Empirical Study of the Impact of QFII Shareholdings on Board Governance and Corporate Performances
——Based on Chinese Listed Companies Data

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Abstract. Board governance structure is introduced into this paper as mediating variables to analyze the indirect impact of QFII shareholdings on corporate operating performances. The data of QFII shareholdings ratio between 5% and 30% of Shanghai and Shenzhen A-share listed companies from 2008 to 2016 after the completion of China’s split-share structure reform are selected to carry out empirical study. Empirical results indicate that the mediating effects of proportion of foreign directors, separation degree of ownership and management right of board, president and general manager being one person or not, proportion of independent directors and senior managers’ shareholdings ratio of board governance structure are significant. However, the mediating effect of the numbers of “four committees” of board is not significant.

1. Introduction

2018 China-US trade war triggers unrest of global capital markets. With the development of global economic integration, China must gradually open financial market and allow foreign capital entering Chinese market. China mainland began to introduce the qualified foreign institutional investors (QFII) system in 2003. As of May 30, 2018, the number of QFII increased to 287, cumulative investment quota of QFII is totaling 944.59 billion.

Some scholars think that QFII actively participating in corporate governance does not seek the control power, instead, to restrict board director by participating in shareholders meeting. In that way, do QFII shareholdings will impact corporate operating performances by affecting board governance of listed companies? In-depth analysis the action mechanism and transmission route of QFII shareholdings impacting corporate operating performances of Chinese listed companies will have theoretical and practical significance to guide improving operating performances of Chinese listed companies. Existing studies of the relationship between QFII shareholdings and corporate performances just remain on the direct impact between them, ignore the deep transmission route and action mechanism of QFII shareholdings impacting board governance. This paper will analyze the mediating effect of board governance of the relationship between QFII shareholdings and corporate operating performances. In addition, because of the difference of QFII shareholdings ratio, discourse power of board and investment motivation of QFII will be different. Hence, QFII shareholdings ratio should be divided into different interval segments to study. In addition, most of scholars only choose profitability to measure corporate performances, which makes the conclusions lack of comprehensiveness and reliability. Therefore, corporate operating performances of this paper will be comprehensive measured from five aspects: profitability, asset quality, debt risk, sales growth and
equity expansion ability.

2. **Hypothesis Construction**

The higher the QFII shareholdings ratio is, the more the proportion of QFII in board, the greater the voting right and discourse power in board. Namely, when QFII shareholdings ratio is higher, QFII can fully propose suggestions on corporate operation management to promote directors make scientific and objective decisions and improve corporate operating performances.

Claessens et al. (2002) and Ye et al. (2007) believe that the separation between ownership and management right will lead major shareholders to infringe the interests of medium-small shareholders and damage corporate performances. This paper believes that the greater the separation degree between ownership and management right is, the smaller the residual income of controlling shareholders obtaining from listed companies, the less the enthusiasm of QFII participating in corporate governance, and the worse the corporate operating performances. Therefore, QFII will impact corporate operating performances through affecting separation degree between ownership and management right of board.

Principal-agency theory believes that president and general manager not being one person will make ownership and management right separated, form principal-agency relationship and produce agency cost. However, president and general manager being one person cannot guarantee the effectiveness of corporate operation decisions and damage corporate operating performances. Liang (2004) empirical results indicate that president and general manager being one person will easily cause losing efficiency of internal supervision system of the corporations, which has a negative effect on corporate operation decisions and corporate performances. Hence, QFII will impact corporate operating performances through affecting separation degree between ownership and management right of board.

The increase of proportion of independent directors is beneficial for listed companies to realize the function of supervision and decision-making and improve corporate performances. Dahya et al. (2008) and Ye et al. (2011) argue that the proportion of independent directors is positively related to corporate operating performances. This paper believes that independent directors will play a positive role and improve corporate operating performances when the benefits of shareholders and managers conflicting, because independent directors can make an objective and fair evaluations on the behavior of managers. Hence, QFII will improve corporate operating performances through increasing the proportion of independent directors.

Mike & Fausto (2006) indicate that the higher the senior managers’ shareholdings ratio is, the better the corporate performances. Ye et al. (2011) also believe that senior managers’ shareholdings should be allowed in order to make the benefits of senior managers closely related to the benefits of corporations. This paper believes that the higher the senior managers’ shareholdings ratio is, the consistent the benefits of senior managers related to the benefits of corporations, which will make QFII work hard to improve corporate governance structure and corporate operating performances. Hence, QFII will improve corporate operating performances through impacting senior managers’ shareholdings ratio.

The “four committees” of board could participate in decision-making on major issues of the corporation, supervise managers’ behavior and improve scienticificity and effectiveness of board decisions. Hence, QFII will improve corporate operating performances through increasing the numbers of “four committees” of board.

In conclusions, QFII shareholdings will impact board governance and further impact corporate operating performances. Based on above analysis, following hypotheses are proposed.

**Hypothesis 1:** Proportion of foreign directors is the mediating variable between QFII shareholdings ratio and corporate operating performances.

**Hypothesis 2:** Separation degree of ownership and management right of board is the mediating variable between QFII shareholdings ratio and corporate operating performances.

**Hypothesis 3:** President and general manager being one person or not is the mediating variable between QFII shareholdings ratio and corporate operating performances.

**Hypothesis 4:** Proportion of independent directors is the mediating variable between QFII shareholdings ratio and corporate operating performances.
Hypothesis 5: Senior managers’ shareholdings ratio is the mediating variable between QFII shareholdings ratio and corporate operating performances.

Hypothesis 6: The numbers of “four committees” of board is the mediating variable between QFII shareholdings ratio and corporate operating performances.

3. Research Design

3.1. Variable Measurement
(1) Independent variables. QFII shareholdings ratio (QFII) between 5% and 10% and between 10% and 30% is selected as independent variable. QFII is measured by the proportion of QFII shares in total shares of Chinese listed companies.

(2) Mediating variables. Board governance structure of listed companies is selected as mediating variable. The proportion of foreign directors, separation degree of ownership and management right of board, president and general manager being one person or not, proportion of independent directors, senior managers’ shareholdings ratio and numbers of “four committees” of board are included in board governance structure.

(3) Dependent variables. Corporate operating performances of this paper will be measured from five aspects: profitability, asset quality, debt risk, sales growth and equity expansion ability. Profitability is measured by return on equity (ROE). Asset quality is measured by total asset turnover (TAT). Debt risk is measured by asset-liability ratio (Debt). Sales growth is measured by sales growth rate (Sales). Equity expansion ability is measured by net assets per share (NVA).

(4) Control variables
Company size (Size) is selected as control variable in this paper, which is measured by natural logarithm of total year-end assets of the company. Research results from the corporate governance team of Nankai University indicate that the governance level of state-owned enterprises is significantly higher than that of non-state-owned enterprises. Hence, the type of control shareholders (State) is selected as control variable. Over-concentration and over-decentralization of ownership are not beneficial to improve corporate operating performances. Hence, the degree of ownership concentration (Herf) is selected as control variable. And the degree of ownership concentration is measured by the shareholding ratio of the first major shareholder.

3.2. Sample Selection and Data Sources
The companies of QFII shareholdings ratio between 5% and 10% and between 10% and 30% of Shanghai and Shenzhen A-share listed companies from 2008 to 2016 after the completion of China’s split-share structure reform are selected as research samples. And samples are selected as following principles. (1) Listed companies of finance & insurance are deleted. (2) Listed companies marked with ST and PT are removed. (3) Listed companies disclosing data not complying with the provisions and lacking relevant data are deleted. Finally, 183 listed companies are selected as research samples.

The data of QFII shareholdings ratio are calculated by authors according to QFII shares disclosed by Oriental Wealth (Data Centre). The data of corporate operating performances are obtained from RESSET database. The data of board governance, company size, type of control shareholders and degree of ownership concentration are obtained from CSMAR database and listed companies’ annual report.

4. Empirical Analysis and Results Discussion
Comprehensive factor score of corporate operating performances should be worked out by using principal component analysis before empirical analysis. And corporate operating performances are represented by the comprehensive factor score.

4.1. Model Formulation and Empirical Test
Based on theoretical study, empirical test model of mediating effect is built as follows.
\[ \text{Perf}_{i,t+1} = \beta_0 + \beta_1 \text{QFII}_{i,t} + \beta_2 \text{Size}_{i,t} + \beta_3 \text{State}_{i,t} + \beta_4 \text{Herf}_{i,t} + \varepsilon_{i,t} \]  
(1)

\[ \text{DSH}_{i,t+1} = \gamma_0 + \gamma_1 \text{QFII}_{i,t} + \gamma_2 \text{Size}_{i,t} + \gamma_3 \text{State}_{i,t} + \gamma_4 \text{Herf}_{i,t} + \varepsilon_{i,t} \]  
(2)

\[ \text{Perf}_{i,t+1} = \delta_0 + \delta_1 \text{QFII}_{i,t} + \delta_2 \text{DSH}_{i,t} + \delta_3 \text{Size}_{i,t} + \delta_4 \text{State}_{i,t} + \delta_5 \text{Herf}_{i,t} + \varepsilon_{i,t} \]  
(3)

Where \( \text{Perf} \) represents corporate operating performances; \( \text{QFII} \) represents QFII shareholdings ratio between 5% and 10%; \( \text{DSH} \) represents board governance; \( \text{Size} \) represents company size; \( \text{State} \) represents type of control shareholders; \( \text{Herf} \) represents degree of ownership concentration; \( a \) represents a random variable; and \( \varepsilon \) represents the stochastic error item; \( i=1, 2, 3 \ldots 183; t=2008, 2009 \ldots 2016 \).

### 4.2. Results Analysis

Following results are obtained from empirical analysis. The proportion of foreign directors is the mediating variable of QFII shareholdings ratio impacting corporate operating performances. The higher QFII shareholdings ratio is, the more the numbers of QFII in board, the greater discourse power for operation management of corporations, and the stronger the ability of participating in corporate governance.

Separation degree of ownership and management right of board is the mediating variable of QFII shareholdings ratio impacting corporate operating performances. The development experiences of QFII in Korea and Taiwan, China indicate that QFII shareholdings can balance major shareholders’ power and improve corporate operating performances (Sun and Lin, 2006). Because board director has ownership right and manager has management right, inevitably, managers will damage corporate interests in order to maintain the maximum of its own interests. Hence, QFII shareholdings will impact separation degree of ownership and management right of board, make two kinds of right body mutual monitoring, jointly promote the improvement of corporate governance structure and improve corporate operating performances.

President and general manager being one person or not is the mediating variable of QFII shareholdings ratio impacting corporate operating performances. This paper believes that the relationship between president and general manager is the supervision and being supervision. If president and general manager being one person will weaken the supervision effectiveness of board, cannot effectively perform the function of board, lead to the occurrence of opportunistic behavior of managers and damage corporate operating performances. Li (2015) empirical results indicate that president and general manager not being one person is beneficial to improve corporate performances. In addition, in order to maximize its own investment returns, QFII will actively participate in corporate governance through “voting by hand”. Hence, QFII shareholdings will actively supervise president and general manager being one person or not and improve corporate governance structure and corporate operating performances.

The proportion of independent directors is the mediating variable of QFII shareholdings ratio impacting corporate operating performances. The separation of ownership and management right inevitably results in principal-agency problem and produces agency cost and agency risk. In order to reduce agency cost and agency risk, the efficiency of managers should be improved and the problem of insider control should be prevented. Because independent directors are independent from corporate shareholders and have no business with the listed company. Independent directors can make relative objective and independent judgment on operating management decisions of the corporation, supervise the behavior of managers, promote the interests of managers and shareholders tend to be consistent, reduce agency cost and agency risk and improve corporate operating performances. In addition, in order to obtain more investment return, QFII will actively participate in corporate governance, increase the proportion of independent directors and improve corporate governance structure and corporate operating performances.

Senior managers’ shareholdings ratio is the mediating variable of QFII shareholdings ratio impacting corporate operating performances. Long-term equity incentive for senior managers can
make the interests of senior managers and the corporation tend to be consistent, which can promote the enthusiasm of senior managers and improve corporate operating performances. Zhou and Chen (2014) empirical results indicate that equity incentive of senior managers can significantly improve corporate performances. Because QFII has the motivation and ability of participating in corporate governance, QFII will supervise senior managers’ shareholdings ratio and improve corporate operating performances.

No. of “four committees” of board is not the mediating variable of QFII shareholdings ratio impacting corporate operating performances, mainly because the average No. of “four committees” of board of Chinese listed companies is close to four. Hence, QFII shareholding will not impact No. of “four committees” of board.

5. Conclusions and Policy Suggestions

5.1. Research Results
Empirical results of mediating effect indicate that the proportion of foreign directors, separation degree of ownership and management right, president and general manager being one person or not, proportion of independent directors and senior managers’ shareholdings ratio are all the mediating variables of QFII shareholdings ratio impacting corporate operating performances. However, No. of “four committees” of board is not the mediating variable of QFII shareholdings ratio impacting corporate operating performances.

5.2. Policy Suggestions
For the purpose of protecting domestic markets and domestic investors, Chinese government implements many restrictions on investment body, investment quota and shareholdings ratio of QFII, which makes the proportion of QFII in Chinese Shanghai and Shenzhen A-share markets be still lower. However, empirical results of this paper show that QFII shareholdings are beneficial to improve board governance and corporate operating performances. Hence, Chinese government should relax QFII subject restrictions of entering China, enlarge QFII investment quota, reduce the threshold on QFII and increase QFII shareholdings ratio. And Chinese government should strengthen the supervision of QFII, encourage long-term equity investment philosophy, restrict short-term investment behavior and prevent manipulative behavior by using information advantages of QFII.

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7. References
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