Multiple Banking Relationships, Multiple Large Shareholders, and Corporate Risk Taking: Evidence from China's Listed Firms[1]

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ABSTRACT

Block shareholders can alleviate the principal-agent conflict of interest between shareholders and managers. However, when a single large shareholder absolutely dominates a firm's decision, another ultimate risk-averse conflict may emerge and expropriate other minority shareholders or stakeholders. Using a sample of China's listed firms over 1999-2008, this paper examines the relationships among a firm's large shareholder structures (internal monitoring), its banking relationships (external monitoring), and corporate risk taking. We use the concentration, deviation, and contestability among multiple large shareholders to measure the large shareholders' coalescence structures, the number of banks and average bank debt ratio to measure a firm's banking relationships, and three proxies for measuring a firm's risk taking- they are cash flow volatility, z-scores, and earnings volatility. We find that firms with higher coalescence of large shareholders indeed have lower cash flow volatility (low risk), firms with high numbers of banking relationships have low cash flow volatility (low risk) as well. These results are consistent with our expectation. After replacing the risk proxy by z-scores, we find that the similar result remains between a firm's large shareholders' concentration and its z-scores. However, the banking relationships turn out to be negative- firms with high numbers of banking relationships have low z-scores (high risk). We find that Chinese firm has its special relationships with banks based on different firm types, and its identity of the largest shareholder. Such factors significantly influence a firm's risk measures. Our results provide potential implications for investors and regulators understanding the ultimate ownerships specialty and its respective bank-firm relationships in a transition market of China.

Key words: Multiple Banking Relationships, Large Shareholders, Risk-Taking; Corporate Governance.