independent directors and executive shareholding have negative influence on corporate performance. Based on these findings, Wenzhou's private listed companies need to focus on optimizing equity structure, strengthening function of the board, improving incentive system and redefining the functions of board of directors, which allows them to improve corporate performance and gain competitive advantages.

ACKNOWLEDGMENTS

This work was financially supported by the Zhejiang Province Natural Science Foundation (Grant No. LQ13G030003), and Innovative Talents Training Program supported by Science Technology Department of Zhejiang Province (Grant No. 2010F20011).

REFERENCES

[1] Andrei Shleifer, Robert, W.Vishny; Large Shareholders and Corporate Control. The Journal of Finance, **(1986)**.

[2] Boyd, K.Brian; CEO Duality and Firm Performance. A Contingency Model. Strategic Management Journal, **(1995)**.

[3] A.Berle, Means; The Modern Corporation and Private Property. MacMillan, **15**, **(1932)**.

[4] L.Donaldson, J.H.Davis; Stewardship Theory or Agency Theory. CEO Governance and Shareholder Returns. Australian Journal of Management, **(1991)**.

[5] Freeman; A Study on Stakeholders: Theory and Its Application. Shanghai Translation Publishing House, **(2006)**.

[6] Harold Demsetz; Ownership, Control and the Firm: The Organization of Economic Activity [M]. Blackwell Publishers, **(2000)**.

[7] M.C.Jensen, W.H.Meckling; Theory of Firm: Managerial Behavior, Agency Costsand Ownership Structure. Journal of Financial Economics, **20**, 3 **(1976)**.

[8] H.Victor, Vroom; Work and Motivation. Jossey-Bass Inc.,U.S., **(1994)**.