Foreign strategic ownership and minority shareholder protection: Evidence from China

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Keywords: Foreign strategic ownership, minority shareholder protection, China

JEL Codes: G34, G38

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Abstract

We show foreign strategic shareholders provide monitoring protection by reducing excess leverage and intercorporate loans. Firms with foreign strategic owners are also associated with higher dividend payouts. The monitoring benefits are more prevalent in firms with less government involvement and are stronger when overall corporate governance is weaker. We use the relatively novel Promoter Foreign Legal Person shareholders as our main proxy, as these are long-term investors who face greater risks compared to other types of foreign investors in Chinese stock markets. As such, Promoter Foreign Legal Person shareholders have greater incentives to actively monitor and influence controlling shareholders.

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1. Introduction

Global financial liberalization has substantially reduced barriers to international investment, enabling foreign investors' easier access to international markets. It has been argued that foreign investors, particularly foreign institutional investors, positively influence corporate governance practices in their targeted firms (Gillan and Starks, 2003). Further, this effect is stronger for foreign institutional investors from stronger investor protection countries investing in firms domiciled in weaker investor protection countries (Aggarwal, Erel, Ferreira, and Matos, 2011).

However, China still tightly regulates and restricts foreign investor access to China's stock markets. In addition, Chinese listed companies are commonly characterized by high ownership concentration and/or government control. Given these complexities facing foreign investors in Chinese companies, it is unsurprising that the evidence of foreign investors influence on corporate governance practices is mixed (Shen, Zhou, and Lau, 2016). However, recent studies provide evidence that foreign strategic investors have benefited minority shareholders during the non-tradable share (NTS) reform in China (e.g., Huang and Zhu, 2015).

We provide empirical evidence to support the argument that foreign strategic investors provide third-party monitoring benefits to minority shareholders by reducing excess leverage and intercorporate loans. Further, firms with foreign strategic investors have higher cash dividend payouts. These results are both statistically and economically significant. We use the relatively novel non-tradable promoter foreign legal person shares as our main measure of foreign strategic ownership. Promoter foreign legal person investors are likely to have longer investment horizons and face greater liquidity risk than foreign investors in the tradable B-

shares and Qualified Foreign Institutional Investors[2] (QFIIs) in tradable A-shares. For these reasons, Zou and Adams (2008) argue that promoter foreign legal person investors have the resources and additional incentives to reduce their risk through closely monitoring operations, nominating board members, and influencing business strategy.

For robustness, we use QFIIs as an alternative foreign strategic ownership measure and find similar third-party monitoring benefits for minority shareholders, especially after the NTS reform. If these foreign strategic investors are able to actively exert the influence argued by Zou and Adams (2008), then they should provide beneficial third-party monitoring to minority shareholders. This is what we find. Firms with foreign strategic investors have lower levels of tunneling activity, including lower excessive debt financing and intercorporate loans to controlling shareholders. Consistent with the liquidity risks faced by foreign strategic investors, they also have a positive influence on cash dividend payout. The active role is more evident in firms controlled by non-state firms, state-owned enterprises (SOEs), and local governments rather than the central government, where government involvement tends to be more prevalent. This finding implies government interference reduces the positive monitoring effect of foreign ownership. We also find the active monitoring role was more pronounced before the NTS reform, suggesting foreign strategic investors are beneficial when financial market development is weaker.

Our paper contributes to the literature on principal–principal conflict between controlling and minority shareholders by focusing on long-term strategic foreign investors. First, we contribute to tunneling studies by providing robust evidence that foreign strategic ownership limits tunneling activities that purely benefit controlling shareholders. Previous tunneling studies typically focus on tunnel mechanisms but provide little evidence on who effectively

[2] These QFIIs are foreign financial institutions that have been allowed to hold tradable A-shares since December 2002.

monitors tunneling. For example, Jiang, Rao, and Yue (2015) find that institutional investment has a negative relation with tunneling, but they focus on market reactions on tunneling and the relation between tunneling and firm performance. Our results have important implications for investors, particularly minority shareholders who benefit from the third-party monitoring provided by foreign strategic investors and policy makers in encouraging foreign strategic investment in China. They are also relevant to any emerging markets with weak minority shareholder protection. Second, we contribute to foreign ownership studies. Huang and Zhu (2015) use the NTS reform compensation ratio as a measure of corporate governance practice, which is a one-off event. We use ongoing monitoring activities and confirm that foreign strategic ownership does improve corporate governance practice in weak institutional environments. Third, previous Chinese studies rely on measures that mingle investor types who almost certainly also have differing investment horizons. For example, prior studies either measure total foreign individual and institutional ownership or include a dummy if a firm has B- or H-shares, which, since 2001, could include both domestic and foreign investors.[3] We use foreign strategic ownership to examine the impact of foreign ownership on corporate governance activities. Given the different characteristics, incentives, and capabilities, foreign strategic investors are more likely to be motivated to influence corporate governance in their favor.

Section 2 reviews the literature and develops our hypothesis. Section 3 outlines the data and details how foreign strategic ownership, proxies for the level of minority shareholder protection, and various control variables are constructed. The core results and robustness and endogeneity checks are described in Section 4 and our conclusions and implications are presented in Section 5.

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[3] The common Chinese corporate governance measures are outlined in the literature review by Shen, Zhou, and Lau (2016).

2. Literature review and hypothesis development

2.1 Minority shareholder protection in China

The conflict of interest between controlling shareholders and minority shareholders is one of the major concerns for Chinese corporate governance. Such conflict can cause tunneling, where controlling shareholders expropriate the wealth of minority investors (Jiang, Lee, and Yue, 2010; Shan, 2013), particularly since the legal protection of minority shareholders tends to be weak in China compared to that of most developed economies (Allen, Qian, and Qian, 2005).

First, state control is still strong in privatized firms after share issue privatizations (Sun and Tong, 2003; Huang and Zhu, 2015). State shareholders can extract rents from firms to fulfill social or political goals (Shleifer and Vishny, 1994). In weak governance settings, state expropriation is typically high and rife (Boubakri, Cosset, and Saffar, 2013). Second, China has a unique share segmentation system in which the shares of listed companies are divided into tradable shares and non-tradable shares (e.g., Chen, Jian, and Xu, 2009; Wei and Xiao, 2009). Before the NTS reform launched in 2005,[4] two-thirds of the total outstanding shares were non-tradable. The split ownership structure limits non-tradable shareholders' benefits of stock price appreciation while increasing their tunneling incentives (Jiang et al., 2010; Liao, Liu, and Wang, 2014). Third, ownership concentration of Chinese listed firms is very high. Liu, Uchida, and Yang (2014) show that, on average, the largest shareholding one year before the NTS reform was 42.4% and these shares were mainly controlled by the government. The highly concentrated ownership structure in Chinese listed firms leaves little room for

[4] The purpose of the NTS reform is to grant non-tradable shareholders the right to trade their shares gradually in the secondary market. Tradable shares are priced based on the market value, while non-tradable shares' value is primarily based on the net asset value of the firm, which is typically much lower than the market value (Liao et al., 2014). Therefore, compensation is paid to tradable shareholders during the reform.

minority shareholders to have a direct influence on corporate decisions. In addition, under the current legal system in China, minority shareholders have few options to take private enforcement action against blockholder misconduct (Jiang et al., 2010).

Researchers have found various channels through which controlling shareholders expropriate wealth from minority shareholders. While Cheung, Rau, and Stouraitis (2010) find that related party transactions in China can be used for either tunneling or propping up, blockholders of Chinese listed firms have been shown to engage in various related party transactions, which consequently hurt firm value (Berkman, Cole, and Fu, 2010). Jiang et al. (2010) further show the widespread use of intercorporate loans to controlling shareholders who extracted billions in funds from Chinese listed firms from 1996 to 2006. The authors also find that firms with a large ratio of other receivables to total assets (the proxy for intercorporate loans) experience worse future operating performance and are much more likely to become candidates for delisting. [5]

Jensen and Meckling (1976) argue that debt could constrain managerial expropriation by imposing obligations on corporate cash flows. However, Stulz (1988) argues that controlling shareholders tend to use excess leverage to control more resources without diluting their control. Faccio, Lang, and Young (2001) state that, in Asian corporations, where the key agency problem comes from conflicts between the controlling and minority shareholders, controlling shareholders often exert control through a pyramid structure by increasing leverage in firms lower down the pyramid and acquiring more resources to expropriate from minority shareholders. Liu and Tian (2012) provide empirical evidence that, in emerging markets where legal protection is weak, such as China, controlling shareholders borrow

[5] Jiang, Rao, and Yue (2015) indicate that, since 2006, the Chinese Securities Regulatory Commission has acted to regulate tunneling activities through other receivables. Controlling shareholders are required to disclose in detail the amount of non-operational fund occupancy, which is usually included in the balance sheet item "other receivables."

excess debt to tunnel through intercorporate loans, which destroy firm value. Their evidence also shows that the NTS reform and further privatization reduces controlling shareholders' tunneling activities.

Agency theory suggests outside shareholders prefer higher cash dividend payouts as firms' free cash flows under insider control is reduced. However, given the high ownership concentration, non-tradable shares and the strong state control in China, an important question is whether firms use cash dividends to tunnel. Chen et al. (2009) argue that Chinese companies may tunnel cash to non-tradable shareholders through dividend payment due to the differential pricing of tradable and non-tradable shares at initial public offerings (IPOs). However, controlling shareholders can tunnel through other subtle ways, such as related party transactions or intercorporate loans for their sole benefit, rather than pay cash dividends, where all shareholders benefit (Firth, Gao, Shen, and Zhang, 2016). Bradford, Chen, and Zhu (2013) find empirical evidence to show tunneling is not the main incentive of Chinese firms paying cash dividends. Su, Fung, Huang, and Shen (2014) directly test the relation between cash dividends and related party transactions and find that firms that pay lower cash dividends are associated with more related-party transactions, which is a direct measure of wealth expropriation (Berkman et al., 2010).

2.2 The role of foreign ownership in firm performance

Research has found that the presence of foreign institutional investors affects the degree of performance improvement in newly divested firms. It is argued that foreign investors generally require high standards of information disclosure, provide managerial and technical expertise, bring new funds to firms, and maintain strict control of managers' actions due to their reputational concerns (D'Souza, Nash, and Megginson, 2001; Dyck, 2001). In addition, foreign investors are much more active in monitoring activities, while other local institutions,

especially those that have business relations with local corporations, can feel compelled to be loyal to management (Ferreira and Matos, 2008). Most studies find a positive impact of foreign ownership on firm performance.

D'Souza et al. (2001) compare firms with foreign ownership and firms with none after privatization. The results show that firms with foreign ownership have better gains in profitability, efficiency, and output. Utilizing a sample of 129 privates firms from 23 developed (Organisation for Economic Co-operation and Development) countries in the period from 1961 to 1999, D'Souza, Megginson, and Nash (2005) find a significantly negative relation between foreign ownership and post-privatization employment levels. The authors argue that foreign owners reduce overstaffing inefficiencies because they are less affected by local political and social concerns. Chinese studies such as those of Wei, Varela, D'Souza, and Hassan (2003) and Jia, Sun, and Tong (2005) document a positive relation between foreign ownership and firm operating performance change after the partial share issue privatizations of SOEs. However, the positive effect of foreign ownership seems to be limited, possibly due to foreign ownership accounting for a being relatively small share of total ownership and tradable foreign shares being widely held by individual investors (Jia et al., 2005).

2.3 Foreign ownership and minority shareholder protection

Foreign institutional investors play an active role in improving corporate governance practices, particularly in countries with weak shareholder protection (Aggarwal et al., 2011). Utilizing firm data from 23 countries during the period 2003 to 2008, Aggarwal et al. (2011) find foreign institutional investors are instrumental in improving corporate governance in countries with weak shareholder protection. They report a significant positive relation between foreign institutional ownership and a firm-level governance index, but no significant

relation between domestic institutional ownership and the governance index. Ferreira and Matos (2008) find evidence of foreign investors being more active in comparison to domestic investors in reducing capital expenditure overinvestment. Chen, El Ghoul, Guedhami, and Wang (2014) examine newly privatized firms from 64 countries and find that foreign ownership increases investment efficiency, since it helps mitigate information asymmetry and agency problems through two channels: first, through foreign investors implementing strong governance to safeguard their investments and, second, through foreign investors' investment expertise in collecting and processing information. In addition, Bena, Ferreira, Matos, and Pires (2016) find greater foreign institutional ownership promotes long-term investment in fixed capital, innovation, and human capital. These findings can be explained by the disciplinary role of foreign institutions on managers worldwide.

In China, Huang and Zhu (2015) investigate the role of QFIIs in minority shareholder protection practice. They argue foreign institutional investors' involvement limits potential expropriation, since they are less prone to political pressure and more likely to perform arms-length negotiations with non-tradable shareholders during the NTS reform. Huang and Zhu show that, for state-controlled firms, QFII ownership is positively related to the compensation ratio, suggesting Chinese minority shareholders benefit from foreign institutional investor representation. Huang (2016) finds foreign-invested firms have experienced greater decreases in related party loan guarantees than domestic firms since 2008. Shan (2013) finds foreign ownership is negatively related to tunneling activities through direct transfer. It is argued that foreign investors play a positive role in improving minority shareholder protection, but only in firms that issue both A- and B-shares,[6] since their average foreign ownership is higher than

[6] In China, there are different types of foreign ownership in listed firms. During IPOs, Chinese firms can issue tradable B-shares or H-shares to foreign investors, who are generally individual investors (Jia et al., 2005). The B-shares are traded in US dollars in the Shanghai Stock Exchange and in Hong Kong dollars in the Shenzhen Stock Exchange. The B-shares were initially aimed for foreign investors, given that Chinese renminbi could not

in firms that issue only A-shares. In addition, Berkman et al. (2010) examine the wealth effects of key regulatory changes designed to improve minority shareholder protection in China. They document that minority shareholders in firms with foreign owners (B-shares) are less likely to experience expropriation by controlling shareholders. They argue this is due to enhanced transparency within firms with foreign investors, as well as the greater sophistication of the foreign investors themselves.

2.4 Hypothesis development

This study utilizes the proportion of "Promoter Foreign Legal Person Shares" as a main proxy for foreign strategic ownership and examines the impact of such ownership on minority shareholder protection. In addition, QFII ownership is employed as a robustness check for foreign strategic ownership. We use promoter foreign legal person shares as the main measure because it gives us a longer time period and a larger sample with which to tackle the research question. There are several reasons to support the notion of promoter foreign legal person shareholders being strategic investors. First, promoter foreign legal person shares are non-tradable shares. Such ownership cannot be freely transferred in the secondary market, even after a lock-up period between 12 to 36 months. Second, promoter foreign legal person investors are institutions rather than individual investors, so other major shareholders could value these foreign strategic investors more than foreign individual investors (Huang and Zhu, 2015). Lastly, foreign institutions have resources to analyze firm performance and the ability to influence firm operations and management when firm efficiency is low (Chen, Firth, and Rui, 2006; Shan, 2013). Therefore, we expect promoter foreign legal person shares to be a valid proxy for foreign strategic investment. Foreign strategic investors are expected to play

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be exchanged freely in the foreign exchange markets. However, B-shares were sold at a deep discount in comparison with A-shares. To stimulate the B-share market, Chinese investors have been allowed to trade B-shares since February 2001 using either US or Hong Kong dollars. The H-shares are shares of Chinese companies sold in the Hong Kong Stock Exchange.

active and positive roles in providing better minority shareholder protection in Chinese listed firms. We therefore propose the following hypothesis.

> H_1: Chinese listed firms with foreign strategic ownership have better minority shareholder protection than firms without such ownership.

3. Data and methodology

3.1 Data collection

The initial sample includes all companies listed on the Shanghai and Shenzhen Stock Exchanges from 2003 to 2013. We exclude the Small-and-Medium section of the Shenzhen Stock Exchange, since these firms have different characteristics, including listing requirements, compared to those of Main Board firms (Huang, Shen, and Sun, 2011). We exclude firms newly listed within 12 months, firms from the financial sector, and firms with missing data. Our final sample includes 1,750 listed firms that comprise 11,782 firm–year observations.

The QFII data were downloaded from http://english.sse.com.cn/investors/qfii/information/. All other data are from the China Listed Firms Research Database of China Stock Market & Accounting Research.

3.2 Variable construction

3.2.1 Foreign strategic ownership measures

The key foreign strategic ownership measure we use is *FOREIGN*, a dummy equal to one if the firm has promoter foreign legal person shares and zero otherwise. For robustness checks in Section 4.4, we construct an alternative foreign strategic ownership proxy using QFII data,

where *QFII* is a dummy variable equal to one if a QFII investor is one of the top 10 tradable shareholders of the sample firm and zero otherwise.

3.2.2 Minority shareholder protection measures

We use three measures to proxy for the level of minority shareholder protection in Chinese listed firms. First, *Excess Debt* is calculated as the ratio of a firm's total liabilities to total assets minus the industry average debt ratio in the same observation year. The variable *Excess debt* is used to capture the level of minority shareholder protection, since it is argued controlling shareholders use excess debt financing to control more resources without diluting their control in corporations (Stulz, 1988). When overall corporate governance is weak, controlling shareholders have more incentive to use excess leverage to expropriate wealth from minority shareholders, since they can shift downside risk onto minority shareholders (Faccio, Lang, and Young, 2010). Alternatively, it is argued that firms with excess debt financing tend to take excess risks (Faccio, Marchica, and Mura, 2016). Risk taking could reflect potential expropriation in firms when overall investor protection is weak (John, Litov, and Yeung, 2008). Therefore, a higher level of *Excess Debt* indicates a lower level of minority shareholder protection.

Second, following Jiang et al. (2010), *Intercorporate Loan* (the ratio of other receivables to total assets) is employed as a measure for intercorporate Loans to controlling shareholders. Controlling shareholders use intercorporate Loans to expropriate wealth from Chinese listed firms, thereby hurting minority shareholders' interests (Jiang et al., 2010; Liu and Tian, 2012). A higher level of *Intercorporate Loan* indicates a lower level of minority shareholder protection. Due to the regulation effect addressed by Jiang et al. (2015), we use related party loan guarantees as a proxy for tunneling through intercorporate Loans, following Berkman et al. (2010), as an additional robustness check. This is discussed in detail in Section 4.4.

Our third measure of minority shareholder protection is a firm's cash dividend payout ratio[7] minus the industry average dividend payout ratio in the same observation year *(Excess Cash Dividend)*. As discussed, agency theory suggests that cash dividend payments mitigate the free cash flow problem (Jensen, 1986). Empirical evidence shows firms that pay less cash dividends tend to conduct more tunneling (Su et al., 2014). Hence, a higher *Excess Cash Dividend* indicates a higher level of minority shareholder protection.

Insert Table 1 here

Table 1 reports the summary statistics of our three minority shareholder protection measures. Panel A shows the time trend of the three measures, divided along a dimension, foreign versus non-foreign. Foreign refers to the subsample that has promoter foreign legal person shares (the proxy for foreign strategic ownership) and non-foreign refers to the subsample without foreign strategic ownership. Panel B shows the mean values of the three minority shareholder protection measures and examines whether the mean differences of the measures are statistically different between the foreign and non-foreign subsamples by conducting *t*-tests.

On average, 4.46% of sample firms have foreign strategic ownership. The average percentage of firms having foreign strategic investors was 6.4% in the period from 2003 to 2008 and it dropped to 2.7%, on average, in 2009 due to the NTS reform launched in 2005.[8] The *t*-test

[7] Following Firth et al. (2016), we define the dividend payout ratio as the cash dividend per share to total assets per share.

[8] Since the NTS reform was implemented, non-tradable shareholders in a firm face a lock-up period, during which they are blocked from selling converted shares in the secondary markets or through transfer arrangements for at least 12 months to maintain the overall stability of the stock market. A firm's shares will usually become fully tradable 36 months after the reforms are implemented within a firm (Liu and Tian, 2012). Promoter foreign legal person shares are non-tradable shares but have been gradually converted into tradable shares after 2005. Our promoter foreign legal person shares measure involves the non-tradable shares, but foreign investors could still hold ownership in the sample firms following conversion. Due to data limitations, we are unable to track the changes of Promoter Foreign Legal Person Shares after conversion. Therefore, we use QFIIs as an alternative measure of foreign strategic ownership for a robustness check. This is discussed in Section 4.4.

results show that firms with foreign strategic ownership have better minority shareholder protection measures, proxied by *Excess Debt*, *Intercorporate Loan*, and *Excess Cash Dividend*, respectively. The mean differences between the two subsamples (foreign versus non-foreign) are all statistically significant at the 1% level.

3.2.3 Control variables

Due to the importance of state agencies and SOE ownership in Chinese listed firms, we control for the impact of the state on minority shareholder protection. State shareholders could have a strong incentive to tunnel by using listed firms to pursue their political objectives, such as excessive employment and regionally targeted investments (Shleifer and Vishny, 1994). However, Huang, Shen, and Sun (2011) indicate that "state assets are everybody's assets and, thus, nobody's assets. (p. 125)" Therefore, state-controlled firms could have less incentive to tunnel. Moreover, the government could also prop their controlled firms for various reasons, including political or social stability reasons (Huang et al., 2011). The variable *STATE* is a dummy equal to one if a firm's ultimate controller is a government agency or an SOE and zero otherwise. The *STATE* dummy can be positively or negatively related to minority shareholder protection.

Most shares held by controlling shareholders were not freely traded in secondary markets prior to the NTS reform. It has been suggested that controlling shareholders care less about minority shareholders' interests or market-based share values, since they cannot enjoy price appreciation (Liao et al., 2014). Studies indicate that the NTS reform has exogenously narrowed the incentive divergence between controlling and minority shareholders (Kuo, Ning, and Song, 2014). We expect the improved share tradability to reduce controlling shareholders' tunneling motivation and activities. The share tradability effect is captured by creating a

dummy variable *TRADE* that equals one if the ultimate controller holds tradable shares and zero otherwise.

Following prior literature (e.g., Jiang et al., 2010; Huang et al., 2011; Liu and Tian, 2012; Firth et al., 2016), we control for the factors that have been documented as the determinants of tunneling. Firm size (*LNSIZE*) is calculated as the natural logarithm of total assets. Jiang et al. (2010) document a negative association between firm size and intercorporate Loans. Large firms are found to have a higher leverage ratio (Liu and Tian, 2012). In addition, large firms are generally more mature and have fewer growth opportunities and hence have more cash to be distributed as dividends (Huang et al., 2011). Firm performance is captured by *ROA* (net profits over total assets). Well-performing firms are found to be more likely to pay higher dividends (Chen et al., 2009; Huang et al., 2011), use less intercorporate Loans (Jiang et al., 2010), and have lower leverage (Liu and Tian, 2012). We control for the level of operational cash flows held by the firm (*NOCF*), calculated as net operational cash flow over total sales. Less free cash flow reduces the resources under insider control and could mitigate agency problems (Firth et al., 2016). Firm growth is captured by *M/B*, which is calculated as the market value of equity over the book value of equity. We also control for the board monitoring effect, including board size (*B/SIZE,* calculated as the natural logarithm of the total number of directors on a board) and board independence (*B/IND,* calculated as the total number of independent directors over the total number of directors on a board). Small boards and boards with high independence are suggested to be more efficient at monitoring and could therefore provide better minority shareholder protection (Dahya, Dimitrov, and McConnell, 2008). Finally, *CONTROL* is a measure of ownership concentration calculated as the proportion of the ultimate controller's shareholding to total shares outstanding. Ownership concentration is found to have a negative relation with intercorporate Loans

(Jiang et al., 2010) and a positive relation with the dividend payout ratio (Firth et al., 2016). Each variable is described in the Appendix.

3.3 Summary statistics

Table 2 presents the summary statistics of the variables. As discussed, 4.46% of sample firms have foreign strategic investors.[9] Chinese government agencies or SOEs maintain ultimate control in 64.49% of the sample firms. On average, 48.37% of ultimate controlling shareholders hold tradable shares[10] and, on average, hold 32.85% of firms' shares outstanding, with a maximum ratio of 89.89%.

Insert Table 2 here

Table 3 reports the pairwise correlation matrix of the key variables. Consistent with our expectation, *FOREIGN* is positively related to better minority shareholder protection measures. The correlation matrix does not suggest any serious multicollinearity concerns.

Insert Table 3 here

4. Results and discussion

In this section, we present and discuss the results of the impact of foreign strategic ownership on minority shareholder protection. We also present the results of the robustness checks.

[9] The average foreign strategic ownership ratio, calculated as the proportion of Promoter Foreign Legal Person Shares to total shares, is very small (0.08%) for the whole sample. However, for the subsample that has foreign strategic investors, the average Promoter Foreign Legal Person Share ratio reaches 19.27%, with a maximum ratio of 88.55%.

[10] We determine the summary statistics of the state control and share tradability of sample firms. These show that the state control of sample firms decreases over time, from 77.46% in 2003 to 49.64% in 2013, while the ratio of ultimate controllers holding tradable shares has increased sizably since 2006. Just 2.79% of ultimate controllers were holding tradable shares in 2005, with the ratio reaching 76.92% in 2013.

4.1 Foreign strategic ownership and minority shareholder protection

To examine the impact of foreign strategic ownership on minority shareholder protection, we conduct multivariate regression of the panel data with standard errors clustered by firm, controlling for year and industry fixed effects.[11] The initial regression specification is as follows:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1\ \textit{FOREIGN} + \beta_2\ \textit{STATE} + \beta_3\ \textit{TRADE} + \beta_4\ \textit{LNSIZE} + \beta_5\ \textit{NOCF} + \beta_6\ \textit{M/B} + \beta_7\ \textit{ROA} + \beta_8\ \textit{B/SIZE} + \beta_9\ \textit{B/IND} + \beta_{10}\ \textit{CONTROL} + \varepsilon$$

We estimate the regression model for the three minority shareholder protection measures defined in Section 3.2.2. The data for the regression analyses cover the period from 2003 to 2013. The regression results are presented in Table 4.

Insert Table 4 here

Model 1 uses *Excess Debt* to proxy for minority shareholder protection. The *FOREIGN* dummy is negatively related to the excess leverage ratio. The coefficient is statistically significant at the 1% level, supporting H_1. In Model 2, we use *Intercorporate Loan* to measure minority shareholder protection.[12] The *FOREIGN* dummy is significantly and negatively related to *Intercorporate Loan* at the 1% level, suggesting firms with foreign strategic ownership tend to undertake fewer tunneling activities. In Model 3, *Excess Cash Dividend* is employed to proxy for firms' minority shareholder protection. The *FOREIGN* dummy is significantly and positively related to dividend payout at the 1% level.

[11] For robustness checks, we perform regressions controlling for province fixed effects for the analyses reported in Tables 4 to 8, since the governance settings and law enforcement can differ across provinces. The results are qualitatively similar to those the main results reported. We also perform regressions controlling for firm fixed effects and again the results are qualitatively similar to those presented in the current tables.

[12] Jiang et al. (2015) indicate that the utilization of intercorporate loans decreased due to government restrictions since 2006, as confirmed by our summary statistics in Table 1. To address this government regulation effect, we perform a subperiod analysis covering the data from 2003 to 2006. The *FOREIGN* dummy is shown to be negatively related to *Inter-corporate Loan* and the coefficient is significant at the 1% level.

In terms of economic significance, the coefficient for *FOREIGN* in Model 2 (-0.0109) indicates firms with foreign strategic ownership, on average, have 6.44% less intercorporate loans than firms without foreign strategic ownership. Foreign strategic ownership appears to reduce tunneling significantly relative to the sample mean of *Intercorporate Loan* (0.0349). The *FOREIGN* coefficient in Model 1 (-0.0405) indicates foreign strategic ownership significantly reduces the use of excess debt financing relative to the small sample mean of *Excess Debt* (close to zero). The *FOREIGN* coefficient in Model 3 (0.0031) indicates that foreign strategic ownership sizably increases cash dividend payment relative to the small sample mean of *Excess Cash Dividend* (close to zero).[13] These results indicate that the effect of foreign strategic ownership is both statistically and economically significant.

The results of the impact of state control on minority shareholder protection are mixed. The positive coefficient of *STATE* is significant at the 1% level when minority shareholder protection is measured by *Excess Debt,* implying worse minority shareholder protection in state-controlled firms. However, the result could also be because state-controlled firms have better access to debt financing than privately controlled firms do. Model 2 shows that state-controlled firms undertake less intercorporate loans, although not significantly so. This result is in line with that of Huang et al. (2011), that state-controlled firms have fewer incentives to tunnel, since state assets are everybody's assets. Model 3 reports that state-controlled firms pay fewer dividends, indicating worse minority shareholder protection. The mixed results on state control could be because foreign strategic ownership acts differently in state- and

[13] We use the standard approach to calculate the economic significance as the coefficient of a variable times the standard deviation of the variable divided by the mean value of the dependent variable. Since the means of *Excess Debt* and *Excess Cash Dividend* are nearly zero, we claim that the economic significance is sizable. We create a dummy variable that equals one if the excess dividend payment is higher than the third quantile of the variable *Excess Cash Dividend*. This shows that firms with foreign strategic investors are 89.5% more likely to pay higher cash dividends (higher than the third quantile of *Excess Cash Dividend*). This result confirms that the monitoring effect of foreign strategic investors is economically sizable.

privately controlled firms. We address the impact of foreign strategic ownership on state- versus privately controlled firms by conducting subsample analyses in Section 4.2.

The share tradability results are also mixed. Share tradability appears to improve minority shareholder protection when measured by *Intercorporate Loan* but tends to aggravate minority shareholder expropriation when measured by *Excess Debt* or *Excess Cash Dividend*. Since foreign strategic ownership could have a different impact on shareholder protection according to different share tradability levels, we examine the effect of foreign strategic ownership by conducting subsample analyses (grouped by share tradability level) in Section 4.3.

Large firms use more debt financing but undertake fewer intercorporate loans. Well-performing firms denoted by *ROA* are shown to have better minority shareholder protection measures, while higher-growth firms tend to provide worse minority shareholder protection. This is not surprising, since greater growth opportunities require more resources, including debt financing. Ownership concentration has a positive impact on the three minority shareholder protection measures, in line with the results of Jiang et al. (2010) and Firth et al. (2016).

Overall, the panel data regression results indicate that foreign strategic investors enhance minority shareholder protection in Chinese listed firms.[14] As discussed, most foreign strategic investors are institutional investors from developed economies. Hence, they have the

[14] We also use *Foreign Ownership Ratio*, which is calculated as the proportion of Promoter Foreign Legal Person Shares to total shares outstanding, to replace the *FOREIGN* dummy to estimate Tables 4 to 8. The results are qualitatively similar to the results presented in the current tables. In addition, we create a *B/H* dummy that equals one if the sample firm issues B or H shares and zero otherwise. The B/H shares are tradable but their shareholders are not necessary institutional investors. The results show that the *FOREIGN* dummy is still significant when controlling for the *B/H* dummy. We do subsample analysis by dividing the sample into firms that issue B/H shares and those that do not. The results show that the monitoring effect of foreign strategic ownership is more pronounced in the subsample of firms that does not issue B/H shares. These untabulated results are available upon request.

capability of monitoring firm operations and management (Shan, 2013). In addition, foreign institutional investors have more negotiation power to enhance minority shareholder interests, since they are valuable investors to the firm (Huang and Zhu, 2015). A higher level of minority shareholder protection is also beneficial to foreign promoters' reputation.

4.2 Foreign strategic ownership and state control

Foreign strategic ownership could have different effects in state-controlled firms and privately controlled firms, respectively. To further evaluate the impact of foreign strategic ownership on minority shareholder protection, we conduct subsample analyses by dividing the whole sample into a state-controlled subsample and a non–state-controlled subsample. The results are reported in Table 5.

Insert Table 5 here

Panel A in Table 5 presents the results for firms whose ultimate controller is either a government agency or an SOE, while the results on firms with private entity ultimate controllers are reported in Panel B. In state-controlled firms, the positive effect of foreign strategic ownership on minority shareholder protection is statistically significant when *Excess Debt* and *Intercorporate Loan* are employed as proxies. The coefficients *FOREIGN* in Models 1 and 2 of Panel A (-0.0359 and -0.0105, respectively) indicate state-controlled firms with foreign strategic ownership have, on average, 22.4% and 5.95% less excess debt and intercorporate loans, respectively, than firms without foreign strategic ownership. In privately controlled firms, foreign strategic ownership is associated with better minority shareholder protection as measured by all three proxies. The coefficients of *FOREIGN* in Models 1 and 2 of Panel B (-0.0438 and -0.0092, respectively) indicate non–state-controlled firms with foreign strategic ownership have, on average, 26.9% and 5.13% less excess debt and intercorporate loans, respectively, than firms without foreign strategic ownership. However,

the coefficient of the *FOREIGN* dummy in Model 3 of Panel B (0.0040) indicates non–state-controlled firms with foreign strategic ownership pay, on average, 19.3% more excess cash dividends than firms without foreign strategic ownership. The results confirm that foreign strategic ownership plays a positive role in enhancing minority shareholder protection in both state- and non–state-controlled firms. Further, this positive effect is more pronounced in privately controlled firms than in state-controlled firms.

Among state-controlled firms, state control can be through an SOE or central or local government agencies. Jiang et al. (2010) indicate that the incentives for these various types of state controllers differ. The authors find minority shareholder expropriation problems are relatively worse in local government-controlled enterprises and argue that this is because local government bureaucrats could be less likely to be prosecuted for misconduct with state funds. We further investigate the impact of foreign strategic ownership by creating subsamples based on whether the ultimate controller is an SOE or a local or central government agency. The results are reported in Table 6.

Insert Table 6 here

Panels A to C in Table 6 show the results for firms with a central or local government agency or an SOE as the ultimate controller, respectively. The results suggest that foreign strategic ownership provides no incremental monitoring benefit when the ultimate controller is a central government bureaucrat. While foreign strategic ownership limits tunneling activities in firms controlled by local government bureaucrats, as measured by *Excess Debt* and *Intercorporate Loan,* the coefficients of the *FOREIGN* dummy in Models 1 and 2 of Panel B (-0.0390 and -0.0186, respectively) indicate local government bureaucrat-controlled firms with foreign strategic ownership have, on average, 28.58% and 10.16% less excess debt and intercorporate loans, respectively, than firms without foreign strategic ownership. In addition,

minority shareholders in SOEs benefit from foreign strategic ownership when tunneling is proxied by *Intercorporate Loan* and *Excess Cash Dividend.* The coefficients of the *FOREIGN* dummy in Models 2 and 3 of Panel C (-0.0225 and 0.0047, respectively) indicate SOE-controlled firms with foreign strategic ownership have, on average, 9.22% fewer intercorporate loans but pay 141.9% more excess cash dividends than firms without foreign strategic ownership.[15] In 2004, the Chinese government introduced inspection teams for firms controlled by central, but not local, government bureaucrats (Gong, 2008). Therefore, we argue that firms controlled by central government bureaucrats are subject to more intensive political interference than firms controlled by SOEs and local government bureaucrats and, therefore, the benefit of foreign strategic investors' monitoring effect tends to be weak in central government agency-controlled firms.

4.3 Foreign strategic ownership and share tradability

As shown in Table 4, the impact of whether the ultimate controller holding tradable shares on minority shareholder protection is mixed. However, since the implementation of full share tradability is a major Chinese capital market reform, we examine more closely foreign strategic ownership for different levels of share tradability. As discussed, share tradability narrows the divergence in incentives between controlling and minority shareholders (Kuo et al., 2014). The foreign strategic ownership effect is expected to be more pronounced in firms where the controlling shareholders have fewer tradable shares. We address this question by conducting a subsample analysis, dividing the whole sample into trade and non-trade subsamples, where trade refers to firms whose ultimate controlling shareholder holds tradable shares and non-trade to firms whose ultimate controller only holds non-tradable shares. The results are reported in Table 7.

[15] The mean value of *Excess Cash Dividend* in the SOE-controlled subsample equals 0.006, which leads to a large economic significance measure.

Insert Table 7 here

Panels A and B in Table 7 show the results of the trade and non-trade subsamples, respectively. In line with our expectations, the positive effect of foreign strategic ownership in enhancing minority shareholder protection is more prominent when the controlling shareholders only own non-tradable shares. The coefficients of the *FOREIGN* dummy are highly significant in Models 1 to 3 for the non-trade subsample. The coefficients of the *FOREIGN* dummy in Models 1 to 3 of Panel B (-0.0359, -0.0117, and 0.0032, respectively) indicate that, in the non-trade subsample, firms with foreign strategic ownership have, on average, 44.63% and 6.19% less excess debt and intercorporate loans, respectively, but pay 114.23% more excess cash dividends than firms without foreign strategic ownership. However, *FOREIGN* is only significant with the expected sign in Model 1 (*Excess Debt*) for the trade subsample. We argue that the monitoring effect of foreign strategic ownership tends to be more pronounced when the overall development of financial markets is weak. Improvements in financial market development and reduced divergence between controlling and minority shareholder incentives following the reform have tempered the positive effect of foreign strategic ownership for minority shareholders.

4.4 Alternative foreign strategic ownership and minority shareholder measures

As reported in Table 1, the presence of the *FOREIGN* dummy decreases in our sample from 2009 onward. Promoter foreign legal person shares are non-tradable shares but are gradually converted into tradable shares after 2005. Foreign strategic investors could still hold their shares in the sample firms following conversion but, unfortunately, we are unable to track the changes of promoter foreign legal person shares after conversion. In this section, we use QFIIs as an alternative foreign strategic ownership measure for a robustness check.

Following Huang and Zhu (2015), we create a dummy variable *QFII* that equals one if a QFII is among a sample firm's top 10 tradable shareholders and zero otherwise. The regression analysis includes 6,046 firm–year observations from 2009 to 2013.[16] The results are reported in Panel A of Table 8.

Insert Table 8 here

Panel A in Table 8 shows the results when *QFII* is employed as the dummy to capture foreign strategic investor representative. The results indicate *QFII* is associated with better minority shareholder protection. The positive effect is significant when *Excess Debt* is used as the minority shareholder protection measure. It is not surprising that the coefficient of *Intercorporate Loan* is not significant, given the post-NTS regulation effect on intercorporate loans discussed by Jiang et al. (2015). The *QFII* dummy is positively related to *Excess Cash Dividend,* although not significantly so (*p*-value equals 0.112). We also conduct a subsample analysis for the state- and non–state-controlled subsamples. The results indicate *QFII* is more pronounced in the non–state-controlled subsample but not significant in the state-controlled subsample.[17]

As an additional robustness check, we use *Loan Guarantees* as a proxy for minority shareholder protection. Following Berkman et al. (2010), we create the variable *Loan Guarantees*, which is calculated as the dollar amount of the related party loan guarantees issued by the listed firm to its related parties scaled by total assets. Berkman et al. indicate

[16] The sample period of the robustness tests is from 2009 onward. This is due to two reasons. The main reason is that Promoter Foreign Legal Person Shares were converted into tradable shares more since 2009. Second, our sample contains very few observations from 2005 to 2008 where the *QFII* dummy equals one. The results for the whole data period available (2005–2013) are robust. These untabulated results are available upon request.

[17] In addition, we create a *B/H* dummy that equals one if the sample firm issues B- or H-shares and zero otherwise. The results show *QFII* is still significant when the *B/H* dummy is controlled for. We also conduct a subsample analysis by dividing the sample into firms issuing B-/H-shares and those that do not. The results show that the monitoring effect of the QFII investment is more pronounced for the subsample of firms who do not issue B-/H-shares. These results are available upon request.

that related party loan guarantees benefit controlling shareholders in two ways: first, by providing controlling shareholders an option to default, leaving the loan repayment burden to listed firms, and, second, by allowing controlling shareholders to obtain financing through related party loan guarantees at a lower interest rate than for the other channels available.

Panel B of Table 8 reports the regression results for a sample of 6,045 firm–year observations from 2009 to 2013. The coefficient of *FOREIGN* is not significant, which is unsurprising, given the conversion of promoter foreign legal person shares into tradable shares during the sample period. When *QFII* is employed to capture foreign strategic investor representation, the results show that firms with QFIIs engage in fewer related party loan guarantees, which is suggested to hurt minority shareholder value significantly. The results of Table 8 provide evidence that foreign strategic investors add value to minority shareholder protection by reducing related party loan guarantees.[18]

4.5 Foreign strategic ownership, endogeneity

In this section, we address the possible endogeneity concern associated with our results. The endogeneity concern is that foreign strategic shareholders could invest in firms that exhibit better corporate governance. This endogeneity is less likely to an issue for promoter foreign legal person shares compared to the QFII measure of foreign strategic owners. Promoter Foreign Legal Person shareholder are foreign owners before a firm becomes listed and therefore a firm's corporate governance practices are less observable to foreign owners when investing and these foreign strategic investors are more likely to be able to impact corporate governance practices before an IPO.

[18] To address a possible endogeneity issue, the generalized method of moments (GMM) is applied to Table 8 (both Panels A and B). The results are qualitatively similar to the results reported in Table 8, which confirm that QFIIs add value to minority shareholders by reducing tunneling activities.

We use the generalized method of moments (GMM to address this causality issue. The GMM is documented to have advantages compared to traditional fixed effect estimates (Wintoki, Linck, and Netter, 2012). It relies on a set of "internal" instruments contained within the panel itself and therefore has no need to create external instruments. It is recommended that the GMM approach be applied in corporate governance studies, for instance, corporate governance–firm performance studies, where biases can arise from ignoring the effect of historical performance on current governance (Wintoki et al., 2012).

Insert Table 9 here

Utilizing the GMM in Panel A of Table 9, we find that the *FOREIGN* coefficient is highly significant in Models 1 and 2, confirming that firms with foreign strategic ownership have better minority shareholder protection.

It is also possible for foreign ownership to be affected by firm performance and other control variables. To further control for this type of endogeneity, we employ the Hausman–Taylor (1981) regression, which is suggested as an efficient approach to address correlation between explanatory variables. Utilizing the Hausman–Taylor approach in Panel B of Table 9, the *FOREIGN* coefficients are highly significant in Models 1 to 3, confirming that foreign strategic ownership is associated with better minority shareholder protection.

5. Conclusion

The conflict between controlling and minority shareholders in China has captured much attention from researchers in the past decade. In their desire to improve corporate governance in Chinese companies, policy makers have continued to make regulatory changes that impact ownership structure, such as the NTS reform and the gradual opening of markets to foreign investors (QFIIs). We explore whether foreign strategic owners who typically reside in

stronger investor protection environments exert a positive influence on reducing the conflict between controlling and minority shareholders. In contrast to the Chinese principal–principal literature, we use the relatively novel promoter foreign legal person shares as our measure of foreign strategic investors. These investors are typically from stronger investor protection environments, are likely to have longer investment horizons, face greater risks than foreign investors in tradable B-shares and QFIIs in tradable A-shares, and have the resources and capabilities to influence corporate governance practices.

We find that foreign strategic investors reduce minority wealth expropriation. Firms with foreign strategic investors rely less on excessive debt financing and have lower levels of intercorporate loans to controlling shareholders. In addition, foreign strategic investors are associated with higher dividend payout ratios. These results have important implications for investors, who benefit from the third-party monitoring provided by strategic foreign investors. In addition, the findings have important implications for policy makers, since the active role played by foreign strategic investors interacts with state control and overall financial market efficiency.

For example, the active monitoring role is more evident in firms controlled by non-state firms, SOEs, and local governments rather than by the central government, implying that the monitoring role of foreign strategic investors is stronger when government involvement is relatively weak. Further, the monitoring role is more pronounced when the overall development of financial markets is weaker (i.e., prior to the NTS reform); therefore, attracting foreign strategic investors should be encouraged among Chinese listed firms, given that the reform of SOEs is an on-going process.

Appendix: Variable definitions

This appendix reports the variables and definitions used in this study.

Variables	Definition
Dependent variables	
Excess Debt	The ratio of a firm's total liabilities to its total assets minus the industry average debt ratio in the same observation year
Intercorporate Loan	Ratio of other receivables to total assets
Excess Cash Dividend	A firm's cash dividend payout ratio (cash dividend per share to total assets per share) minus the industry average dividend payout ratio in the same observation year
Loan Guarantees	The dollar amount of related party loan guarantees issued by the listed firm to its related parties scaled by total assets
Foreign strategic ownership	
FOREIGN	A dummy variable equal to one if the firm has promoter foreign legal person shares and zero otherwise
QFII	A dummy variable equal to one if a QFII is one of the top 10 tradable shareholders of the sample firm and zero otherwise
Control variables	
STATE	A dummy variable equal to one if a firm's ultimate controller is a state agency or SOE and zero otherwise
TRADE	A dummy variable equal to one if the ultimate controller holds tradable shares and zero otherwise
LNSIZE	Natural logarithm of total assets
NOCF	Ratio to net operational cash flow to total sales
M/B	Ratio of the market value of equity to the book value of equity
ROA	Ratio of net profits to total assets
B/SIZE	Natural logarithm of the total number of directors on a board
B/IND	Ratio to the total number of independent director to the total number of directors on a board
CONTROL	The percentage of ownership held by the ultimate controlling shareholder

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Table 1: Summary statistics of excess debt, intercorporate loans, and excess cash dividends

This table reports the summary statistics of three minority shareholder protection measures: *Excess Debt* is calculated as the ratio of a firm's total liabilities to total assets minus the industry average debt ratio in the same observation year. The variable *Intercorporate Loan* is calculated as the ratio of other receivables to total assets. The variable *Excess Cash Dividend* is computed as the cash dividend payout ratio (cash dividend per share to total assets per share) of a firm minus the industry average dividend payout ratio in the same observation year. Here foreign refers to the subsample that has promoter foreign legal person shares (the proxy for foreign strategic ownership) and non-foreign refers to the subsample without foreign strategic ownership. Panel A shows the time trend of the measures with their mean value. Panel B shows the mean values of the three minority shareholder measures divided along one dimension, foreign versus non-foreign. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Time trend of excess debt, intercorporate loans, and excess cash dividends

	Observations			*Excess Debt*		*Intercorporate Loan*		*Excess Cash Dividend*	
Year	foreign	non-foreign	foreign /total	foreign	non-foreign	foreign	non-foreign	foreign	non-foreign
2003	36	674	5.07%	-0.0112	0.0006	0.0390	0.0640	0.0060	-0.0003
2004	48	933	4.89%	-0.0351	0.0018	0.0443	0.0737	0.0097	-0.0005
2005	61	943	6.08%	-0.0357	0.0023	0.0384	0.0710	0.0014	-0.0001
2006	74	946	7.25%	-0.0352	0.0028	0.0352	0.0527	0.0015	-0.0001
2007	76	929	7.56%	-0.0173	0.0014	0.0220	0.0317	0.0021	-0.0002
2008	64	952	6.30%	-0.0334	0.0022	0.0192	0.0271	0.0001	0.0000
2009	28	1005	2.71%	-0.0297	0.0008	0.0146	0.0216	0.0038	-0.0001
2010	24	1032	2.27%	-0.0147	0.0008	0.0111	0.0204	0.0072	-0.0002
2011	29	1162	2.43%	-0.0722	0.0018	0.0087	0.0191	0.0083	-0.0002
2012	40	1318	2.95%	-0.0927	0.0028	0.0181	0.0181	0.0073	-0.0002
2013	45	1363	3.20%	-0.0763	0.0025	0.0110	0.0181	0.0053	-0.0002
Average			4.46%						

Panel B: *t*-Test

	Mean			
	foreign	non-foreign	difference	*t*-Test
Intercorporate Loan	0.0252	0.0353	-0.0101	-5.1469***
Excess debt	-0.0395	0.0018	-0.0413	-4.9321***
Excess cash dividend	0.0039	-0.0002	0.0041	5.3526***

Table 2: Summary statistics

This table reports the summary statistics of the variables included in the analysis for a sample of 1,750 listed firms that consists of 11,782 firm–year observations. The description of each variable is summarized in the Appendix.

Variable	Obs.	Mean	Std. Dev.	Min	Max
Excess Debt	11782	0.0000	0.1918	-0.6252	0.6700
Intercorporate Loan	11782	0.0349	0.0763	0.0000	3.9590
Excess Cash Dividend	11782	0.0000	0.0144	-0.0106	0.1694
FOREIGN	11782	0.0446	0.2063	0.0000	1.0000
STATE	11782	0.6449	0.4786	0.0000	1.0000
TRADE	11782	0.4837	0.4998	0.0000	1.0000
LNSIZE	11782	21.7587	1.2554	18.6665	27.5422
NOCF	11782	0.0857	0.2663	-2.9976	2.3652
M/B	11782	3.3227	3.3669	0.4192	43.0777
ROA	11782	0.0311	0.0559	-0.4278	0.2576
B/SIZE	11782	2.2072	0.2105	1.0986	2.9444
B/IND	11782	0.3592	0.0542	0.0000	0.7143
CONTROL	11782	0.3285	0.1772	0.0023	0.8989

Table 3: Correlation matrix of the identified variables

This table presents the correlation matrix of the variables for the sample of 1,750 listed firms with 11,782 firm–year observations over the 2003–2013 sample period. The variable descriptions are summarized in the Appendix.

	Excess Debt	*Intercorporate Loan*	*Excess Cash Dividend*	*FOREIGN*	*STATE*	*TRADE*	*LNSIZE*	*NOCF*	*M/B*	*ROA*	*B/SIZE*	*B/IND*	*CONTROL*
Excess Debt	1												
Intercorporate Loan	0.0954	1											
Excess Cash Dividend	-0.3364	-0.1506	1										
FOREIGN	-0.0445	-0.0273	0.0599	1									
STATE	0.1683	-0.0443	-0.0247	-0.0641	1								
TRADE	0.1081	-0.1674	-0.0519	-0.1119	0.0251	1							
LNSIZE	0.3571	-0.2010	0.0743	0.0102	0.2428	0.2698	1						
NOCF	-0.0329	-0.1035	0.1485	-0.0034	0.0647	-0.0407	0.0670	1					
M/B	0.1089	0.1023	0.0020	-0.0116	-0.1075	0.0554	-0.2706	-0.0448	1				
ROA	-0.3203	-0.2619	0.5053	0.0143	-0.0393	0.0315	0.1382	0.1988	0.0059	1			
B/SIZE	0.1272	-0.0461	0.0641	0.0499	0.2383	-0.0581	0.2340	0.0669	-0.0724	0.0246	1		
B/IND	-0.0261	-0.0557	-0.0147	-0.0107	-0.0896	0.1413	0.0765	-0.0241	0.0290	0.0288	-0.3255	1	
CONTROL	-0.0119	-0.0977	0.1346	-0.0430	0.3479	-0.1157	0.2273	0.0494	-0.0887	0.1093	0.0290	0.0148	1

Table 4: Foreign strategic ownership and minority shareholder protection

This table reports the estimates of the following regression model, with standard errors clustered by firm, using three measures of minority shareholder protection:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1\ \textit{FOREIGN} + \beta_2\ \textit{STATE} + \beta_3\ \textit{TRADE} + \beta_4\ \textit{LNSIZE} + \beta_5\ \textit{NOCF} + \beta_6\ \textit{M/B} + \beta_7\ \textit{ROA} + \beta_8\ \textit{B/SIZE} + \beta_9\ \textit{B/IND} + \beta_{10}\ \textit{CONTROL} + \varepsilon$$

The variable descriptions are summarized in the Appendix. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0405**	0.0010	-0.0109***	0.0000	0.0031***	0.0040
STATE	0.0292***	0.0000	-0.0034	0.1210	-0.0017***	0.0010
TRADE	0.0190***	0.0040	-0.0011	0.4010	-0.0007	0.1190
LNSIZE	0.0810***	0.0000	-0.0025***	0.0010	0.0002	0.2920
NOCF	0.0015	0.8720	-0.0156**	0.0150	0.0016***	0.0020
M/B	0.0171***	0.0000	0.0031***	0.0000	0.0001**	0.0480
ROA	-1.2540***	0.0000	-0.2770***	0.0000	0.1259***	0.0000
B/SIZE	-0.0054	0.7340	-0.0138***	0.0070	0.0027***	0.0030
B/IND	-0.1042**	0.0340	-0.0170	0.3820	-0.0019	0.5470
CONTROL	-0.1090***	0.0000	-0.0278***	0.0000	0.0076***	0.0000
Intercept	-1.7223***	0.0000	0.1379***	0.0000	-0.0151***	0.0000
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	11782		11782		11782	
R^2	0.3255		0.0933		0.2718	

Table 5: Impact of foreign strategic ownership, state- versus non–state-controlled firms

This table reports the estimates of the following regression model, with standard errors clustered by firm, using three measures of minority shareholder protection:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1\, \textit{FOREIGN} + \beta_2\, \textit{TRADE} + \beta_3\, \textit{LNSIZE} + \beta_4\, \textit{NOCF} + \beta_5\, \textit{M/B} + \beta_6\, \textit{ROA} + \beta_7\, \textit{B/SIZE} + \beta_8\, \textit{B/IND} + \beta_9\, \textit{CONTROL} + \varepsilon$$

The variable descriptions are summarized in the Appendix. The sample is divided into two subsamples to further evaluate the effects of foreign strategic ownership on minority shareholder protection. Panel A shows the results of firms with a government agency or SOE as the ultimate controller. Panel B reports the results of firms whose ultimate controller is from the private sector. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: State-controlled subsample

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0359**	0.0330	-0.0105***	0.0030	0.0018	0.1130
TRADE	-0.0032	0.7310	-0.0010	0.5330	0.0002	0.6320
LNSIZE	0.0675***	0.0000	-0.0025***	0.0050	0.0004**	0.0410
NOCF	-0.0080	0.5060	-0.0181	0.1030	0.0017**	0.0180
M/B	0.0157***	0.0000	0.0026***	0.0000	0.0002**	0.0200
ROA	-1.3469***	0.0000	-0.2698***	0.0000	0.1307***	0.0000
B/SIZE	0.0033	0.8650	-0.0194***	0.0010	0.0018*	0.0670
B/IND	-0.0813	0.1580	-0.0293	0.1200	-0.0014	0.6800
CONTROL	-0.0849***	0.0010	-0.0231***	0.0010	0.0057***	0.0000
Intercept	-1.4124***	0.0000	0.1525***	0.0000	-0.0201***	0.0000
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	7598		7598		7598	
R^2	0.3047		0.1037		0.2964	

Panel B: Non–state-controlled subsample

Variables	*Excess Debt*		*Intercorporate Loan*		*Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0438**	0.0190	-0.0092**	0.0370	0.0040**	0.0250
TRADE	0.0265***	0.0040	-0.0039*	0.0670	-0.0011	0.2080
LNSIZE	0.1073***	0.0000	-0.0036**	0.0300	0.0002	0.6180
NOCF	0.0132	0.3080	-0.0133**	0.0170	0.0013**	0.0440
M/B	0.0198***	0.0000	0.0035***	0.0050	0.0001	0.3990
ROA	-1.0801***	0.0000	-0.2559***	0.0000	0.1158***	0.0000
B/SIZE	-0.0170	0.4840	-0.0028	0.7560	0.0046**	0.0110
B/IND	-0.0849	0.3140	0.0033	0.9270	-0.0007	0.9160
CONTROL	-0.0741**	0.0130	-0.0309***	0.0010	0.0087***	0.0010
Intercept	-2.2972***	0.0000	0.1268***	0.0000	-0.0193**	0.0260
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	4184		4184		4184	
R^2	0.3290		0.0904		0.2344	

Table 6: Impact of foreign strategic ownership, with identification of the state control

This table reports the estimates of the following regression model, with standard errors clustered by firm, using three measures of minority shareholder protection:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1\, \textit{FOREIGN} + \beta_2\, \textit{TRADE} + \beta_3\, \textit{LNSIZE} + \beta_4\, \textit{NOCF} + \beta_5\, \textit{M/B} + \beta_6\, \textit{ROA} + \beta_7\, \textit{B/SIZE} + \beta_8\, \textit{B/IND} + \beta_9\, \textit{CONTROL} + \varepsilon$$

The variable descriptions are summarized in the Appendix. The sample is divided into three subsamples to further evaluate the effects of foreign strategic ownership on minority shareholder protection. Panel A shows the results of firms with the central government agency as the ultimate controller. Panel B reports the results of firms with a local government agency as the ultimate controller. Panel C reports the results of firms with an SOE as the ultimate controller. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
Panel A: Central government agency as the ultimate controller						
FOREIGN	-0.0395	0.2500	0.0110	0.1990	0.0024	0.2870
TRADE	0.0044	0.8280	-0.0003	0.8880	-0.0001	0.9490
LNSIZE	0.0641***	0.0000	-0.0014	0.2190	0.0003	0.2750
NOCF	0.0284	0.2820	-0.0105	0.1080	0.0022	0.2770
M/B	0.0137***	0.0000	0.0012*	0.0980	0.0002*	0.0880
ROA	-1.2608***	0.0000	-0.2038***	0.0000	0.1273***	0.0000
B/SIZE	0.0118	0.7490	-0.0104	0.2760	0.0031*	0.0690
B/IND	-0.1538	0.1940	0.0172	0.5370	0.0030	0.5750
CONTROL	-0.0987*	0.0870	-0.0221*	0.0970	0.0064**	0.0260
Intercept	-1.3362***	0.0000	0.0860***	0.0040	-0.0231***	0.0020
Obs.	1818		1818		1818	
R^2	0.3202		0.1191		0.3232	
Panel B: Local government agency as the ultimate controller						
FOREIGN	-0.0390*	0.0640	-0.0186***	0.0000	0.0011	0.4110
TRADE	-0.0070	0.4840	-0.0008	0.7140	0.0002	0.7730
LNSIZE	0.0694***	0.0000	-0.0034***	0.0080	0.0006**	0.0310
NOCF	-0.0116	0.4120	-0.0204	0.2340	0.0010	0.2210
M/B	0.0164***	0.0000	0.0032***	0.0010	0.0002**	0.0180
ROA	-1.3739***	0.0000	-0.2757***	0.0000	0.1346***	0.0000
B/SIZE	0.0164	0.4870	-0.0173**	0.0180	-0.0001	0.9070
B/IND	-0.0877	0.2190	-0.0422*	0.0950	-0.0038	0.4090
CONTROL	-0.0729**	0.0100	-0.0187**	0.0260	0.0060***	0.0010
Intercept	-1.4788***	0.0000	0.1691***	0.0000	-0.0190***	0.0020
Obs.	4750		4750		4750	
R^2	0.3059		0.1113		0.2927	
Panel C: SOE as the ultimate controller						
FOREIGN	-0.0111	0.6220	-0.0225***	0.0000	0.0047*	0.0750
TRADE	-0.0032	0.9170	-0.0025	0.6510	0.0025	0.1310
LNSIZE	0.0721***	0.0000	-0.0042**	0.0440	0.0000	0.9470
NOCF	-0.0652**	0.0190	-0.0205	0.1650	0.0044**	0.0290
M/B	0.0177***	0.0000	0.0028***	0.0000	-0.0001	0.5930
ROA	-1.4626***	0.0000	-0.2874***	0.0000	0.1294***	0.0000
B/SIZE	-0.0655*	0.0590	-0.0353***	0.0020	0.0074***	0.0020
B/IND	0.0835	0.4070	-0.0416	0.3350	0.0034	0.6440
CONTROL	-0.1072**	0.0320	-0.0419**	0.0170	0.0035	0.2350
Intercept	-1.4022***	0.0000	0.2458***	0.0000	-0.0193**	0.0230
Obs.	1030		1030		1030	
R^2	0.2738		0.1191		0.2975	

Table 7: Impact of foreign strategic ownership, trade versus non-trade

This table reports the estimates of the following regression model, with standard errors clustered by firm, using three measures of minority shareholder protection:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1\, \textit{FOREIGN} + \beta_2\, \textit{STATE} + \beta_3\, \textit{LNSIZE} + \beta_4\, \textit{NOCF} + \beta_5\, \textit{M/B} + \beta_6\, \textit{ROA} + \beta_7\, \textit{B/SIZE} + \beta_8\, \textit{B/IND} + \beta_9\, \textit{CONTROL} + \varepsilon$$

The variable descriptions are summarized in the Appendix. The sample is divided into two subsamples to further evaluate the effect of foreign strategic ownership on minority shareholder protection: Trade refers to firms whose ultimate controlling shareholder holds tradable shares and non-trade refers to firms whose ultimate controlling shareholder holds non-tradable share only. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Trade subsample

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0402**	0.0130	-0.0027	0.2670	0.0020	0.1860
STATE	0.0311***	0.0010	-0.0020	0.2810	-0.0017***	0.0060
LNSIZE	0.0797***	0.0000	-0.0007	0.2860	0.0001	0.5140
NOCF	0.0185	0.1360	-0.0057*	0.0770	0.0016**	0.0340
M/B	0.0156***	0.0000	0.0018***	0.0010	0.0001	0.2450
ROA	-1.3047***	0.0000	-0.0648***	0.0000	0.1320***	0.0000
B/SIZE	-0.0104	0.6030	-0.0021	0.4850	0.0024**	0.0310
B/IND	-0.2322***	0.0000	-0.0022	0.8420	-0.0024	0.5490
CONTROL	-0.0905***	0.0010	-0.0207***	0.0000	0.0055***	0.0010
Intercept	-1.6371***	0.0000	0.0461***	0.0020	-0.0133***	0.0020
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	5699		5699		5699	
R^2	0.3560		0.0682		0.2895	

Panel B: Non-trade subsample

Variables	*Excess Debt*		*Intercorporate Loan*		*Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0359**	0.0140	-0.0117***	0.0000	0.0032**	0.0110
STATE	0.0150	0.1110	-0.0048	0.1870	-0.0015**	0.0140
LNSIZE	0.0784***	0.0000	-0.0065***	0.0000	0.0004*	0.0850
NOCF	-0.0134	0.2500	-0.0261**	0.0220	0.0016**	0.0130
M/B	0.0184***	0.0000	0.0047***	0.0010	0.0002**	0.0330
ROA	-1.1842***	0.0000	-0.4139***	0.0000	0.1203***	0.0000
B/SIZE	0.0027	0.8800	-0.0226***	0.0050	0.0029**	0.0140
B/IND	0.0234	0.7060	-0.0229	0.5190	-0.0006	0.8830
CONTROL	-0.1000***	0.0000	-0.0310***	0.0010	0.0088***	0.0000
Intercept	-1.7075***	0.0000	0.2588***	0.0000	-0.0215***	0.0000
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	6083		6083		6083	
R^2	0.2942		0.1351		0.2895	

Table 8: Foreign strategic ownership and minority shareholder protection, with alternative measures

Panel A of this table reports the estimates of the regression model when *QFII* is used as the alternative measure for foreign strategic ownership. The variable *QFII* is a dummy that equals one if a QFII is one of the top 10 tradable shareholders of the sample firm and zero otherwise. The variables are described in the Appendix. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
QFII	-0.0298**	0.0380	-0.0013	0.6450	0.0039	0.1120
STATE	0.0514***	0.0000	-0.0018	0.2500	-0.0027***	0.0000
TRADE	0.0348***	0.0000	0.0022*	0.0780	-0.0007	0.2300
LNSIZE	0.0869***	0.0000	-0.0001	0.8480	-0.0001	0.6060
NOCF	0.0108	0.3430	-0.0009	0.7430	0.0019***	0.0050
M/B	0.0170***	0.0000	0.0015***	0.0000	0.0000	0.7750
ROA	-1.3314***	0.0000	-0.0517***	0.0000	0.1404***	0.0000
B/SIZE	-0.0441**	0.0230	-0.0004	0.8840	0.0029**	0.0160
B/IND	-0.2573***	0.0000	0.0004	0.9700	0.0033	0.4120
CONTROL	-0.1045***	0.0000	-0.0191***	0.0000	0.0058***	0.0000
Intercept	-1.7585***	0.0000	0.0246**	0.0380	-0.0104**	0.0120
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	6046		6046		6046	
R^2	0.4235		0.0546		0.3005	

Panel B of this table reports the estimates of the regression model when *Loan Guarantees* is utilized as an alternative measure for minority shareholder protection. The variable *Loan Guarantee* refers to the related party loan guarantee, which is calculated as the amount of the related party loan guarantee issued by the listed firm to its related parties, scaled by total assets.

Variables	Model 1 *Loan Guarantees*		Model 2 *Loan Guarantees*	
	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	0.0166	0.4070		
QFII			-0.0210**	0.0280
STATE	-0.0221***	0.0020	-0.0225***	0.0010
TRADE	0.0068	0.2950	0.0058	0.3960
LNSIZE	0.0103***	0.0000	0.0104***	0.0000
NOCF	-0.0241***	0.0070	-0.0239***	0.0070
M/B	0.0003	0.7250	0.0002	0.7450
ROA	-0.1722***	0.0000	-0.1692***	0.0000
B/SIZE	-0.0138	0.4640	-0.0138	0.4650
B/IND	-0.0150	0.7940	-0.0130	0.8200
CONTROL	-0.0809***	0.0000	-0.0814***	0.0000
Intercept	YES		YES	
Industry effects	YES		YES	
Year effects	YES		YES	
Obs.	6045		6045	
R^2	0.0296		0.0297	

Table 9: Foreign strategic ownership and minority shareholder protection, endogeneity

Panel A of this table reports the estimates of the following regression when the GMM approach is used:

$$\textit{Minority Shareholder Protection} = \alpha + \beta_1 \text{ Lag Minority Shareholder Protection} + \beta_2 \textit{FOREIGN} + \beta_3 \textit{STATE} + \beta_4 \textit{TRADE} + \beta_5 \textit{LNSIZE} + \beta_6 \textit{NOCF} + \beta_7 \textit{M/B} + \beta_8 \textit{ROA} + \beta_9 \textit{B/SIZE} + \beta_{10} \textit{B/IND} + \beta_{11} \textit{CONTROL} + \varepsilon$$

The variable descriptions are summarized in the Appendix. Panel B reports the results when the Hausman–Taylor approach is used. The superscripts *, **, and *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: GMM approach

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
Lag Excess Debt	0.6821***	0.0000				
Lag Intercorporate Loan			0.4855***	0.0000		
Lag Excess Cash Dividend					0.3703***	0.0000
FOREIGN	-0.0452***	0.0000	-0.0072**	0.0360	0.0009	0.3160
STATE	-0.0179**	0.0160	-0.0135***	0.0010	0.0010	0.6860
TRADE	-0.0006	0.8420	-0.0021	0.1980	0.0004	0.3630
LNSIZE	0.0942***	0.0000	-0.0035*	0.0580	0.0005	0.1520
NOCF	-0.0023	0.5940	-0.0145***	0.0000	0.0006	0.6440
M/B	0.0054***	0.0000	-0.0004**	0.0160	0.0000	0.7520
ROA	-0.7263***	0.0000	-0.0459***	0.0000	0.0030***	0.0000
B/SIZE	-0.0137	0.2390	-0.0075	0.2260	0.0016	0.6030
B/IND	0.0211	0.5050	-0.0210	0.2130	0.0042**	0.0230
CONTROL	0.0065	0.6970	0.0472***	0.0000	0.0022*	0.0760
Intercept	-1.9437***	0.0000	0.1247***	0.0020	0.0074	0.4860
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	9303		9303		9303	

Panel B: Hausman–Taylor approach

Variables	Model 1 *Excess Debt*		Model 2 *Intercorporate Loan*		Model 3 *Excess Cash Dividend*	
	Coef.	*p*-Value	Coef.	*p*-Value	Coef.	*p*-Value
FOREIGN	-0.0406***	0.0000	-0.0111***	0.0000	0.0031***	0.0000
STATE	0.0296***	0.0000	-0.0035**	0.0220	-0.0017***	0.0000
TRADE	0.0186***	0.0000	-0.0010	0.5740	-0.0007**	0.0220
LNSIZE	0.0802***	0.0000	-0.0025***	0.0000	0.0002	0.1330
NOCF	0.0054	0.3320	-0.0161***	0.0000	0.0018***	0.0000
M/B	0.0171***	0.0000	0.0031***	0.0000	0.0001***	0.0010
ROA	-1.2509***	0.0000	-0.2779***	0.0000	0.1261***	0.0000
B/SIZE	-0.0034	0.6550	-0.0143***	0.0000	0.0029***	0.0000
B/IND	-0.1073***	0.0000	-0.0169	0.1870	-0.0020	0.3740
CONTROL	-0.1091***	0.0000	-0.0281***	0.0000	0.0076***	0.0000
Intercept	-1.7485***	0.0000	0.1424***	0.0090	-0.0169***	0.0000
Industry effects	YES		YES		YES	
Year effects	YES		YES		YES	
Obs.	11782		11782		11782	