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The Impact of Ownership Structure on the Capital Structure of Chinese Listed Companies

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ABSTRACT
In corporate governance research, the relationship between ownership structure and capital structure has always been a key focus for scholars. A-share businesses that are listed on the stock exchanges in Shenzhen and Shanghai in 2023 were examined as the research object to explore the impact of the proportion of external block shareholder shareholdings and management shareholdings on corporate capital structure. This paper employs a fixed effects model for empirical analysis and further conducts subgroup regression analysis based on state-owned businesses and businesses that are not state-owned. The empirical results indicate that the external large shareholders' stock holding ratio has a significant impact on the capital structure of a company. However, the management's equity holding ratio has a significant influence on the long-term leverage ratio but has no significant effect on the overall leverage ratio. The findings of this study enrich the existing research on the relationship between ownership structure and capital structure, providing empirical evidence for corporate financing decisions and the optimization of governance structures for company directors.

KEYWORDS
Capital structure; Ownership structure; Managerial ownership; External block ownership

1 Introduction

Investments made in the past and the future determine the value of a company. Companies must choose a suitable finance structure, which refers to the explicit fusion of debt and equity to support organizations' operating and investment decisions, in order to provide enough funds for these investments [1]. Therefore, corporate financial decisions are crucial to the valuation of the company. In terms of capital structure, a company's future growth can be driven by an optimal capital structure. However, if management chooses poorly regarding the capital structure equilibrium, financial difficulties, which could result in bankruptcy, could materialize [2]. As a result, one of the main concerns for businesses is capital structure. Over the past few decades, significant progress has been made in the study of this area. Research on this topic covers multiple dimensions, including theory, the influence of determining factors, and the impact on corporate value. In addition, capital structure is influenced by ownership structure [3]. Moreover, in terms of ownership, the financial objectives of various shareholder groups vary. As a result, ownership has been cited in numerous studies as a key component of capital structure [4-5]. From a variety of perspectives, including capital concentration, management holdings, external ownership, state ownership, institutional holdings, and so on, the researchers examined the impact of the ownership structure [6-9]. Even though there's a substantial amount of empirical evidence, most of these focus on companies in developed countries. While there is some research on developing capital structures, there are still gaps. Additionally, these capital elements continue to be important determinants even in developing nations where institutional variables differ greatly [10]. However, the financing order of Chinese enterprises did not seem to conform to the pecking order theory, preferring retained earnings to be used first, followed by bond financing and equity financing [11-12]. This shows that although these associated theoretical studies are mostly universal across nations, further research is still needed to determine how these important elements affect the choice of capital structure under various systems.

Chinese enterprises are greatly influenced by national policies. Since 2002, most listed companies in China have been former state-owned enterprises [11]. As a result, Chinese enterprises have unique characteristics in terms of their equity structure. With the advancement of enterprise ownership reform, private investors gradually entered the market. The number of non-state-owned enterprises gradually increased. Therefore, Western theories on the impact of ownership on capital structure may not necessarily apply to Chinese enterprises. This essay examines whether China's ownership structure has an impact on corporate capital structure, providing new insights into the choice of corporate capital structure in non-Western environments. Since state-owned shares and institutional holdings have been studied extensively because of the characteristics of China's system, this essay will conduct relevant research on the shareholding ratio of external major shareholders and management shareholding.

There will be four sections in the article that follows. Section 2 reviews theoretical research related to capital structure and ownership. Section 3 will discuss methodology, data. Results and analysis will be discussed in Section 4. Section 5 will further demonstrate the impact of ownership on capital structure by distinguishing between state-owned companies and non-state-owned companies.

2 Review of literature

2.1 Capital structure theories

According to the M&M hypothesis, a company's capital structure has no bearing on its total value in a perfect market [13]. Capital structure has drawn substantial attention since this theory was put forth, while theoretical model research in this field has advanced [11]. Capital structure theory includes trade-off theory, agency cost theory, pecking order theory, market timing theory, and so on [3,12,14-15].

Since firms operate under diverse conditions, there is no universally applicable rule or exact calculation for defining their optimal capital structure. Each firm's financing mix is shaped by its own circumstances, such as the industry in which it works as well as its macro and microenvironments.

Studies have closely investigated how factors including ownership structure, profitability, growth opportunities, and asset collateral value affect capital structure from the standpoint of internal organizational characteristics [3,16]. External environmental issues also have an impact on firms. Economic cycles have a dynamic impact on their financing arrangements, which means that market forces influence financial decisions [1]. Based on the level of stock market valuations, businesses determine whether to participate in equity financing [15].

2.2 Ownership structure

According to agency theory, agency issues arise when managers and shareholders have competing interests. The agency cost theory suggests that management does not own all residual revenue rights. Therefore, they do not suffer the entire cost of corporate resource waste. As a result, managers may invest less effort in management. Additionally, management tends to avoid debt constraints. Self-interested management is more willing to control the company's free cash flow, which could result in excessive investment costs. To a certain degree, management stock ownership can alleviate these agency issues. Management shareholding is actually a form of equity incentive for listed companies. There are many studies on the value and behavior of companies influenced by management shareholding. However, the research conclusions on the effect of management shareholding on the capital structure of enterprises have not yet reached a consensus.

For the external major shareholders and the management team, their objectives and risk tolerance of them do not coincide [3]. Since management must take on the unavoidable risks related to the firm's wealth, they often exhibit higher levels of risk aversion relative to substantial outside investors. In response, managers may implement strategies aimed at reducing undiversifiable employment risks, thereby supporting the sustainability of the firm's operations. Reducing reliance on debt is an effective method for managers to mitigate these risks, as debt increases the company's bankruptcy risk [19]. It is implied that there might be a situation in which agents lower the company's debt below the optimal level, which might be detrimental to shareholder interests.

As a result, external major shareholders have a strong incentive to supervise management behaviors and influence corporate decision-making, ensuring that their own interests are protected. To alleviate the agency problem between management and external shareholders, external major shareholders tend to increase their shareholdings to influence decision-making and choose more debt financing.

Therefore, some researchers believe that the proportion of external ownership is positively correlated with the debt ratio of enterprises, as external major shareholders with high shareholding ratios have the right to force managers to choose a capital structure with higher debt, which may be a better capital structure. Businesses with external block owners typically have greater debt because debt can lower agency costs by forcing managers to give away free cash flows to investors rather than wasting them on low-return ventures. However, some studies have also proposed and confirmed that concentrated external shareholding has a substitution effect on the debt supervision of management.

Therefore, this essay proposes the following hypotheses:

(1) The management shareholding ratio is related to the capital structure of the company.

(2) The external big shareholders' shareholding ratio significantly affects the company's leverage.

3 Research methodology

3.1 Sample

This study utilized the annual report data of 2,048 Chinese listed companies from the SZES-A or SSE-A for the year 2023. The data was obtained from the CSMAR database. Since the circumstances of the financial industry differ from those of non-financial industries, the financial sector was excluded. Additionally, companies marked as ST or ST* were also excluded due to the risk of delisting or imminent delisting to avoid special cases influencing the results. Furthermore, companies with missing data in 2023 were excluded, and some independent variables with extreme values were

smoothed.

3.2 Data

Table 1 presents the maximum, minimum, average, and standard deviation values for the independent and dependent variables. Table 2 further demonstrates that multicollinearity is not a concern, since the correlation values across the independent, dependent, and control variables are relatively minor.

Table 1 Summary statistics [Owner-draw]

variable	Observations	Mean	S.D.	Minimum	Maximum
CON	2084	0.5400	0.1579	0.2035	0.9864
MO	2084	0.1058	0.1738	0.0000	0.8269
LEV	2084	0.4494	0.2003	0.0255	0.9882
LLEV	2084	0.0994	0.1104	0.0000	0.5965
PROF	2084	0.0568	0.0636	-0.5020	0.3796
SIZE	2084	22.8700	1.4460	19.2700	28.7000
GROWTH	2084	0.6540	5.7046	-24.6969	32.7877
TANG	2084	0.3421	0.1731	0.0009	0.8996
EVOL	2084	0.3078	0.4475	0.0024	3.0652
NDTS	2084	0.0202	0.0150	0.0001	0.1493

Table 2 Correlation matrix [Owner-draw]

	LEV	LLEV	EBO	MO	PROF	SIZE	GROWTH	TANG	EVOL	NDTS
LEV	1.00									
LLEV	.54***	1.00								
EBO	-.03	.07***	1.00							
MO	-.23***	-.16***	.11***	1.00						
PROF	-.21***	-.05**	.23***	.00	1.00					
SIZE	.44***	.41***	.23***	-.36***	.17***	1.00				
GROWTH	-.04**	-.08***	.01	.00	-.02	-.02	1.00			
TANG	.20***	.25***	.01	-.12***	.13***	.14***	-.02	1.00		
EVOL	.01	.06***	-.06***	-.05**	-.11***	-.05**	.00	.00	1.00	
NDTS	.01	.15***	-.06***	-.06***	.20***	.06***	-.03	.57***	-.04*	1.00

* Significant at 10% level.** Significant at 5% level.*** Significant at 1% level.

3.3 Variables

As the conceptual definition of capital structure is controversial, narrow capital structure emphasizes the function of long-term debt, while broad capital structure considers the functions of long-term and short-term debt to be similar. This paper defines independent variables as the overall leverage and the long-term leverage [11]. The independent variables are the management shareholding ratio and the top 5 shareholding ratio. The external major shareholder ownership ratio is represented by the top 5 shareholder ownership ratios [7]. The management ownership ratio is defined as the board members' ownership ratio [23]. Although it is impossible to completely rule out the possibility of management shareholding within the top 5 shareholder shareholding ratio due to information constraints, the probability of this is very low. Furthermore, if the results are still significant, this would make the results more credible [7]. Table 3 indicates the measurements of all variables of this essay.

Table 3 Measurements of varibles [Owner-draw]

Varibles	
Dependent varibles	
Overall leverage (LEV)	Ratio of book value total debt to total assets
Long-term leverage (LLEV)	Ratio of book value of long-term debt to total assets
Independent varibles	
External block ownership (EBO)	The proportion of share ownership of top five largest shareholders
Management ownership (MO)	The proportion of shares held by board members to that held by total shareholders
Control varibles	
Profitability (PROFIT)	Ratio of earnings before interest, tax and depreciation to total assets
Size (SIZE)	Logarithm of total assets
Growth opportunities (GROWTH)	Sales growth/total asset growth
Asset structure (TANG)	Ratio of tangible assets
Earning volatility (EVOL)	Absolute value of the first difference of percentage change of operating income
Tax shields effects (NDTS)	Ratio of depreciation to total assets

3.4 The model

$$Overallleverage = \beta_0 + \beta_1 Profitability_i + \beta_2 Size_i + \beta_3 Growth\ opportunities_i + \beta_4 Asset\ structure_i + \beta_5 Cost\ of\ financial\ distress_i + \beta_6 Tax\ shields\ \ effects_i + \beta_7 external\ block\ ownership_i + \beta_8 managerial\ ownership_i + factor(industry) + u_i$$

$$Long-term\ leverage = \beta_0 + \beta_1 Profitability_i + \beta_2 Size_i + \beta_3 Growth\ opportunities_i + \beta_4 Asset\ structure_i + \beta_5 Cost\ of\ financial\ distress_i + \beta_6 Tax\ shields\ \ effects_i + \beta_7 external\ block\ ownership_i + \beta_8 managerial\ ownership_i + factor(industry) + u_i$$

4 Results and Analysis

4.1 Results

The data indicate that the equity share of outside large shareholders and the total leverage ratio have a substantially negative association (Table 4). Table 5 demonstrates that the long-term leverage is significantly impacted by the ratio of management's shareholding and that of external large shareholders.

Table 4 The estimators of LEV equation [Owner-draw]

Dependent varible: LEV	
Independent varibles	Fixed effects
EBO	-0.0010
	(0.0002)***
MO	-0.0218
	(0.0225)
PROF	-0.8990
	(0.0602)***
SIZE	0.0584
	(0.0029)***
GROWTH	-0.0008
	(0.0006)
TANG	0.2657
	(0.0286)***
EVOL	-0.0113
	(0.0082)
NDTS	-0.4429
	(0.3313)
_CONS	-0.7286
	(0.0826)***
No. of observations	2084
R^2	0.4364
Adjusted-R^2	0.4133
F statistic	18.9
Probability > F	(.0000)

Standard errors in parentheses are for coefficient
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.
Standard errors in parentheses are for coefficient
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

4.2 Analysis

4.2.1 External Block Ownership

From Table 3, External large ownership evidently has a substantial detrimental effect on the overall leverage. Moreover, there is a significant negative influence between it and the long-term leverage ratio. This conclusion is opposite to what previous research argued, which is that companies with external block shareholders generally adopt higher debt financing [19]. However, the results verify the alternative effect of shareholder supervision and debt supervision [22]. Debt is

Table 5 The estimators of LLEV equation [Owner-draw]

Dependent varible: LLEV	
Independent varibles	Fixed effects
EBO	-0.0002
	(0.0001)*
MO	0.0410
	(0.0124)***
PROF	-0.2634
	(0.0333)***
SIZE	0.0269
	(0.0016)***
GROWTH	-0.0008
	(0.0003)**
TANG	0.0833
	(0.0158)***
EVOL	0.0061
	(0.0045)
NDTS	0.2102
	(0.1832)
_CONS	-0.5020
	(0.0456)***
No. of observations	2084
R^2	0.4335
Adjusted-R^2	0.4103
F statistic	18.67
Probability > F	(.0000)

frequently used by businesses with widely distributed ownership structures to monitor management and minimize managerial opportunism [11]. It is not necessary for companies with large external shareholders to choose more debt financing in order to exert control over their managers. External shareholders' interests become more directly linked to the company's success as their shareholdings grow, which increases their motivation and provides them with more authority to oversee and manage management. Another explanation could be that shareholders prefer dividends to capital gains [24]. A steady dividend each year is preferred by many stockholders. Significant interest costs must be paid annually if a company's overall debt is excessive. It implies that the high interest rates may take up a significant portion of cash flow, making it impossible for the corporations to pay dividends to shareholders promptly. Therefore, shareholders may want less debt to ensure a consistent dividend. In addition, companies with a high proportion of external major shareholder holdings may have potential threats and other moral hazards, such as the major shareholder looting effect [25]. This may increase the bank ' s supervision costs and credit risk, thereby increasing the company's debt costs [26]. Therefore, when the proportion of this is high, companies may also choose to reduce corporate debt financing.

4.2.2 Managerial ownership

According to the regression results, there is a substantial positive correlation between long-term debt financing and management ownership. Nevertheless, the link with the overall leverage ratio is statistically insignificant. These imply that the percentage of shares held by management has a more pronounced effect on long-term capital structure choices, while the short-term liabilities, which are incorporated into the leverage, may mask this effect on the capital structure decisions. It means that even though the shares of many Chinese firms are mostly held directly or indirectly by the state, when management holds a larger share of the equity, firms are still more likely to prefer long-term debt financing. This seems to confirm the earlier point that management shareholding can mitigate agency problems, reducing the likelihood that management will choose a suboptimal leverage level to evade debt constraints [3]. This outcome also supports existing empirical evidence showing that there is a high degree of positive correlation between long-term leverage and the level of managerial shareholding[27]. This is due to the fact that debt financing can raise the value of the business without taking away management's ability to vote. It can also lessen the possibility that the company will be acquired, which is advantageous to managers.

5 Subgroup analysis

From Table 6, the shareholding ratio of external block shareholders has a notable effect on the total leverage ratio of companies, both in state-controlled businesses and non-state-owned enterprises. This indicates that external major

shareholder holdings have a considerable influence on the total leverage ratio of Chinese enterprises. It is worth noting that there is no obvious relationship between the proportion of external major shareholder holdings in state-owned enterprises and long-term loans. However, in non-state-owned enterprises, it exhibits a statistically meaningful negative relationship with the long-term liability ratio. Moreover, the shareholding ratio of management is only significant for the long-term leverage of non-state-owned enterprises (Table 7). This suggests that corporate ownership in state-owned enterprises is not a decisive factor in the choice of long-term finance, which may be due to China's unique political system. State-owned enterprises dominate the Chinese stock market, which is supported by state-owned banks[4]. The choice of long-term finance by state-owned enterprises may be more influenced by the government, possibly involving government policies or national projects. Therefore, the influence of external major shareholders or management on corporate financing decisions is relatively limited. The corporate governance structure of SOEs, inherited from the public ownership system, has deficiencies. Therefore, short-term loans are more advantageous for supervision and control [11]. The results indicate that SOEs still rely more on short-term loans (Table 1). Moreover, the influence of corporate ownership on long-term loans is limited.

For non-SOEs, capital markets are not well-developed in China [28]. Due to policy, state-owned banks appear willing to offer long-term debt to businesses. However, their lending capability is actually restricted. Compared with enterprises under state ownership, non-state-owned enterprises do not enjoy special support from the government and financial institutions, making it more difficult for them to obtain long-term loans. With such limited external financing, the long-term debt financing of non-state-owned enterprises is less affected by policy factors. The ownership structure of an enterprise may have a more significant impact on its long-term debt financing decisions.

Table 6 Subgroup analysis of LEV [Owner-draw]

Dependent varible: LEV		
Independent varibles	State-owned enterprises	Non-state-owned enterprises
EBO	-0.0015	-0.0009
	(0.0004)***	(0.0003)***
MO	0.0170	0.0240
	(0.1793)	(0.0257)
PROF	-1.2539	-0.7617
	(0.0948)***	(0.0781)***
SIZE	0.0513	0.0668
	(0.0042)***	(0.0042)***
GROWTH	-0.0005	0.0000
	(0.0008)	(0.0009)
TANG	0.1810	0.3166
	(0.0396)***	(0.0403)***
EVOL	0.0230	-0.0389
	(0.0118)*	(0.0113)***
NDTS	-0.4360	-0.1393
	(0.4443)	(0.4751)
_CONS	-0.5255	-1.156
	(0.1027)***	(0.1810)***
No. of observations	873	1211
R^2	0.5046	0.4206
Adjusted-R^2	0.4607	0.3829
F statistic	11.49	11.14
Probability > F	(.0000)	(.0000)

Standard errors in parentheses are for coefficient
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.
Standard errors in parentheses are for coefficient
* Significant at 10% level.
** Significant at 5% level.
*** Significant at 1% level.

Table 7 Subgroup analysis of LLEV [Owner-draw]

Dependent varible: LLEV		
Independent varibles	State-owned enterprises	Non-state-owned enterprises
EBO	-0.0003	-0,0003
	(0.0002)	(0.0000)**
MO	0.0713	0.0250
	(0.1132)	(0.0130)*
PROF	-0.4022	-0.2141
	(0.0599)***	(0.0394)***
SIZE	0.0303	0.0250
	(0.0027)***	(0.0021)***
GROWTH	-0.0005	-0.0007
	(0.0005)	(0.0005)
TANG	0.0874	0.0604
	(0.0250)***	(0.0203)***
EVOL	0.0211	-0.0074
	(0.0074)***	(0.0057)
NDTS	-0.3576	0.7612
	(0.2805)	(0.2395)***
_CONS	-0.5710	-0.5812
	(0.0649)	(0.0913)***
No. of observations	873	1211
R^2	0.5583	0.3229
Adjusted-R^2	0.5192	0.2788
F statistic	14.26	7.322
Probability > F	(.0000)	(.0000)

6 Conclusion

Based on the data analysis of companies listed on the SEZE-A and SSE-A markets in 2023, this research explores the association between corporate ownership structure and capital structure decisions. According to the model analysis, the research findings indicate that management shareholding has a significant positive effect on long-term leverage, while the external block ownership has a significant negative impact on both total leverage and long-term leverage. In state-owned enterprises, corporate ownership has little to no explanatory power for the long-term leverage. However, management and external major shareholders have a significant influence on the selection of long-term bonds in non-state-owned enterprises. This study enriches the analysis of China's capital structure. Additionally, it suggests that some theories and factors regarding capital structure in Western capitalist countries are equally applicable to Chinese enterprises. However, there appears to be some controversy regarding the role of external major shareholders in adjusting capital structure, which may be due to the unique characteristics and differences in China's political system, corporate governance, and market environment.

This paper still has some limitations. Firstly, the sample size is insufficient. This paper only used cross-sectional data from 2023, which makes it difficult to reveal the long-term relationship between corporate ownership and capital structure. Data from multiple years for further analysis could be used in future research. Additionally, the conclusions of this study are only applicable to A-share listed businesses on the Shanghai and Shenzhen stock exchanges in China, which may not be totally applicable to non-listed companies or companies in other countries and regions. Second, there exists variability in the definitions of the shareholding ratios related to both external major shareholders and management. Different measurement methods may yield differing results. For instance, the equity holdings of management are proxied by board member equity holdings, which fail to contain and show more dimensions, such as equity incentive plans or individual executive equity holdings. Moreover, companies were simply divided into SOE-type and non-SOE-type based on the text data provided by CSMAR. However, there are some mixed-ownership enterprises whose nature is difficult to categorize completely in China's capital market, which may affect the accuracy of the subgroup analysis. In terms of methodology, although a fixed-effects model was used to control for some unobservable factors, it still failed to fully address the potential endogeneity issues between ownership structure and capital structure. Future research could further explore these issues from dynamic perspectives, through data for a longer period of time, indicator diversification, endogeneity treatment, and cross-market comparisons.

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