

CITY UNIVERSITY OF HONG KONG

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Does a Dual-class Share Ownership Structure
Exacerbate Earnings Management Activities?
Empirical Analysis of Chinese Companies Listed on
US Public Markets

雙重股權結構會否加劇盈餘管理行為？
以美國上市的中資公司作實證研究

Submitted to
College of Business

商學院

in Partial Fulfillment of the Requirements
for the Degree of Doctor of Business Administration

工商管理學博士學位

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August 2021

二零二一年八月

Abstract

The emergence and development of the dual-class ownership structure of company stocks has received mixed comments in the literature, reflecting its conspicuous advantages and disadvantages. Its central advantage for companies is that managers can raise funds from the capital market without diluting corporate control and protect the company from the acquisition of control by shareholders and other market players. The main disadvantage from the perspective of public investors and regulators is that under the reduced pressure of mergers and acquisitions and ineffective supervision of the board of directors, company founders and top executives may infringe on the interests of public investors and abuse their controlling power for personal gain. This opportunistic behaviour may create agency problems between the controlling shareholders and outside shareholders and facilitate managers to engage more in earnings management activities.

This dissertation focuses on the correlation between the dual-class structure and earnings management activities by analysing and comparing the general statistical characteristics of single-class and dual-class Chinese companies participating in US public markets from 2007 to 2019. An empirical test is conducted with descriptive statistical analysis and multiple regression analysis. The sample includes 27,368 records from 220 US-listed Chinese Concept Stocks, including 50 with a dual-class structure. The results show that (1) the overall

average earnings management level of Chinese dual-class firms is higher than that of Chinese single-class firms; (2) based on the regression results for Chinese dual-class firms, voting rights have a positive correlation with both discretionary accruals and real earnings management; (3) based on the regression results for Chinese dual-class firms, cash flow rights have a negative correlation with both discretionary accruals and real earnings management; and (4) combining the positive impact of the voting rights ratio and the negative impact of the cash flow rights ratio shows that the greater the wedge between the two rights, the higher the magnitude of earnings management. In prior studies, dual-class structure does have correlation with earnings management, but the direction varies. Some studies show negative correlation and some show positive. By using Chinese concept stocks listed in US as samples, this dissertation shows the four findings which indicate that the dual-class structure has a positive correlation with earnings management and is likely to exacerbate earnings management activities. Furthermore, some related findings emerge from the study: (5) the higher the stability of an industry, the lower the earnings management levels, and vice versa; and (6) the average level of earnings management has a positive relationship with the prosperity of the stock market.