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However, founding-family ownership can largely mitigate the tunnelling effect of controlling shareholder while privately controlled firms through taking-over from former State owned firms tends to facilitate the tunnelling effect of controlling shareholder through its political connections.

Keywords

Political, connections, founding, family, ownership, leverage, decision, privately, owned, firms

Disciplines

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Political Connections, Founding family ownership and Leverage Decision of privately owned Firms

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Abstract

In this paper, we examine the effect of political connections versus founding family ownership on the relationship between disproportional ownership structure and leverage decisions of privately owned firms listed in Chinese market. We find that disproportional ownership has positive effect on leverage, indicating that controlling shareholder tends to use both disproportional ownership structure and debt to expropriate. We also find that the interacted term between disproportional ownership and political connections has a positive impact on leverage ratio, and disproportional ownership structure is negatively related with leverage ratio of founding-family controlled firms, which indicate a substitute effect between political connections and founding-family ownership for the impact of disproportional ownership on leverage ratio. Finally, we provide evidence that controlling shareholder of firms with disproportional ownership structure tends to use more related party loans for tunnelling. We argue that under China's weak creditor protection institutions, political connections of chairman or CEO provide better access to financing for private-owned firms, but also provide excess external resources for controlling shareholder to expropriate.

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However, founding-family ownership can largely mitigate the tunnelling effect of controlling shareholder while privately controlled firms through taking-over from former State owned firms tends to facilitate the tunnelling effect of controlling shareholder through its political connections.

Key words: disproportional ownership structure; political connections; leverage decision; founding-family ownership

JEL Classification: G32, G34

1. Introduction

Prior researches on the effect of disproportional ownership often focus on the relationship between disproportional ownership structure and firm value (e.g., Claessens et al., 2002; Maury and Pajuste, 2004; Bennedsen and Nielsen, 2006; Gompers et al., 2009). There are also literatures that investigate the impact of disproportional ownership on firm's financing decisions in recent years. For example, Du and Dai (2005) find that the separation between cash flow rights and control rights is positively associated with corporate leverage, due to the non-dilution entrenchment effect, by investigating a sample of nine East Asia economies before the Asian financial crisis in 1997; Faccio et al., (2010) find that controlling shareholder tends to use both pyramiding and leverage to expand the resources to facilitate tunnelling when the creditor protection is weak. In addition, prior studies also indicate that political connections help firms' access to external financing resources such as bank loans, especially for private-owned firms (Khwaja and Mian, 2005; Faccio, 2006; Faccio et al., 2006). Moreover, studies also show that founding family ownership can reduce the agency conflicts between equity and debt claimants (Anderson et al., 2003), and founding-family firms perform better than nonfamily firms (Anderson and Reeb, 2003). However, no current literature links the effect of disproportional ownership structure, political connections and family ownership on firm's leverage decisions, especially their impact on tunnelling of controlling shareholder. Particularly, given that political connections and founding-family ownership may influence firms' access to external resources and agency conflicts between controlling shareholder and external investors, prior literature provide no evidence on whether they dampen or facilitate expropriation of ultimate controlling shareholders. In this paper, we attempt to link the three research areas and examine their impact on leverage and expropriation of controlling shareholder by using privately owned firms listed in Chinese capital market.

We conduct our research using a sample of Chinese private firms for the following reasons. First, since the late 1970s, when Chinese government introduced the economic reforms, private business has advanced and grown rapidly. According to 2009 China Statistical Yearbook, about two third of Chinese GDP was produced by private owned firms (China Statistical Yearbook, 2009). Previous studies on Chinese firms often focus on the agency costs of State-Owned Enterprises (SOEs), where the agency costs mainly stem from the

different objectives of the government and the firms (e.g., Lin et al., 1998; Fan et al., 2007; Rousseau and Xiao, 2007). It is important to investigate the agency conflicts of private-owned firms in Chinese capital market because around the world, the proportion of publicly listed family firms far exceeds that of state-owned firms, as shown by La Porta et al., (1999), Claessens et al. (2000) and Faccio and Lang (2002). Therefore, the results from these privately controlled firms can not only enrich the current literature but also provide more relevant and comparable implication to most of other countries where private sector dominates their economy.

Second, due to history reasons, private-owned firms in Chinese capital market can be classified into two types, which are founding-family controlled firms that are ultimately controlled by entrepreneurs and go public through IPOs, and non-founding-family controlled firms that are transformed from former SOEs and go public through mergers and acquisitions. It is argued that the incentive structure of founding-family firms may differs from that of non-founding-family firms (e.g., Demsetz and Lehn, 1985; Stein, 1988, 1989; Burkart etal., 2002; Anderson et al., 2002; Anderson and Reeb, 2003; Anderson et al., 2003), so investigating the agency cost of Chinese private-owned firms also provide implications to see whether entrepreneurs or the non-entrepreneurs have higher incentive to use leverage and expropriate.

Third, a distinct feature of China that differs with other transition economy is the continuing rule of the Communist Party and the continuing ideological discrimination against private ownership, despite the dramatic reform of the economy (Li et al., 2006). Therefore, political connections in China may be even more important than other countries. Previous studies also indicate that political connections have an important influence on firm value and performance (e.g., Faccio, 2006; Fan et al., 2007; Li et al., 2008; Wu et al., 2010). Therefore, China provides a unique dataset to see the impact of political connections on tunnelling activities of controlling shareholders through leveraging.

Forth, the tunnelling incentive of controlling shareholder in Chinese private firms is more likely to be influenced by political connections and founding-family ownership. Political connections could play different role in founding-family and non-founding-family controlled firms. In non-founding-family controlled firms, political connections are grabbling hands of the tunnelling behaviour of controlling shareholder, this is because that 1) political connections help controlling shareholder of non-founding-family controlled firms to get the

control right over the former SOEs. Particularly, with the process of China's gradual reform, state ownership gradually retreats from some competitive industries, and a number of former SOEs (usually the SOEs controlled by local government) become private owned firms (non-founding-family controlled firms) through MBO or mergers and acquisitions in recent years (Chow, 2007). Usually the government decides who can get the control right over the former SOEs, so usually the potential buyer who has political connections finally get the control right over the former SOEs with relatively low price. 2) Political connections in those non-founding-family controlled firms mainly inherited from the former SOEs, this is because those firms are privatized through taking over from those state owned firms where they normally had political connected CEO from government offices. Therefore, controlling shareholder of non-founding-family controlled firms may have stronger incentive to tunnelling because they are eagle to convert the former "state assets" to "private assets", and political connections facilitate this tunnelling. These tunnelling also results in a huge state asset losses in China in recent years, it is estimated that there are 1,400 billion Yuan state assets losses since the early 1980s (State-owned Assets Supervision and Administration Commission Report).Unlike the case in non-founding-family controlled firms, in founding-family controlled firms, political connections may be newly established by recruiting some politically connected person for the purpose of accessing financial resources. Founding families may have less incentive to tunnelling because the interest of founding families are always align with the firms and the founding families tend to concern more about their long-term interest in the firm (Anderson et al., 2003). In short, compared with the founding families, controlling shareholder of non-founding-family controlled firms could have more incentive to expropriate, and political connections facilitate this tunnelling.

A typical example is the recent case of Jian Long Group's taking over Tong Gang Group in China. "Jian Long Group" is a privately controlled firm who has strong political connections in China. Since 1999, the "Jian Long Group" has acquired the ownership of several former state-owned steel companies with relatively low prices. In 2005, "Jian Long Group" obtained the control right over "Tong Gang Group", which is the largest State owned steel company in Jilin province. However, after tunnelling Tong Gang Mine, which is the most valuable subsidiary of "Tong Gang Group", and transforming huge operation loss to "Tong Gang Group", "Jian Long Group" retreated from "Tong Gang Group" in 2008 because the price of steel products fell down sharply due to global financial crisis. Then in 2009, "Jian Long Group" went back, and got the control right again because the steel products price recovered

dramatically in China. The reason for the success taking over by Jian Long Group twice is its strong political connections. But this time, the tunnelling behaviour of "Jian Long Group" irritates the employees of "Tong Gang Group", they killed Chen Guojun, the CEO from "Jian Long Group" in July 2009. In order to ease the social destabilisation, the provincial government, the ultimate owner of Tong Gang Group, interfered and stopped the whole taking over process of "Jian Long Group" over "Tong Gang Group". (http://baike.baidu.com/view/2675039.htm). (See Figure 1)

Another important feature of the tunnelling behaviour of controlling shareholder in China is that the ways that controlling shareholder used to tunnelling are also more complex than those in other economies. For example, as documented by Jiang et al. (2010), Chinese firms often use more related party loans which is recorded as "other receivables" in firm's balance sheet. This is because most of private firms in China are controlled by the controlling shareholder through complex pyramid structures. On the other hand, different from other economies, the controlling shareholder in China tends to spin-off part of its assets to go public. As a result, most of listed firms in China have a large number of related parties, which are ultimately controlled by the same controlling shareholder. There are usually lots of transactions between the listed firms and their related parties, so the controlling shareholder can easily occupy funds of the listed firms through related party loans. Therefore, the disproportional ownership structure may also facilitate the tunnelling of controlling shareholder, especially when the controlling shareholder chooses to tunnelling through related party loans.

This paper makes three major contributions to current literature: first, while previous studies often examine the effect of disproportional ownership structure and political connections on firm value or performance respectively, this paper links the two areas and investigates their impact on firm leverage decisions, using a sample of private-owned firms from Chinese capital market. To the best of our knowledge, this is the first paper that investigating this issue. Second, this paper further examines the effect of disproportional ownership structure on tunnelling behaviour of Chinese private-owned firms, by using related party loans as a new measure of tunnelling, thus this paper identifies an important channel through which the agency costs affect firm value. Third, this paper compares agency cost of disproportional ownership between founding-family controlled firms and non-founding family controlled

firms, which extend the existing literature that mainly focus on the comparison between founding family controlled firms and rest listed firms.

Using our full sample of Chinese private-owned firms, we find that disproportional ownership structure and political connections are positively associated with leverage, while founding-family ownership is negatively associated with leverage. We further find that the interaction between disproportional ownership structure and political connections are also positively associated with leverage. These results indicate that controlling shareholders of Chinese private-owned firms tend to use both disproportional ownership structure and debt to expand resources they controlled, and to expropriate the external investors and creditors, while political connections facilitate the tunnelling of controlling shareholder.

By investigating whether disproportional ownership structure and political connections have different impact on leverage between founding-family controlled firms and non-founding-family controlled firms, we find that disproportional ownership structure is negatively associated with leverage of family controlled firms, indicating that founding families have less incentive to control more resources to tunnelling.

Finally, we find that the interacted term between disproportional ownership structure and regional creditor protection index is negatively associated with firm leverage, suggesting that better creditor protection could effectively reduce the tunnelling incentive of controlling shareholder. We also find that disproportional ownership structure and the interacted term of disproportional ownership structure and political connections both have a positive relationship related party loans, which indicates that both disproportional ownership structure and political connections facilitate the tunnelling of controlling shareholder.

The remainder of this paper is organized as follows: section 2 presents literature reviews and develops several testable hypotheses. Section 3 describes how the variables are measured and what methodology was chosen. Section 4 presents our main empirical results and interpretation. Lastly, section 5 summarizes the main conclusions of the research.

2. Literature Review and Institutional Background

2.1 Literature Review

2.1.1 The Impact of disproportional ownership structure on firm leverage

After the seminal paper of Classens et al. (2000) that identify the pyramid structure and cross-holding as firms' major organizational forms to separate their ownership and control in eight East Asian economies, a number of prior studies have estimated the effect of disproportional ownership structure on firm value (Claessens et al., 2002; Lins, 2003; Maury and Pajuste, 2004; Gompers et al., 2009). Although the estimates of these studies range widely, these researches often find that the separation of cash flow rights and control rights decreases firm value. Another important literature that examines the agency cost of disproportional ownership structure is to link the separation of cash flow rights and control rights to firm's cost of borrowing. For example, Aslan and Kumar (2009), and Lin et al. (2009) both find that the divergence between cash flow rights and control rights is associated with a higher cost of borrowing. Overall, all the above literature indicate that disproportional ownership structure increases firm's agency costs and reduces firm value. Considering the effect of disproportional ownership structure on firm's leverage ratio, Du and Dai (2005) find that the separation of cash flow rights and control rights is positively associated with leverage ratio due to the non-dilution effect, while Faccio et al. (2010) find a negative relationship between ownership control ratio (O/C) and leverage when the creditor protection system is weak. They argue that in firms with a weak creditor protection system, controlling shareholder tends to use both disproportional ownership structure and debt to expand control of resources, and also to facilitate tunnelling.

2.1.2 Disproportional ownership structure and tunnelling of controlling shareholders

Johnson et al. (2000) first define "tunnelling" as "the transfer of resources out of a company to its controlling shareholder." They also propose some channels of "tunnelling", for example, asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, and so on. After that, a number of studies analysed the effect of tunnelling by linking disproportional ownership structure to related party transactions. For example, Cheung et al. (2006) investigates the connected party transactions in Hong Kong during 1998-2000.They find that the announcing of connected party transactions is associated with a negative excess returns, and they argue that investors just have limited evidence that firms undertaking connected party transactions trade at a discounted valuation. Xiao and Zhao (2009) also find that the divergence between cash flow rights and control rights is negatively associated with

firm value, and the stock returns decrease around the connected party transaction announcements, by using a sample of Chinese private-owned firms during 2002-2007. In addition, Jiang et al. (2010) find that under during the period of 1996 to 2006, the divergence of cash flow rights and control rights is positively associated with tunnelling of controlling shareholder, by using related party loans as measures of tunnelling of controlling shareholder.

2.1.3 Political connections and firm leverage decision

The value of political connections has been widely studied in recent literature. Prior studies show that political connections help firms to secure favourable regulatory conditions (Agrawal and Knoeber, 2001) and access to external financial resources such as bank loans (Khwaja and Mian, 2005; Faccio, 2006; Adhikari et al., 2006; Claessens et al., 2008), which ultimately increases the value of firms (Roberts, 1990; Fisman, 2001; Ramalho, 2007) or improves their performance (Johnson and Mitton, 2003). In particular, there are also studies investigating the role of political connections in China, but the results are mixed. Fan et al. (2008), Francis et al. (2009), Li et al. (2008) find that political connections in China have positive effect on firm value. While Fan et al. (2007) find that listed firms in China with politically connected CEOs underperform those without connected CEOs. In addition, Wu et al. (2010) show that private firms with political connections have higher value, while local state-owned enterprises with political connections have lower value.

2.1.4 Family controlled firms and Disproportional ownership

Prior studies indicate that founding families tend to concern more about their long-term interest in the firm, so the interest of founding-families are usually consistent with the firms. For example, James (1999) shows how founding family ownership provides incentives to invest according to the market rule (i.e., positive NPV projects) and suggests that founding-family-controlled firm usually invest more efficiently than nonfamily firms because the family intends to pass the firms onto succeeding generations by demonstrating a two-period model. Casson (1999) and Chami (1999) provide further evidence to the argument of James (1999) by showing that founding-families tend to view the firms as an asset to pass on to their descendants rather than wealth to consume during their lifetimes, so founding families are usually long-term value maximization advocates. Considering the economic consequence of founding family ownership, Anderson et al. (2003) show that founding family firms have incentive structures that result in fewer agency conflicts between equity and debt claimants,

so one consequence of families maintaining a long-term presence is that the firm will enjoy a lower cost of debt financing compared to non-family firms. Therefore founding-family-owned firms performed better than non-founding-family firms (Anderson and Reeb, 2003).

2.2 Salient feature of Chinese private-owned firms

Historically, firms in China are almost fully owned by the central and local governments. Since the economic reform in 1978 particularly the establishment of two stok exchange markets in early 1990s, the percentage of ownership of firm owned by the government has been reduced markedly and private business in China has advanced and grown rapidly. In the year end of 2009, about 40 percent of Chinese A-share firms are ultimately controlled by private sectors. The emergence of private-owned firms in Chinese capital market follows two ways: 1) in the process of China's SOEs reform, some private entities or individuals have become the controlling shareholder in many listed firms through mergers and acquisitions (Chow, 2007). These are non-founding-family controlled firms; 2) since the setting up of the capital markets, a increasing number of entrepreneurs bring their businesses public by issuing shares in these two stock markets. These are the founding-family controlled firms.

However, private-owned firms in China have suffered both political and social discrimination. Due to ideological reasons, private firms in China are always considered as an inferior form of ownership, the political environment was antagonistic toward the private sector (Li et al., 2008). In addition, the economic environment in China is also unfavourable to private firms. Particularly, Chinese government still controls most of the resources, and SOEs still enjoy preferential status in obtaining bank loans, especially the bank loans from the state-owned commercial banks (Che, 2002; Brandt and Li, 2003). On the other hand, the purpose of the establishment of both the Shanghai and Shenzhen stock exchanges in the early 1990s is to help revitalization and refinance its ailing state owned enterprises (SOEs) and to help to instill some elements of market discipline on top management (Firth et al., 2010). Compared to the SOEs, it is more difficult for the private-owned firms to get chance to raise capital through initial public offering or seasonal issuing. Under this circumstance, political connections become important for the private-owned firm's access to external financial resources for both bank loans and issuing equity.

Furthermore, private-owned firms in China are conducive to tunnelling for the following reasons. 1). Most the private-owned firms listed in Chinese capital market have concentrated

ownership structure with a largest controlling shareholder and many minority small shareholders. 2). Due to lack of access to external funds, ultimate shareholder of private firms in China tends to use pyramid ownership structure to create internal capital markets that help relieving their external financing constraints (Fan et al., 2005). 3). Creditor and minority investor protection system in China is still weak. For example, China does not provide comprehensive laws and regulations regarding external investors, or cannot effectively implement the existing laws of administrating operation of the corporate or securities markets (Kaoto and Long, 2005). At the same time, listed firms in China face few external governance mechanisms (such as takeovers or other forms of investor activism) that might monitor the tunnelling behaviour of controlling shareholder effectively. Institutional ownership, particularly by mutual funds, is also low among Chinese firms (Jiang et al., 2010).

2.4Hypothesis development

Based on the forgoing analysis, in this subsection, we develop our main hypotheses considering the relationship between disproportional ownership structure, political connections and leverage decision of Chinese private-owned firms, with particular focus on the institutional environment in which private firms have grown up and the salient feature of Chinese private-owned firms.

The influence of disproportional ownership structure (the divergence between cash flow rights and control rights of ultimate shareholder) on firm leverage is expected to be positive because as stated by Faccio et al. (2010) both disproportional ownership structure and higher leverage allows the controlling shareholder to control more resources without diluting his or her control over the firm. So pyramiding and debt should be substitutes, that is, great leverage should be associated with less pyramiding. However, they further find that controlling shareholder tends to use both higher leverage and disproportional ownership structure to expropriate resources from debtors and minority shareholders or to exploit new investment when the creditor protection system is weak. As discussed above, due to China's specific institutions, controlling shareholder of Chinese private-owned firms may have strong incentive to use both disproportional ownership structure and leverage to expropriate. Hence, we develop the following hypothesis:

H1a: The divergence between cash flow rights and control rights of controlling shareholder is positively related with leverage ratio of Chinese private-owned firms.

In addition, we expect that entrepreneurs may have less incentive to tunnelling because founding families may concern more about their long-term interest in the firm (James, 1999; Casson, 1999; Chami, 1999), and founding-family ownership may reduce the agency conflicts between controlling shareholder and minority shareholders effectively (Anderson et al., 2003; Anderson and Reeb, 2003). Therefore, we expect that founding-family controlled firms with a disproportional ownership structure should have a lower leverage ratio. Thus, we propose the following hypothesis:

H1b: The divergence between cash flow rights and control rights of controlling shareholder is negatively related with leverage ratio of Chinese entrepreneur controlled firms.

As discussed in above sections, prior literature shows that political connections help firms to secure favourable regulatory conditions (Agrawal and Knoeber, 2001) and access to external financial resources such as bank loans (Khwaja and Mian, 2005; Faccio, 2006; Adhikari et al., 2006; Claessens et al., 2008). We expect the positive effect of political connections on firm's access to external financial resources also exists for Chinese private-owned firms, due to the political and social discrimination faced by private-owned firms in China. Thus, we propose the following hypothesis:

H2a: Political connections are positively associated with leverage ratio of Chinese private-owned firms.

On the other hand, we expect that political connections strengthen the positive impact of disproportional ownership structure on leverage. In other word, political connections are grabbing hands for controlling shareholder to expropriate. This is because political connections provide more excess external financial resources, which expands the resources controlled by controlling shareholder without the dilution of his/her control rights (Faccio et ak., 2010). Furthermore, the positive effect of political connections on the relationship between disproportional ownership structure and leverage should be more important when the separation between cash flow rights and control rights is high. Particularly, it is argued that firms with larger divergence between cash flow rights and control rights usually have higher agency conflicts and face higher borrowing cost (Aslan and Kumar, 2009; Lin et al., 2009), so the controlling shareholder tends to depend on political connections to expand the resources they controlled. So we further expect that the interaction of disproportional

ownership structure and political connections are positively associated with firm leverage. Thus, we propose the following hypotheses:

H2b: the interaction of political connections and the divergence of cash flow rights and control rights are also positively associated with firm leverage.

Recent studies also show that the tunnelling incentive of controlling shareholders may also be influenced by regional creditor and investor protection system. For example, Dyck and Zingales (2002) argue that better protection of invertors could lead to a decrease of the private interest of largest shareholders, and thus reduce the tunnelling effect of the controlling shareholders. Du and Dai (2005), Faccio et al., (2010) also find that the separation of cash flow rights and control rights is negatively associated with firm leverage when the creditor protection system is strong. We expect that the interaction of creditor protection and disproportional ownership structure on leverage also exist within China as China has a diverse markets structure and geographic regions, and the legal and institutional environment within China also differs in different regions. Thus, we propose our last hypothesis:

H3: the interaction of creditor protection system and the divergence of cash flow rights and control rights are negatively associated with firm leverage.

3. Methodology and Measurement of Variables

3.1 Data Collection

All the data used in this paper comes from a series of datasets developed by the SinoFin Information Services of the China Centre for Economic Research (CCER) at Beijing University: the Chinese Listed Firm Annual Report Database (2004-2009), the Chinese Listed Firm Corporate Governance Database (2004-2009), the Database of Chinese Listed Firms with Private Ultimate Owners (2004-2009). The Chinese Listed Firms with Private Ultimate Owners Database (2004-2009) presents ownership structure, corporate governance and ultimate shareholder information of all Chinese publicly listed private-owned firms. This database collects information directly from firms' annual reports. Since 2004, all Chinese listed firms have been required by the CSRC (China Securities Regulatory Commission) to report the identities of their ultimate owners as well as the control chains in their annual reports. The CSRC defines the "ultimate owner" of a publicly listed company as: (1) the

largest shareholder; or (2) the shareholder with a greater voting power than the largest shareholder; or (3) the shareholder with shareholding or voting rights above 30% of the total shares or voting rights in the company; or (4) the shareholder who can determine over half of the board members.

We exclude (1) Financial firms; (2) "ST" firms or negative-equity firms; (3) firms whose relevant data are not complete or cannot be acquired. To ensure that our results are not driven by firms entering and leaving the samples, we include only firms that existed in the databases for the entire period between 2004 and 2009. The final sample consists of 1,614 firm-year observations during 2004 to 2009.

3.2 Measuring Variables

This study uses three different measures of capital structure as dependent variables, which are leverage ratio (LEV), short-term debt ratio (STDR) and short-term bank ratio (STBR) for the following reasons: 1) due to the under-development of China's long-term debt market, most of Chinese firms depend mainly on short-term debt; 2) We also use short-term bank ratio as dependent variable because bank loans remain the most important form of external financing in most economies around the world (Demirguc-Kunt and Levine, 2001; Drucker and Puri, 2006). In this paper, we use the regression results of LEV as main dependent variable, and the regression results of STDR and STBR are used as robust tests for the main results.

Variables that measure the separation of cash flow rights and control rights are used as one type of main independent variables in the regression. The above database also defines the cash flows rights and control rights of the ultimate owners in the same way as in Claessens et al. (2000), Claessens et al. (2002), and Faccio and Lang (2002). The cash flow rights are measured by the sum of the products of the proportions of ownership along the control chains, while the control rights are measured by the minimum proportions of ownership along the control chains. To measure the separation of cash flow rights and control rights of Chinese listed firms, we compute the divergence between the cash flow rights and control rights in three methods: (1) the "wedge", which is computed by subtracting the cash flow rights from the control rights; (2) the separate dummy, which is set equate to 1 if control rights of the ultimate shareholders exceeds the cash flow rights; (3) the "ratio", which is computed by

dividing the control rights by the cash flow rights (the "ratio" is the same as the "cash flow rights leverage" in Lemmon and Lins (2003).

In addition, variables that measure political connections and founding-family ownership are also used as key independent variables in this paper. Following Fan et al. (2007), we define a CEO as politically connected if he or she is currently serving or formerly served in the government or military, or as a deputy of the National/provincial People's Congress or People's Political Consultative Conference. However, we extend their exploration of the political connectedness of CEOs to include chairmen, as both are important in China, especially for private-owned firms. Following Anderson et al. (2003), we also use ownership-based dummy-variable approach as the primary indicator of family ownership in our paper, we define a firms as founding-family if the firm is controlled by entrepreneur or founding family. Information about political connections and founding-family ownership is mainly collected by hands.

Furthermore, several control variables are also included in our regression, considering other factors that influence capital structure decision of Chinese listed firms. Detailed definition and calculation of all variables used in this paper is report in Table 1.

<Table 1 here>

3.3 Regression model

In this paper, we use the following equation as basic regression model.

$$\text{Dependent variables}=\alpha+\beta_1\text{disproportional ownership}+\beta_2\text{political connections}+\beta_3\text{Founding family ownership}+\beta_4\text{other control variable}+\text{Industry and Year dummies}+\varepsilon \quad \text{Eq (1)}$$

In Equation (1), the measure of main dependent and independent variable are as detailed in previous section. The interacted terms of main independent variables may be added to this basic model when necessary.

4. Empirical results

4.1 Sample description

Table 2 presents the descriptive statistics for our sample. Panel A of Table 2 reports the summary statistics for the full sample. Panel A shows that the average leverage ratio (short-term debt ratio) for our sample is 46.39 (40.51) percent, as expected, most of the total leverage comes from short-term debt. In addition, 75.64 percent of our sample firms have disproportional ownership structures, and the wedge (ratio) between cash flow rights and control rights is 9.86 percent (1.7788), obviously, disproportional ownership structure is widely used by our sample firms. Panel A also shows that 42.34 percent of our sample firms have political connections (political connected chairman or CEO); 51.64 percent of the sample firms are controlled by founding-families. Considering the firm specific control variables, panel A shows that the average cash flow rights of the controlling shareholder are 25.69 percent, indicating that controlling shareholder controls a relatively high portion of the firms; Approximately 25.56 percent of the total assets are fixed assets; the average effective tax rate, total assets, ROA, and growth is 1.17 percent, 1.4808 billion Yuan, 4.15 percent and 30.52 percent respectively.

Panel B of Table 2 presents a simple bivariate mean comparison of the main dependent and independent variables based on different classifications. In panel B, column 1 through 3 presents the mean comparison of firms with and without political connections; column 4 through 6 presents the mean comparison of founding-family and non-founding family controlled firms; while column 7 through 9 presents the mean comparison of firms with and without disproportional ownership structure. The results in column 1 through 3 show that firms with political connections have statistically significantly higher level of leverage ratios (leverage ratio, short-term debt, and short-term bank loan ratio) than firms without political connections, which is consistent with H2a, thus H2a is supported by our bivariate test here. The results in column 4 through 6 show that founding family controlled firms tend to have lower leverage ratios, lower control-ownership wedge, and less political connections than non-founding-family controlled firms. The results in columns 7 through 9 show that firms with disproportional ownership structure also have higher leverage ratios, which is also consistent with H1a. In addition, panel B also shows that large firms, firms with higher level of control-ownership wedge, and non-founding-family controlled firms are more likely to have political connections.

<Table 2 here>

4.2 Regression results for full sample

Table 3 presents the full sample regression results that link the disproportional ownership structure and political connections with leverage ratio of private-owned firms in Chinese capital market. In the regression, the degree of separation of cash flow rights and control rights is measured by three different variables separately. The "wedge" columns present the regression results, using the control-ownership wedge as independent variable, and leverage ratios as dependent variables. The "Separate" columns and "C/O" columns employ two alternative measures of the degree of separation of control rights and cash flow rights, which are the separate dummy, and the control-ownership ratio. We expect that the larger the independent variables, the higher are the degree of separation of ownership and control.

Panel A of Table 3 presents the results using leverage ratio as dependent variable. In Panel A, in column 1 through 3, we use the three measure of the separation of cash flow rights and control rights and political connections as main independent variables, while in column 4 through 6, we further add the interacted terms of the measures of disproportional ownership structure and political connections to our regression to see their interaction effect on firm leverage.

The results in column 1 show that control-ownership wedge is statistically positively related to leverage ratio, the results are robust when we use the divergence dummy and control-ownership ratio as independent variables, as shown in column 2 and 3. These results indicate that controlling shareholder of private-owned firms tends to use both pyramiding and debt to expropriate, especially when the control-ownership wedge of the controlling shareholder is high, which is consistent with hypothesis H1a, so this hypothesis is proved.

The results in column 1 through 3 also show that political connections is also positively related to leverage ratio, indicating that political connections are helpful for private-owned firms in China to get access to external debt financing, which is consistent with hypothesis H2a and other prior studies such as Khwaja and Mian (2005) and Faccio(2006). In addition, founding-family controlled firms have lower leverage ratio than non-founding family controlled firms.

Column 4 through 6 presents the regression results considering the interaction effect of political connections and disproportional ownership on leverage. As expected, the interacted term is statistically positively related to leverage ratio of Chinese private-owned firms, so our hypothesis H2b is also proved. This result indicates that political connections in China not only help private-owned firms getting external resources, but also facilitate the expropriation of controlling shareholders.

Turning to the other explanatory variables, we find that most of them have statistically significant explanatory power. Our result shows that higher effect tax rate is associated with lower leverage ratios, which is inconsistent with the prediction of the trade-off theory, arguing that firms with higher tax rate should borrow to utilize the tax-shield effect. This suggests that the tax advantages of debt capital are not attractive to firms in China – a result not uncommon in developing countries (see Booth et al., 2001). Our result also shows that the coefficient of firm size is positive and statistically significant. The result supports the view that firm size serves as an inverse proxy for unobservable credit risk, which implies that larger firms should be more highly leveraged. As predicted by the pecking-order theory, higher profitability is associated with a lower leverage level. This is due to the fact that higher profit firms tend to rely more on internal financing, while lower profit firms raise more external debt to compensate for the shortage of internal funds.

Panel B and panel C of Table 3 presents the regression results using short-term debt ratio and short-term bank loans ratio as key dependent variable. We find that almost all the results in panel B and panel C are consistent with the results in panel A. So our results in panel A are robust.

<Table 3 here>

4.3 Regression results of founding-family and non-founding family controlled firms

As discussed in above sections, private-owned firms in China can further be classified into two types, which are founding-family controlled firms and non-founding-family controlled firms, we also expect that the disproportional ownership structure may have negative impact on founding-family controlled firms. In order to test this argument, we further separate our sample to founding-family controlled and non-founding-family controlled firms, and conduct

a new regression, the results are reported below in Table 4. In Table 4, we also measure the disproportional ownership structure using three different measures, which are control-ownership wedge, separate dummy and control-ownership ratio. Panel A of Table 4 presents the regression results of founding-family controlled firms and panel B presents the results of non-founding-family controlled firms. In both panel A and panel B, column 1 through 3 presents the results using leverage ratio as dependent variable, column 4 through 6 presents the results using short-term debt ratio as dependent variable, and column 7 through 9 presents the results using short-term bank loans ratio as dependent variable.

Panel A shows that the control-ownership wedge is statistically negatively related to leverage ratio of founding-family controlled firms. Therefore, our hypothesis H1b is also proved. This result indicates that compared to the controlling shareholders of non-founding-family controlled firms, founding families have less incentive to use more debt to expropriate, especially when the control-ownership wedge is large. While in panel B, we find that the control-ownership wedge is statistically positively related with firm leverage, indicating that non-founding-family controlled firms with a disproportional ownership structure tends to use more debt to expropriate. In addition, Table 4 shows that the interacted term of political connections and disproportional ownership is statistically positively related with leverage ratio in both panel A and panel B, which is consistent with H2b.

The results in column 4 through 9 in both panel of Table 4 show that all our results are also robust when we use short-term debt ratio and short-term bank loans ratio as dependent variable.

<Table 4 here>

4.4 The interaction effect of disproportional ownership structure and creditor protection index

As documented by Faccio et al. (2010), the relationship between disproportional ownership and leverage is also influenced by the quality of creditor protection. However, no prior literature tests this relationship within one country, such as China. In this paper, we can test this argument by examining the effect of disproportional ownership structure on leverage in

regions that have different quality of creditor protection. In order to conduct our regression, we further create interacted terms that combine our measures of the separation of cash flow rights and control rights with measures of legal and institutional environment quality in different regions within China. We use the market index (Index) constructed by Fan et al. (2007) to measure the cross-province differential in creditor rights protection. The market index considered encompass various dimensions such as "relationship between government and market", "development of non-state-owned economy", "development of product market ", "development of factor market", and "legal and institutional environment" to construct market index in different provinces. A higher value of the creditor rights index corresponds to stronger rights of creditors. Among all Chinese provinces, there exists a substantial variation in the value of creditor rights index and thus in legal protection of creditors. For example, Tibet has the lowest score (4.25), and Shanghai has the highest score (11.71) in the year 2007.

However, the report of Fan et al. (2007) provide the yearly market index up to 2007, but our sample is during 2004 to 2009, so we just have 4 years observations in this regression. The results are presented in Table 5. In Table 5, column 1 through 3, column 4 through 6, and column 7 through 9 present the results using leverage ratio, short-term debt ratio and short-term bank loan ratio as dependent variable respectively.

The results in Table 5 show that the coefficients for the interacted term between disproportional ownership structure variables and legal protection of creditor rights indexes are consistently negative, and are statistically significant in most cases (all the coefficients are statistically significant when using divergence dummy and control-ownership ratio as measures of disproportional ownership structure). This result indicates that in regions with weak creditor protection system, the controlling shareholder tends to use more debt to expropriate in the case of a high control-ownership wedge, so our hypothesis H3 is also proved. This result is also consistent with Faccio et al. (2010), who also find this relationship using a cross-country sample.

<Table 5 here>

4.5 Further robust tests

4.5.1 The effect of disproportional ownership structure and political connections on related party loans

While in above sections, we estimate the effect of disproportional ownership structure on leverage decision of Chinese private-owned firms. The evidences indicate that controlling shareholder of private-owned firms in China tend to use both disproportional ownership structure and debt to expropriate. However, we still do not know the effect of disproportional ownership on the related party loans, which is always considered to be an important channel through which the controlling shareholder expropriates the interest of external investors in Chinese capital market (Jiang et al., 2010).

As indicated by Jiang et al. (2010), the related party loans, especially the funds occupied by controlling shareholders in China are usually recorded as "Other receivable" in firm's Balance Sheet. In this section, we further examine the impact of disproportional ownership structure on related party loans, as a robust test for our main argument that controlling shareholder of private-owned firms in China tend to use both disproportional ownership structure and debt to expropriate. In order to do this, we create a new variable "ORECTA" (other receivables scaled by total assets) as dependent variable, and conduct a new regression. The results are reported in Table 6, we expect a positive relationship between the control-ownership wedge and the variable ORECTA. In Table 6, column 1 through 3 presents the regression results using different measures of disproportional ownership structure.

The results in Table 6 show that the coefficients of the three measures of disproportional ownership structure are statistically significantly positive at 10% level of significance, indicating that controlling shareholders of firms with larger control-ownership wedge are more likely to tunnelling through related party loans. This result is consistent with Jiang et al. (2010), indicating that controlling shareholder in China tends to occupy more funds from their listed affiliate, when the separation of cash flow rights and control rights of the controlling shareholder is high. The result also supports our argument in above sections that controlling shareholder of private-owned firms in China tends to use both disproportional ownership structure and debt to tunnelling.

In addition, the coefficients of the interacted term between disproportional ownership structure and political connections are consistently positive, and most of the coefficients are statistically significant at 10% level of significance. This result indicates that when the

control-ownership wedge is large, political connections facilitate the tunnelling behaviour of controlling shareholder. This result is also consistent with our results in above sections.

Table 6 also shows that founding-family controlled firms and firms in regions with strong creditor protection have less ORECTA, which is also consistent with our above results, arguing that founding families have less incentive to tunnelling and better creditor protection is important for reducing the tunnelling behaviour of controlling shareholder.

<Table 6 here>

4.5.2Regression results of firms with a founding-family CEO

Following Anderson et al. (2003) who show that founding-family can further influence agency conflicts by placing one of their family members in the CEO position, by holding the role of CEO, families can more closely align the firm's actions with their own interests; suggesting an incremental reduction in the agency cost of debt or a better performance relative to non-family firms or family firms with outside CEOs. We also distinguish firms with or without founding CEOs, and analysing whether founding-family CEOs have positive or negative impact on the relationship between disproportional ownership structure and firm leverage. In order to do this, we create a new variable "Founder CEO", which equates to 1 if the firm's CEO is a founding-family member. The results are reported in Table 7.

Our results show that the interacted term of disproportional ownership structure and founder CEO is statistically significantly related with leverage ratio, indicating that compared to controlling shareholder of non-founding family firms or family firms with outside CEOs, who tends to use both disproportional ownership structure and debt to expropriate, controlling shareholder of firm with founding-family CEOs tends to use less debt when the separation of cash flow rights and control rights is large. This result is similar to the results reported in Table 4, where we separate our sample to founding-family and non-founding-family controlled firms, and find a negative relationship between disproportional ownership structure and leverage in non-founding-family controlled firms.

<Table 7 here>

5. Conclusions

This study shows that under China's specific institutional environment, disproportional ownership structure has a positive influence on leverage ratio of Chinese private-owned firms, which is consistent with the theory that controlling shareholder of firms with disproportional ownership structure tends to use excess debt to tunnelling when the creditor protection is weak (Faccio et al., 2010). The results also show that political connections and founding-family ownership have positive and negative impact on leverage ratio and the effect between disproportional ownership structure and leverage ratio. In addition, this study also provides evidence that a better protection of market institutions can effectively reduce the tunnelling incentive of controlling shareholder, especially when the control-ownership wedge is large. Finally, this paper also provides some evidence that how the controlling shareholder of firms with disproportional ownership structure expropriate the external investors. We show that controlling shareholder of firms with disproportional ownership structure tends to occupy more funds from their listed affiliate through related party loans.

Overall, this paper suggests that controlling shareholder of Chinese private-owned firms tends to use both disproportional ownership structure and debt to tunnelling. Political connections through political connected chairman or CEO facilitate the tunnelling, while founding-family ownership and strong creditor protection legal and institutional environment reduce the tunnelling of controlling shareholder.

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Tables

Table 1 Detailed definitions for all variables used in this paper

Variables names	**variable definitions**
dependent variables:	
Leverage ratio (LEV)	Total debt to total assets
Short-term debt ratio (STDR)	Total short-term debt to total assets
Short-term Bank loan ratio (STBR)	Total short-term bank financing to total assets
Main independent variables:	
Control-Ownership wedge (Wedge)	cash flow rights subtracted by control rights
Separate dummy(Separation)	A dummy variable that equals to 1 if control rights of the ultimate shareholders exceeds the cash flow rights
Control-Ownership ratio (C/O)	Control rights divided by cash flow rights
Political connections (Political)	A dummy variable that equals to 1 if the CEO or chairman of the board is currently or was formerly an officer of the government or military or a deputy of the National People's Congress or People's Political Consultative Conference.
Founding-family control dummy(Founder)	A dummy variable that equals to 1 if the firm is controlled by the entrepreneur
Firm-specific control variables:	
Cash flow rights (Cashflow)	Total cash flow rights of the ultimate controlling shareholder
Tangibility (Tangi)	Net fixed assets/Total assets
Effective tax rate (Tax)	Total tax paid by the firm to total assets
Size (Size)	Log 10 of total assets
Profitability (ROA)	Ratio of pre-tax profits to total assets
Growth (Grow)	Percentage change of sales revenue
Other control variables:	
Creditor protection index(Index)	we adopt the marketization index for China's provinces by Fan et al. (2007)
Industry dummy (Industry)	Dummy variables that reflect firm's industry
Year dummy (Year)	Dummy variables that reflect the year

Table2 Description statistics of the sample

Panel A. Summary statistics

	MEAN	Medium	STDEV	P25	P75
LEV	0.4639	0.4725	0.1652	0.3437	0.5861
STDR	0.4051	0.4092	0.1581	0.2882	0.5190
STBR	0.1643	0.1593	0.1184	0.0661	0.2459
Wedge	0.0986	0.0816	0.0947	0.0023	0.1619
Separate	0.7564	1.0000	0.4279	1.0000	1.0000
C/O	1.7788	1.3369	1.1931	1.0039	1.9612
Political	0.4234	0.0000	0.4939	0.0000	1.0000
Cashflow	0.2569	0.2300	0.1534	0.1446	0.3487
Founder	0.5164	1.0000	0.4996	0.0000	1.0000
Tangi	0.2556	0.2379	0.1563	0.1400	0.3581
TAX	0.0117	0.0084	0.0133	0.0038	0.0158
SIZE	1.4808	1.3826	0.4640	0.7268	2.6712
ROA	0.0415	0.0351	0.0652	0.0130	0.0665
Grow	0.3052	0.1257	2.8282	-0.0052	0.3205

Panel B. Mean comparison of main dependent and independent variables based on different classifications

	political	Non-pol	Diff.	Founder	non-fou	Diff.	Separate	non-sep	Diff.
LEV	0.5218	0.4213	12.6609***	0.4230	0.5076	-10.6293***	0.4790	0.4169	6.5747***
STDR	0.4466	0.3747	9.2706***	0.3762	0.4360	-7.7484***	0.4204	0.3578	6.9329***
STBR	0.1827	0.1508	5.4219***	0.1515	0.1780	-4.5218***	0.1712	0.1430	4.1392***
Wedge	0.1006	0.0971	0.7381	0.0902	0.1075	-3.7065***			
Separation	0.7804	0.7387	1.9273*	0.6591	0.8603	-9.6695***			
C/O	1.8771	1.7167	2.7382***	1.5196	2.0555	-9.7288***			
Political				0.3806	0.4692	-3.6144***	0.4369	0.3817	1.9273*
Found	0.4641	0.5548	-3.6144***				0.4500	0.7226	-9.6695***

Notes: This Table reports the mean comparison of the main dependent and independent variables. Definitions of all the variables are reported in Table 1. Political (non-pol) column presents the mean of firms with political connections (without political connections); Founder (non-fou) column presents the mean of firms controlled by founding-family (non-founding-family); Separate (non-sep) column presents the mean of firms with disproportional ownership structure (without disproportional ownership structure). Diff. columns present the T-test results for the bivariate mean comparisons. * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Table3. Regression results for the full sample

Panel A. leverage ratio as dependent variable

Variable	LEV			LEV		
	Wedge	separate	C/O	Wedge	separate	C/O
C	-0.8090	-0.8018	-0.8222	-0.8772	-0.8147	-0.8515
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
Wedge	0.0129***			0.0100**		
	0.0044			*0.0294*		
Separate		0.0169*			-0.0065	
		0.0507			*0.4864*	
C/O			0.0176***			0.0050
			0.0000			*0.1959*
Wedge*Political				0.2343***		
				0.0000		
Separate*Political					0.0597***	
					0.0000	
C/O*Political						0.0237***
						0.0000
POLITICAL	0.0627***	0.0618***	0.0605***			
	0.0000	*0.0000*	*0.0000*			
CASHFLOW	-0.0312	-0.0155	0.0344	-0.0063	-0.0141	0.0280
	0.1917	*0.5377*	*0.2010*	*0.7977*	*0.5764*	*0.3023*
Founder	-0.0602***	-0.0599***	-0.0591***	-0.0648***	-0.0618***	-0.0601***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
TANGIBILITY	-0.0359	-0.0236	-0.0210	-0.0290	-0.0205	-0.0184
	0.1096	*0.2899*	*0.3429*	*0.2045*	*0.3623*	*0.4088*
TAX	-0.5577*	-0.5291*	-0.5644*	-0.5456*	-0.4981	-0.5447*
	0.0723	*0.0887*	*0.0674*	*0.0836*	*0.1112*	*0.0793*
SIZE	0.1446***	0.1419***	0.1407***	0.1534***	0.1459***	0.1473***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.6654***	-0.6760***	-0.6689***	-0.6894***	-0.6860***	-0.6880***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
GROWTH	0.0019	0.0020	0.0022	0.0018	0.0018	0.0020
	0.2311	*0.2090*	*0.1790*	*0.2745*	*0.2585*	*0.2105*
R2	0.3214	0.3196	0.3292	0.3002	0.3108	0.3209
Adj. R2	0.3155	0.3137	0.3233	0.2941	0.3048	0.3150
F-stat	54.0706	53.6203	56.0124	48.9680	51.4715	53.9457

Panel B. short-term debt ratio as dependent variable

Variable	STDR			STDR		
	Wedge	separate	C/O	Wedge	separate	C/O
C	-0.3856	-0.3782	-0.3982	-0.4205	-0.3653	-0.4034
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
Wedge	0.0152***			0.0128***		
	0.0012			*0.0066*		
Separate		0.0297***			0.0084	
		0.0009			*0.3803*	
C/O			0.0183***			0.0072*
			0.0000			*0.0739*
Wedge*Political				0.2230***		
				0.0000		
Separate*Political					0.0543***	
					0.0000	
C/O*Political						0.0208***
						0.0000
POLITICAL	0.0473***	0.0462***	0.0449***			
	0.0000	*0.0000*	*0.0000*			
CASHFLOW	-0.0530**	-0.0259	0.0156	-0.0295	-0.0248	0.0093
	0.0326	*0.3203*	*0.5766*	*0.2450*	*0.3407*	*0.7397*
Founder	-0.0353***	-0.0341***	-0.0344***	-0.0388***	-0.0350***	-0.0347***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
TANGIBILITY	-0.0736***	-0.0571**	-0.0569**	-0.0669***	-0.0539**	-0.0544**
	0.0016	*0.0137*	*0.0133*	*0.0044*	*0.0198*	*0.0179*
TAX	-0.3587	-0.3147	-0.3642	-0.3661	-0.3016	-0.3592
	0.2647	*0.3278*	*0.2550*	*0.2580*	*0.3478*	*0.2614*
SIZE	0.0924***	0.0881***	0.0881***	0.0968***	0.0885***	0.0913***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.5777***	-0.5873***	-0.5834***	-0.5922***	-0.5899***	-0.5950***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
GROWTH	0.0016	0.0018	0.0018	0.0015	0.0016	0.0017
	0.3393	*0.2874*	*0.2714*	*0.3719*	*0.3278*	*0.2969*
Adj. R2	0.1941	0.1943	0.2023	0.1849	0.1957	0.2027
F-stat	28.7324	28.7741	30.1966	27.1250	29.0094	30.2668

Panel C. short-term bank loan ratio as dependent variable

Variable	STBR			STBR		
	Wedge	separate	C/O	Wedge	separate	C/O
C	-0.3483	-0.3412	-0.3448	-0.3715	-0.3443	-0.3452
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
Wedge	0.0112***			0.0104***		
	0.0013			*0.0028*		
Separate		0.0063			-0.0004	
		0.3460			*0.9539*	
C/O			0.0034			-0.0011
			0.1992			*0.7231*
Wedge*Political				0.0588*		
				0.0944		
Separate*Political					0.0170***	
					0.0068	
C/O*Political						0.0083***
						0.0011
POLITICAL	0.0182***	0.0174***	0.0172***			
	0.0010	*0.0016*	*0.0019*			
CASHFLOW	-0.0680***	-0.0618***	-0.0549***	-0.0618***	-0.0614***	-0.0574***
	0.0002	*0.0014*	*0.0085*	*0.0010*	*0.0015*	*0.0059*
Founder	-0.0116**	-0.0122**	-0.0124**	-0.0129**	-0.0127**	-0.0124**
	0.0407	*0.0322*	*0.0295*	*0.0224*	*0.0255*	*0.0283*
TANGIBILIT?	0.1497***	0.1586***	0.1585***	0.1515***	0.1595***	0.1595***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
TAX	-1.4748***	-1.4588***	-1.4687***	-1.4679***	-1.4503***	-1.4678***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
SIZE	0.0564***	0.0550***	0.0551***	0.0594***	0.0560***	0.0561***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.2715***	-0.2832***	-0.2827***	-0.2793***	-0.2859***	-0.2869***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
GROWTH	-0.0011	-0.0010	-0.0010	-0.0011	-0.0011	-0.0011
	0.3903	*0.4050*	*0.4066*	*0.3724*	*0.3811*	*0.3903*
R2	0.2178	0.2132	0.2135	0.2138	0.2119	0.2140
Adj. R2	0.2110	0.2063	0.2067	0.2070	0.2050	0.2072
F-stat	31.7877	30.9235	30.9925	31.0477	30.6880	31.0849

Notes: This Table presents the regression results for the full sample firms. Definitions of all the variables are reported in Table 1. Panel A presents the results using leverage ratio as dependent variable; Panel B presents the results using short-term debt ratio as dependent variable; Panel C presents the results using short-term bank loans ratio as dependent variable; Wedge columns present the results using control-ownership wedge as measure of disproportional ownership structure; separate columns present the results using separate dummy as measure of disproportional ownership structure; C/O columns present the results using control-ownership ratio as measure of disproportional ownership structure; Column 1 through 3 presents the results without the interaction effect of disproportional ownership structure and political connections; column 4 through 6 presents the results considering the interaction effect of disproportional ownership structure and political connections. The year dummies and industry dummies are included in each regression, but not reported; p-values are displayed in italics; * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Table 4. Regression results for founding-family and non-founding-family controlled firms

Panel A. Regression results for founding-family controlled firms									
Variable	LEV			STDR			STBR		
	wedge	separate	C/O	Wedge	separate	C/O	Wedge	separate	C/O
C	-1.2045	-1.1674	-1.0965	-0.6388	-0.6090	-0.5442	-0.4175	-0.4140	-0.3545
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0001*
Wedge	-0.1098**			-0.1269**			-0.1160***		
	0.0490			*0.0240*			*0.0058*		
Separate		-0.0105			-0.0066			-0.0116	
		0.3258			*0.5392*			*0.1491*	
C/O			-0.0036			-0.0103			-0.0118**
			0.5848			*0.1179*			*0.0172*
Wedge*Political	0.2667**8			0.2768***			0.1125***		
	0.0003			*0.0002*			*0.0411*		
Separate*Political		0.0467***			0.0461***			0.0164*	
		0.0001			*0.0001*			*0.0668*	
C/O*Political			0.031***			0.029***			0.0148***
			0.0000			*0.0000*			*0.0005*
CASHFLOW	-0.0311	-0.0217	-0.0014	0.0030	0.0186	0.0144	-0.0540**	-0.042*	-0.053**
	0.3208	*0.4775*	*0.9675*	*0.9237*	*0.5472*	*0.6763*	*0.0221*	*0.0654*	*0.0388*
TANGIBILITY	-0.0835***	-0.0863***	-0.089***	-0.152 **	-0.155***	-0.160**	0.153***	0.152***	0.145***
	0.0070	*0.0054*	*0.0036*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
TAX	0.4660	0.4941	0.3876	0.5974	0.6486	0.5329	-0.9034**	-0.8780**	-0.9395***
	0.3285	*0.2996*	*0.4108*	*0.2141*	*0.1771*	*0.2637*	*0.0121*	*0.0150*	*0.0088*
SIZE	0.1848***	0.1798***	0.170***	0.118***	0.113***	0.107***	0.063***	0.062***	0.056***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.9586***	-0.9526***	-0.9364***	-0.8936***	-0.8889***	-0.8763***	0.3326***	0.3356***	0.3272***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
GROWTH	0.0368***	0.0375***	0.0375***	0.0382***	0.0391***	0.0383***	0.0017	0.0024	0.0019
	0.0001	*0.0001*	*0.0001*	*0.0001*	*0.0000*	*0.0000*	*0.8059*	*0.7372*	*0.7909*
Adj. R2	0.3477	0.3497	0.3629	0.2408	0.2420	0.2530	0.1927	0.1883	0.1986
F-stat	35.1199	35.4114	37.4508	21.3019	21.4342	22.6729	16.2803	15.8486	16.8632

Panel B. Regression results for non-founding family controlled firms									
Variable	LEV			STDR			STBR		
	Wedge	Separate	C/O	Wedge	separate	C/O	Wedge	separate	C/O
C	-0.6136	-0.5832	-0.6383	-0.2328	-0.2092	-0.2605	-0.3530	-0.3363	-0.3468
	0.0000	*0.0000*	*0.0000*	*0.0511*	*0.0726*	*0.0257*	*0.0001*	*0.0002*	*0.0001*
Wedge	0.0095*			0.0126**			0.0116***		
	0.0556			*0.0139*			*0.0026*		
Separate		0.0178			0.0581***			0.0274**	
		0.2952			*0.0009*			*0.0399*	
C/O			0.0121**			0.0147***			0.0038
			0.0179			*0.0058*			*0.3487*
Wedge*Political	0.2765***			0.2710***			0.0646		
	0.0000			*0.0001*			*0.2023*		
Separate*Political		0.0687***			0.0645***			0.0166*	
		0.0000			*0.0000*			*0.0653*	
C/O*Political			0.0188***			0.0164***			0.0045
			0.0000			*0.0002*			*0.1830*
CASHFLOW	0.0298	0.0321	0.1006	-0.0788	-0.0435	0.0012	-0.0932***	-0.0706**	-0.0684*
	0.4625	*0.4382*	*0.0244*	*0.0604*	*0.3056*	*0.9800*	*0.0030*	*0.0298*	*0.0530*
TANGIBILITY	0.0050	0.0371	0.0167	-0.0105	0.0414	0.0039	0.1395***	0.1691***	0.1543***
	0.8816	*0.2594*	*0.6017*	*0.7609*	*0.2201*	*0.9064*	*0.0000*	*0.0000*	*0.0000*
TAX	-0.7159*	-0.5712	-0.6981	-0.3738	-0.2201	-0.3619	-1.6185***	-1.5718***	-1.6126***
	0.0981	*0.1807*	*0.1000*	*0.4027*	*0.6148*	*0.4106*	*0.0000*	*0.0000*	*0.0000*
SIZE	0.1227***	0.1153***	0.1204***	0.0755***	0.0640***	0.0730***	0.0587***	0.0529***	0.0564***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.6053***	-0.6092***	-0.6172***	-0.5232***	-0.5233***	-0.5400***	-0.3009***	-0.3126***	-0.3200***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
GROWTH	0.0008	0.0011	0.0010	0.0006	0.0012	0.0009	-0.0012	-0.0010	-0.0011
	0.6605	*0.5427*	*0.5526*	*0.7318*	*0.5016*	*0.6225*	*0.3786*	*0.4865*	*0.4120*
Adj. R2	0.1887	0.2105	0.2194	0.1416	0.1763	0.1674	0.2167	0.2163	0.2114
F-stat	14.9332	16.9739	17.8419	10.8868	13.8293	13.0471	17.5790	17.5418	17.0653

Notes: This Table presents the regression results for founding-family controlled firms and non-founding-family controlled firms. Definitions of all the variables are reported in Table 1. Panel A presents the results of founding-family controlled firms; Panel B presents the results of non-founding-family controlled firms; Wedge columns present the results using control-ownership wedge as measure of disproportional ownership structure; separate columns present the results using separate dummy as measure of disproportional ownership structure; C/O columns present the results using control-ownership ratio as measure of disproportional ownership structure; Column 1 through 3 presents the results using leverage ratio as dependent variable; column 4 through 6 presents the results using short-term debt ratio as dependent variable; column 7 through 9 presents the results using short-term bank loans ratio as dependent variable; The year dummies and industry dummies are included in each regression, but not reported; p-values are displayed in italics; * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Table 5. Regression results with the interaction of creditor protection index

Variable	LEV			STDR			STBR		
	Wedge	Separate	C/O	Wedge	Separate	C/O	Wedge	Separate	C/O
C	-0.7577	-0.7580	-0.7635	-0.4104	-0.4168	-0.4186	-0.4380	-0.4354	-0.4354
	0.0000	*0.0000*	*0.0000*	*0.0001*	*0.0001*	*0.0001*	*0.0000*	*0.0000*	*0.0000*
Wedge	0.0080			0.0106*			0.0098**		
	0.1917			*0.0886*			*0.0444*		
Separate		0.0529**			0.0724***			0.0501***	
		0.0187			*0.0016*			*0.0054*	
C/O			0.0279***			0.0241***			0.0133**
			0.0003			*0.0023*			*0.0316*
Wedge*Index	-0.0031			-0.0009			-0.0042		
	0.5579			*0.8636*			*0.3184*		
Separate*Index		-0.0050**			-0.0050**			-0.0047**	
		0.0280			*0.0295*			*0.0103*	
C/O*Index			-0.0027***			-0.0022**			-0.0019**
			0.0039			*0.0192*			*0.0122*
POLITICAL	0.0611***	0.0593***	0.0600***	0.0465***	0.0444***	0.0451***	0.0144***	0.0127***	0.0134***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0396*	*0.0694*	*0.0538*
CASHFLOW	-0.0646**	-0.0421	-0.0258	-0.0695**	-0.0367	-0.0396	-0.0774***	-0.0529**	-0.0704***
	0.0363	*0.1729*	*0.4468*	*0.0271*	*0.2423*	*0.2531*	*0.0017*	*0.0318*	*0.0098*
Founder	-0.0742***	-0.0722***	-0.0706***	-0.0525***	-0.0482***	-0.0492***	-0.0222***	-0.0207***	-0.0209***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0022*	*0.0044*	*0.0042*
TANGIBILITY	-0.0284	-0.0237	-0.0227	-0.0901***	-0.0814***	-0.0849***	0.1490***	0.1556***	0.1534***
	0.3111	*0.3917*	*0.4097*	*0.0016*	*0.0039*	*0.0026*	*0.0000*	*0.0000*	*0.0000*
TAX	-1.0756***	-0.9871***	-1.0251***	-0.9207***	-0.7968**	-0.8667**	-1.5802***	-1.4996***	-1.5405***
	0.0019	*0.0044*	*0.0029*	*0.0089*	*0.0236*	*0.0136*	*0.0000*	*0.0000*	*0.0000*
SIZE	0.1422***	0.1402***	0.1401***	0.0989***	0.0958***	0.0977***	0.0690***	0.0665***	0.0685***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*
ROA	-0.5181***	-0.5199***	-0.5160***	-0.4525***	-0.4502***	-0.4583***	-0.2263***	-0.2309***	-0.2366***
	0.0000	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0000*	*0.0003*	*0.0002*	*0.0002*
GROWTH	0.0015	0.0016	0.0016	0.0013	0.0015	0.0013	-0.0013	-0.0013	-0.0014
	0.3434	*0.3282*	*0.3251*	*0.4150*	*0.3679*	*0.4114*	*0.2900*	*0.3120*	*0.2793*
Adj. R2	0.3190	0.3214	0.3263	0.2122	0.2187	0.2170	0.2046	0.2071	0.2059
F-statistic	38.6818	39.1107	39.9734	22.6778	23.5257	23.3053	21.6930	22.0140	21.8677

Notes: This Table presents the regression results for the interaction effect of disproportional ownership structure and regional creditor protection index. Definitions of all the variables are reported in Table 1. Column 1 through 3 presents the results using leverage ratio as dependent variable; column 4 through 6 presents the results using short-term debt ratio as dependent variable; column 7 through 9 presents the results using short-term bank loans ratio as dependent variable; Wedge columns present the results using control-ownership wedge as measure of disproportional ownership structure; separate columns present the results using separate dummy as measure of disproportional ownership structure; C/O columns present the results using control-ownership ratio as measure of disproportional ownership structure; The year dummies and industry dummies are included in each regression, but not reported; p-values are displayed in italics; * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Table 6. The effect of disproportional ownership structure on related party loans

Variable	ORECTA		
	Wedge	Separate	C/O
C	0.1883	0.1733	0.1550
	0.0000	*0.0000*	*0.0000*
Wedge	0.0012*		
	0.0580		
Separate		0.0074	
		*0.0792**	
C/O			0.0043
			*0.0108***
Wedge*Political	0.0800***		
	0.0000		
Separate*Political		0.0065*	
		0.0757	
C/O*Political			0.0000
			0.9985
CASHFLOW	-0.0011	-0.0012	0.0061
	0.9170	*0.9127*	*0.6149*
Founder	-0.0151***	-0.0141***	-0.0146***
	0.0000	*0.0000*	*0.0000*
SIZE	-0.0126***	-0.0116***	-0.0096**
	0.0024	*0.0059*	*0.0206*
ROA	-0.1572***	-0.1564***	-0.1595***
	0.0000	*0.0000*	*0.0000*
INDEX	-0.0026***	-0.0025***	-0.0026***
	0.0000	*0.0000*	*0.0011*
Adj. R-squared	0.1217	0.1151	0.1142
F-stat	14.1863	13.3843	13.2651

Notes: This Table presents the regression results of the effect of disproportional ownership structure on related party loans. Definitions of all the variables are reported in Table 1. Wedge columns present the results using control-ownership wedge as measure of disproportional ownership structure; Separate columns present the results using separate dummy as measure of disproportional ownership structure; C/O columns present the results using control-ownership ratio as measure of disproportional ownership structure; The year dummies and industry dummies are included in each regression, but not reported; p-values are displayed in italics; * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Table 7. Interaction effect of disproportional ownership and family CEO

Variable	LEV		
	Wedge	Separate	C/O
C	-0.8104	-0.8032	-0.8216
	0.0000	*0.0000*	*0.0000*
Wedge	0.0130		
	0.0040		
Separate		0.0237	
		0.0078	
C/O			0.0179
			0.0000
wedge*Founder CEO	-0.1272		
	0.0918		
separate*Founder CEO		-0.0360	
		0.0020	
C/O*Founder CEO			-0.0136
			0.0126
Political	0.0622	0.0606	0.0598
	0.0000	*0.0000*	*0.0000*
CASHFLOW	-0.0334	-0.0111	0.0337
	0.1635	*0.6583*	*0.2097*
Founder	-0.0586	-0.0567	-0.0564
	0.0000	*0.0000*	*0.0000*
TANGI	-0.0332	-0.0184	-0.0152
	0.1395	*0.4112*	*0.4949*
TAX	-0.5718	-0.5558	-0.5789
	0.0653	*0.0731*	*0.0602*
SIZE	0.1448	0.1415	0.1406
	0.0000	*0.0000*	*0.0000*
ROA	-0.6560	-0.6601	-0.6556
	0.0000	*0.0000*	*0.0000*
GROW	0.0019	0.0020	0.0021
	0.2392	*0.2140*	*0.1902*
Adj. R2	0.3163	0.3173	0.3255
F-stat	50.7139	50.9538	52.8659

Notes: This Table presents the regression results of the interaction effect of disproportional ownership structure and founding-family CEO on leverage ratio. Founder CEO is a dummy variable that equates to 1 if the firm has a founding family CEO. Definitions of other variables are reported in Table 1. Wedge columns present the results using control-ownership wedge as measure of disproportional ownership structure; Separate columns present the results using separate dummy as measure of disproportional ownership structure; C/O columns present the results using control-ownership ratio as measure of disproportional ownership structure; The year dummies and industry dummies are included in each regression, but not reported; p-values are displayed in italics; * Statistical significance at the 10% level. ** Statistical significance at the 5% level. *** Statistical significance at the 1% level.

Figure 1 Jian Long Group taking over Tong Gang Group