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ECONOMIC OUTCOMES OF CONTROLLING SHAREHOLDERS' FOREIGN RESIDENCY RIGHTS: EVIDENCE FROM CHINA

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ABSTRACT. *This paper studies the impact of foreign residency rights on tunnelling. Using hand-collected data of controlling persons of Chinese family firms from 2004 to 2017, we find that family firms with controlling persons having foreign residency rights are associated with higher expropriation incentives, they are more likely to tunnel through fund occupation and cash dividends. And this positive effect is enhanced as the separation of cash flow and control rights grows but is lessened when firms are located in a better institution environment, have a higher ratio of independent directors, or better shareholder balance mechanism. Our study enriches the works of literature on economic outcomes of actual controllers' foreign residency rights and also suggests that Chinese regulators should pay more attention to this phenomenon.*

KEYWORDS: foreign residency rights, tunnelling, China.

JEL classification: M41, M19, P2.

Introduction

In recent years, foreign residency rights have attracted scholars' widespread attention. While current research mainly focuses on the impact of foreign residency rights on corporate fraud, corporate performance, auditor selection, or cash holdings (Chen *et al.*, 2018; Kong *et al.*, 2018; Yang *et al.*, 2019; Lu *et al.*, 2020; Hou, Liu, 2020), neglecting its effect on the controlling shareholders' tunnelling behaviour. According to the Wall Street Journal (2010)¹, more and more Chinese private entrepreneurs choose to own foreign residency rights, even foreign nationality in order to transfer civil wealth and assets. Against this background, our paper will fill in the gap by researching how actual controllers' foreign residency rights affect their expropriation incentive.

Tunnelling is the behaviour of asset appropriation by large shareholders, which legally or illegally transfer assets and profits to themselves (Johnson *et al.*, 2000). Especially in the emerging economy, due to imperfect institutional environments and weaker protection of property rights, family firms typically enhance their control via cross-holdings or pyramid structures, which also leads to ownership concentrated in the family shareholders (Shleifer, Vishny, 1997; La Porta *et al.*, 1999). Family shareholders as the large shareholders can effectively monitor the opportunistic behaviour of the managers and decrease the first type agency conflict. However, excess control rights of the controlling family shareholders worsen the second type of agency problem, leading the controlling shareholders to have more incentives and power to expropriate minority shareholders (La Porta *et al.*, 2002; Young *et al.*, 2008; Aslan, Kumar 2012; Wei *et al.*, 2011). Research has found that family shareholders take a variety of forms to tunnel the firm such as outright theft or fraud, transfer of corporate funds and assets, insider trading, or related party transactions to realise the private benefits of control rights (Jensen, Meckling, 1976; Cheung *et al.*, 2006; Jian, Wong, 2010; Aslan, Kumar 2012), and fund occupation and cash dividends are the common way for large shareholders to tunnel the firm (Jiang *et al.*, 2010; Aharony *et al.*, 2010; Faccio *et al.*, 2001; Chen *et al.*, 2009; Boateng, Huang, 2017; Subramaniam, 2018; Jiang *et al.*, 2019).

¹ A news article (<https://www.wsj.com/articles/SB10000872396390443507204578020272862374326>) reports that more and more Chinese private entrepreneurs emigrate to transfer civil wealth and assets, leading to capital loss from China.

And foreign residency rights refer to the right of residence granted to foreigners by the governments according to their state law. Compared with family firms whose actual controllers are without foreign residency rights, actual controllers with foreign residency rights may be more likely to tunnel the firm and infringe on the interests of minority shareholders. And the reasons are as follows: on the one hand, actual controllers with foreign residency rights can reduce the cost of tunnelling behaviour (Furnham, 1990). Chen *et al.* (2018) have found that controlling persons who obtain foreign residency rights can more easily flee from China and evade domestic sanctions, so they are inclined to commit corporate fraud. On the other hand, some Chinese family firms are restructured from former state-owned enterprises, “original sin” is always questioned (Yang *et al.*, 2019; Hou, Liu, 2020). Therefore, in order to protect private property and escape the government for “after-autumn accounts”, the possibility for family firm controllers with foreign residency rights to transfer domestic assets and profits is further enhanced.

Based on the above analysis, using the sample of Chinese family firms listed in the Small and Medium-sized Board and Second-board Market from 2004 to 2017, this paper investigates the impact of actual controllers’ foreign residency rights on their tunnelling behaviour. And we find that family firms whose actual controllers have foreign residency rights are more likely to tunnel the firm through fund occupation and cash dividends. And the higher separation of cash flow and control rights, the higher possibility of controlling shareholders’ tunnelling. But this positive relationship is lessened when firms are located in a better institutional environment, with more independent directors on the board or a better shareholder balance mechanism.

Our paper makes several contributions. First, from the perspective of the actual controller’s individual heterogeneity, it further enriches the research on the economic outcomes of private entrepreneurs’ migration; second, from the perspective of foreign residency rights, this study provides new empirical evidence for family firm controllers to tunnel firms through fund occupation and cash dividend; third, this paper also provides new evidence and support on entrepreneurs’ motivation of obtaining foreign residency rights to evade domestic legal sanctions.

The remaining of this paper is organised as follows. Section 1 presents a relevant literature review. In Section 2, we describe data and methodology. Empirical results and robust checks are contained in Section 3 and Section 4. Section 5 concludes this paper.

1. Literature Review

La Porta *et al.* (1998) have shown that concentrated ownership structure is widespread around the world, except in developed countries such as the UK and the United States. Particularly in emerging markets, due to imperfect institutional environments and their weaker protection of property rights, family firms typically enhance their control via cross-holdings or pyramid structures. And this also provides convenience for large family shareholders to infringe on the interests of minority shareholders through their control rights, Johnson *et al.* (2000) define this phenomenon as “tunnelling”. And the current research mainly focuses on the ways for large shareholders to tunnel and the factors influencing their expropriation incentive (Jensen, Meckling, 1976; Cheung *et al.*, 2006; Jian, Wong, 2010; Jiang *et al.*, 2010; Maury, Pajuste, 2005).

First of all, as for tunnelling ways, Jiang *et al.* (2010) show that fund occupation is the main way for family large shareholders to tunnel the firm, which is widespread among Chinese listed companies. Cheung *et al.* (2006) and Jian and Wong (2010) also find that the

controlling shareholders will transfer the companies' assets and profits through related-party transactions. In addition, it has been found that cash dividend, which appears to be catering to regulation, may actually be a "mask" for the controlling shareholders to infringe on the interests of minority investors (Chen *et al.*, 2009; Jiang *et al.*, 2019).

As for factors influencing the large shareholders' expropriation incentive, it is found that a higher separation of the two rights will enhance family large shareholders' motivation to tunnel (Claessens *et al.*, 2002; Faccio *et al.*, 2001). While better institution environment can restrain the opportunistic behaviour of large shareholders and protect the interests of medium and small investors (La Porta *et al.*, 1998; Jian, Wong, 2010). In addition, good corporate governance can also effectively supervise the controlling shareholders and reduce their fund occupation and cash dividends. For example, Fama and Jensen (1983) and Gong *et al.* (2020) have found that the higher proportion of independent directors, the less likely for controlling shareholders to expropriate. And Maury and Pajuste (2005) also show that a higher degree of shareholder balance mechanism can weaken controlling shareholders' expropriation incentive and protect the interests of minority shareholders.

The so-called foreign residency rights refer to the right of residence granted to foreigners by the governments according to their state law. Past research concentrates on the economic consequences of foreign residency rights. Chen *et al.* (2018) and Kong *et al.* (2018) find that controllers with foreign residency rights usually own a lower sense of long-term commitment, so they incline to commit corporate fraud, which decreases their ability to access external finance and deteriorates firm value (Lu *et al.*, 2020). Therefore, in order to lessen agency conflicts and maintain a good family firm reputation, the private firm's controllers with foreign residency rights tend to hold more cash and use high-quality Big 4 as auditors (Hou, Liu, 2020; Yang *et al.*, 2019). However, few scholars pay attention to the relationship between foreign residency rights and controlling shareholders' tunnelling.

We expect family firms whose controllers have foreign residency rights incline to tunnel the firm and infringe the interests of minority shareholders. And the reasons are as follows: on the one hand, companies with foreign residency rights can reduce the cost of tunnelling behaviour (Furnham, 1990). Chen *et al.* (2018) have found that controllers who obtain foreign residency rights can more easily flee from China and evade domestic punishment, so they are more likely to commit illegal acts. On the other hand, some Chinese family firms are restructured from former state-owned enterprises, "original sin" is always questioned. Especially as the gap between rich and poor widens and social hatred toward private entrepreneurs grows, family firm controllers are increasingly anticipated to be targets of future law sanction (Yang *et al.*, 2019). Therefore, in order to protect private property and escape the government for "after-autumn accounts", family firm controllers are more likely to transfer domestic assets and profits after they migrate.

In order to fill up the above gaps, this study extends the past research on foreign residency rights and investigates the impact of actual controllers' foreign residency rights on their tunnelling behaviour. Besides, we also research the effect of separation between cash flow rights and control rights, institutional environment, independent directors, and shareholder balance mechanism on the controlling shareholders' expropriation incentive.

2. Data and Methodology

2.1 Data

Our initial sample covers all Chinese family firms listed on the Small and Medium-sized Board and Second-board Market. The sample period spans from 2004 to 2017. We manually collect controlling persons' personal characteristics from their annual reports, which are presented in the following two sections: 'Introduction of controlling shareholders and controlling persons' and 'Board of directors, board of supervisors, and senior management sections. And the tunnelling and other control variables are from the CSMAR and WIND databases.

2.2 Research Models

To study the effect of foreign residency rights on the controlling shareholders' tunnelling behaviour, we use the following empirical regression model:

$$\begin{aligned} \text{Tunnel}_{i,t+1} = & \alpha_0 + \alpha_1 \text{FRESID}_{i,t} + \alpha_2 \text{CONTROL_OWN}_{i,t} + \alpha_3 \text{GDP_GROWTH}_{i,t} \\ & + \alpha_4 \text{FIRST_OWN}_{i,t} + \alpha_5 \text{MANAGE_OWN}_{i,t} + \alpha_6 \text{LEV}_{i,t} + \alpha_7 \text{ROA}_{i,t} \\ & + \alpha_8 \text{CHAIRMAN}_{i,t} + \alpha_9 \text{LNBOARD}_{i,t} + \alpha_{10} \text{GROWTH}_{i,t} \\ & + \text{INDUSTRY EFFECTS} + \text{YEAR EFFECTS} + \varepsilon_{i,t} \end{aligned} \quad (1)$$

The dependent variable $\text{Tunnel}_{i,t+1}$, which captures the controlling shareholders' tunnelling, we use four proxies to measure: 1) Tunnel1, the ratio of net fund occupation by the controlling shareholder to total asset, which is computed as (other receivables + receivables + prepayment - other payable - payable - deposit received) / total assets; 2) Tunnel2, cash dividend per share divided by the net incomes. We also run the regression models with Tunnel3 computed as the ratio of the sum of receivables, other receivables, and prepayments to total assets and Tunnel4 equals cash dividend per share divided by earnings per share as robustness checks. And the independent variable $\text{FRESID}_{i,t}$ measures whether the controlling person owns residency rights for Firm i during Year t . We expect FRESID to have a positive coefficient.

As for control variables, we contain factors that potentially influence the controlling persons' expropriation incentive following prior literature (Chen *et al.*, 2018; Kong *et al.*, 2018; Jiang *et al.*, 2019; Gong *et al.*, 2020). The controlling persons or largest shareholders with high ownership incline to transfer assets from the firm to benefit themselves, while as the management holds many shares, they may be in line with the minority shareholders and limit the tunnelling, so we control for family firm controller ownership (CONTROL_OWN), the largest shareholder ownership (FIRST_OWN) and management ownership (MANAGE_OWN). Besides, we also take another two corporate governance characteristics (CHAIRMAN and LNBOARD) into consideration. CHAIRMAN measures whether a firm's CEO also serves as the board chairman. And LNBOARD is defined as the natural logarithm of the number of board directors. Because low leveraged, lower growth, and highly profitable firms are much easier for the controllers to tunnel the firm (Jensen, 1986; Faccio *et al.*, 2001). Thus, we also control for firm leverage (LEV), firm growth (GROWTH), and firm profitability (ROA). In addition, we also account for regional development GDP growth.

Table 1. Variable definition

Variable code	Definition
<i>Tunnel1</i>	The ratio of net fund occupation by the controlling shareholder to total asset
<i>Tunnel2</i>	Cash dividend per share divided by the net incomes
<i>Tunnel3</i>	The ratio of the sum of receivables, other receivables, and prepayments to total asset
<i>Tunnel4</i>	Cash dividend per share divided by earnings per share
<i>FRESID</i>	Foreign residency rights, equals one if the controller has foreign residency rights and zero otherwise
<i>Market</i>	Institutional environment, equals 1 if the firm is located in provinces whose marketization index is higher than the median marketization index, and 0 otherwise, the level of marketization is obtained from Fan et al. (2014).
<i>Idp</i>	Measured as independent directors divided by total directors.
<i>Sbm</i>	First compute SBM, which equals the ratio of the proportion of the shares held by the second to the fifth largest shareholders to the proportion of the largest shareholder. And Sbm equals 1 if the firm's SBM is higher than the median of SBM adjusted by industry, and zero otherwise.
<i>Separation</i>	The number of pyramidal layers between the ultimate family controlling owner and the listed firm
<i>CONTROL_OWN</i>	Family firm controller ownership
<i>GDP_GROWTH</i>	Local GDP growth
<i>FIRST_OWN</i>	Largest shareholder ownership
<i>MANAGE_OWN</i>	Management ownership
<i>LEV</i>	Measured as total debt scaled by total assets.
<i>ROA</i>	Firm profitability, net income scaled by total assets for the same period.
<i>CHAIRMAN</i>	Equals 1 if CEO and the board chairman are the same person, and zero otherwise.
<i>GROWTH</i>	Annual percentage change in sales.
<i>LNBOARD</i>	The natural logarithm of the number of board directors.

Source: created by the authors.

Finally, industry and year effects are also incorporated. Definitions of each variable are found in *Table 1*.

3. Empirical Results

3.1 Summary Statistics

Table 2A (Appendix 1) presents summary statistics. Panel A presents the year distribution of the controlling persons with foreign residency rights. Apparently, more and more private entrepreneurs choose to own foreign residency rights. Especially from the year 2009, the frequency of entrepreneurs' emigration is 15, accounting for 1.79 percent. And after 2013, the number of entrepreneurs with foreign residency rights increases sharply, the frequency is above 100 each year, and the proportion is over 10 percent, too. And in the year 2017, the percentage is even over 20. All of these show that the entrepreneurs emigrating to foreign areas have been an indisputable fact, and it is becoming increasingly fierce.

Panel B shows the industry distribution of residency rights. The first one is the Machinery industry, with an absolute number is 674 and the percent is 80.43, among which the first and second machinery industries own the most emigrants, the frequency is 218 and 317 respectively, and the total account for 70.28 percent. Then, there are 21, 15, and 15 emigrants in the information, construction, and water industries. While Services such as transport, finance, and leasing have fewer controllers with foreign residency rights.

Panel C provides statistics of the main variables. FRESID has a mean of 0.100 with a standard deviation of 0.300. The mean of Tunnel1, Tunnel2, Tunnel3, and Tunnel4 is 0.06, 0.25, 0.1883, and 0.5992 respectively, and Tunnel2 and Tunnel4 are larger than Tunnel1 and Tunnel3, showing that the controlling shareholders prefer cash dividends to fund occupation to tunnel the firm after emigration. And MARKET has a mean of 8.506. As for other variables, on average family firms have independent directors of 37.58% and a shareholder balance mechanism of 50.13%.

3.2 Foreign Residency Rights and Tunnelling

We examine the impact of foreign residency rights on the controlling shareholders' tunnelling behaviour, and the results are reported in *Table 3*.

Table 3. Foreign residency rights and tunnelling

	(1) Tunnel1 _{t+1}	(2) Tunnel2 _{t+1}
FRESID	0.0136** (2.53)	0.0890** (2.09)
CONTROL_OWN	0.0000 (0.13)	0.0024** (2.52)
CHAIRMAN	-0.0045 (-0.75)	0.0518 (1.08)
GDP_GROWTH	-0.0058 (-0.10)	0.3588 (0.77)
FIRST_OWN	-0.0005*** (-3.87)	-0.0005 (-0.49)
MANAGE_OWN	0.0000 (0.32)	-0.0000*** (-2.64)
LEV	-0.0512*** (-4.92)	-0.3825*** (-4.64)
ROA	-0.0924** (-2.18)	-1.2319*** (-3.68)
LNBOARD	-0.0110 (-1.21)	0.0017 (0.02)
GROWTH	0.0025* (1.79)	-0.0065 (-0.58)
Industry	YES	YES
YEAR	YES	YES
_cons	0.0454 (1.24)	0.4903* (1.70)
N	4900	4900
r2	0.1342	0.0222
F	17.8785	2.6266

Notes: This table reports the results of the relationship between foreign residency rights and tunnelling. The independent variable FRESID equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel1 and Tunnel2 to measure the controlling shareholders' tunnelling behaviour, Tunnel1 is the ratio of net fund occupation by the controlling shareholder to total asset, and Tunnel2 is computed as cash dividend per share divided by the net incomes. The sample period is from 2004 to 2017. See Table1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

Column 1 shows that the coefficient on FRESID is positive and significant at the 5% level (0.0136, $t=2.53$), suggesting that after family firm controllers emigrate, they are more

likely to transfer civil wealth and assets. And column 2 shows that the coefficient on FRESID is 0.0890 and also significant at the 5% level (0.0890, $t=2.09$), which is much bigger compared to Tunnel1, showing that the controlling shareholders prefer cash dividends to fund occupation when they expropriate the minority shareholders. This may be because as the supervision of CSRC on fund occupation grows strict, controlling shareholders tend to grab private benefits of control through the mask of cash dividends, which is consistent with Faccio *et al.* (2001), and Jiang *et al.* (2019) findings.

Besides, we find that firms controlled by family owners (CONTROL_OWN) are more inclined to tunnel the firm. While tunnelling is negatively related to LEV and ROA, indicating that firms with higher liabilities or higher growth lessen the controllers' motivation to expropriate the minority shareholders. And we also find that board size (LNBOARD) does not affect the controlling shareholders' tunnelling.

3.3 Further Analysis

In this section, we further investigate the effect of internal and external governance mechanisms on the relationship between foreign residency rights and the controlling shareholders' tunnelling behaviour, including the two rights separation, institutional environment, independent directors, and shareholder balance mechanism (Cheung *et al.*, 2006; Gao, Kling, 2008; Jian, Wong, 2010; Gong *et al.*, 2020).

3.3.1 The Effect of Separation between Cash Flow Rights and Control Rights

Due to imperfect institutional environments and their weaker protection of property rights and legal environment (Shleifer, Vishny, 1997), Chinese family firms typically enhance the control of their firms via cross-holdings and pyramid structures (La Porta *et al.*, 2002), they can maintain a lesser share of ownership to control the firm, creating a separation between control and ownership. Such a phenomenon also leads large shareholders to have the motive to expropriate other shareholders at a lower cost (Claessens *et al.*, 2002). Faccio *et al.* (2001) find that the higher degree of separation, the more severe agency conflict between the controlling shareholders and minority shareholders, the more cash dividend controlling shareholders pay to expropriate. Therefore, we expect the separation enhances the relationship between the company's foreign residency rights and tunnelling. And the results are presented in Table 4.

Table 4. The effect of separation between cash flow rights and control rights

	(1) Tunnel1_{t+1}	(2) Tunnel2_{t+1}
FRESID	0.0120 (1.24)	-0.6519*** (-7.47)
Separation	-0.0078*** (-3.79)	-0.0287 (-1.41)
Separation×FRESID	0.0028* (1.69)	0.4401*** (8.97)
CONTROL_OWN	-0.0001 (-1.18)	0.0010 (1.26)
CHAIRMAN	0.0017 (0.35)	0.1045** (2.50)
GDP_GROWTH	0.1814***	0.1156

Table 4 (continuation). The effect of separation between cash flow rights and control rights

	(1) Tunnel1_{t+1}	(2) Tunnel2_{t+1}
	(3.50)	(0.27)
FIRST_OWN	-0.0002**	0.0002
	(-2.13)	(0.28)
MANAGE_OWN	0.0000	-0.0000**
	(1.63)	(-2.26)
LEV	-0.0776***	-0.3757***
	(-9.58)	(-5.42)
ROA	-0.1904***	-1.1873***
	(-5.56)	(-4.07)
LNBOARD	0.0255**	-0.0285
	(3.58)	(-0.47)
GROWTH	0.0041***	-0.0062
	(3.26)	(-0.43)
Industry	YES	YES
YEAR	YES	YES
_cons	-0.0246	0.3080
	(-0.81)	(1.24)
N	7800	7800
r2	0.2298	0.0343
F	52.5163	6.2795

Notes: This table presents the results of whether two rights separation affects the actual controllers' tunnelling. FRESID equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel1 and Tunnel2 to measure the controlling shareholders' tunnelling behaviour, Tunnel1 is the ratio of net fund occupation by the controlling shareholder to total asset, and Tunnel2 is computed as cash dividend per share divided by the net incomes. And Separation is the number of pyramidal layers between the ultimate family controlling owner and the listed firm. The sample period is from 2004 to 2017. See Table1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

In Columns (1) and (2), the coefficient on Separation×FRESID is positive and significant at the 10% and 1% levels respectively. The results are consistent with the argument that divergence between control and cash flow rights further enhances the controlling shareholders' expropriation motivation especially after they emigrate (La Porta *et al.*, 2002; Faccio *et al.*, 2001).

3.3.2 The Effect of the Institutional Environment

A mass of studies has reported that corporate behaviour is influenced greatly by the outside institutional environment (Aharony *et al.*, 2010; Jian, Wong, 2010). Due to differences in resource endowments, geographical locations, and national policies, different regions have different levels of marketisation, and the variation is large (Jin *et al.*, 2005; Chen *et al.*, 2020). When family firms are located in a better institutional environment, the sound legal systems can inhibit controlling shareholders' tunnelling behaviour, as they are hard to escape from law sanctions (La Porta *et al.*, 1998; Cheung *et al.*, 2006). On the other hand, a better institutional environment can provide more protection for minority shareholders, so the minority shareholders can monitor the family large shareholders more easily and reduce their expropriation incentives, such as insider trading or related party transactions (Shleifer, Vishny, 1997; Djankov *et al.*, 2008). Therefore, we expect the level of marketisation will

inhibit expropriation from the controlling shareholders with foreign residency rights. The results are presented in *Table 5*.

Table 5. The effect of the institutional environment

	(1) Tunnel1 _{t+1}	(2) Tunnel2 _{t+1}
FRESID	0.0168 (1.50)	0.0914** (2.31)
Market	0.0129** (2.38)	-0.0034 (-0.18)
Market×FRESID	-0.048* (-1.72)	-0.1399** (-2.49)
CONTROL_OWN	0.0003 (1.58)	0.0016*** (2.73)
CHAIRMAN	0.0022 (0.25)	-0.0019 (-0.06)
GDP_GROWTH	0.2440** (2.51)	0.5374 (1.56)
FIRST_OWN	-0.0005** (-2.49)	-0.0004 (-0.67)
MANAGE_OWN	-0.0000 (-0.49)	-0.0000*** (-5.78)
LEV	-0.0800*** (-5.00)	-0.4526*** (-7.99)
ROA	-0.1927*** (-2.86)	-1.2151*** (-5.09)
LNBOARD	-0.0020 (-0.15)	-0.0183 (-0.39)
GROWTH	0.0341*** (3.80)	-0.0883*** (-2.78)
Industry	YES	YES
YEAR	YES	YES
_cons	-0.0571 (-1.13)	0.4322** (2.41)
N	2200	2200
r2	0.1725	0.1179
F	11.4007	7.3080

Notes: This table presents the effect of the institutional environment on actual controllers' tunnelling. The independent variable FRESID is an indicator of residency rights, which equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel1 and Tunnel2 to measure the controlling shareholders' tunnelling behaviour, Tunnel1 is the ratio of net fund occupation by the controlling shareholder to total asset, and Tunnel2 is computed as cash dividend per share divided by the net incomes. Market equals 1 if the firm is located in provinces whose marketization index is higher than the median marketization index, and 0 otherwise, the level of marketization is obtained from Fan et al. (2014). The sample period is from 2004 to 2014. See Table1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

In column (1) in *Table 5*, we can see that the coefficient on the interaction of Market×FRESID is negative and significant at the 10% level (coefficient of -0.048 and t-statistic of -1.72). And in column (2), the coefficient on Market×FRESID is also negative and significant at the 5% level (coefficient of -0.1399 and t-statistic of -2.49). The results show that family firms located in a better institutional environment are less likely to transfer

corporate assets and profits, weakening the positive impact of foreign residency rights on tunnelling, which is consistent with the findings of La Porta *et al.* (1998) and Jian and Wong (2010).

3.3.3 The Effect of Independent Directors

Independent director is an important internal corporate governance mechanism, though outside board members do not know the firm's operations well compared to internal board members, while a higher percentage of outside board members can represent other minority shareholders and restrain the controlling shareholders' self-interest behaviour (Yermack, 1996; Gao, Kling, 2008; Atanassov, Mandell, 2018). For example, Zhang and Zhang (2021) find more independent directors lower large shareholders' asset occupation. Gong *et al.* (2020) also observe that as the percentage of independent directors grows, the company's tunnelling behaviour drops sharply. Therefore, we expect the controlling shareholders' tunnelling will be reduced with an increase of independent directors. And the estimated results are given in *Table 6*.

Table 6. The effect of independent directors

	(1) Tunnel1_{t+1}	(2) Tunnel2_{t+1}
FRESID	0.0936** (2.55)	0.7503** (2.50)
Idp	0.1031** (2.48)	0.0418 (0.12)
Idp×FRESID	-0.2066** (-2.14)	-1.7318** (-2.20)
CONTROL_OWN	-0.0000 (-0.20)	0.0027** (2.56)
CHAIRMAN	-0.0064 (-0.98)	0.0639 (1.20)
GDP_GROWTH	0.0131 (0.21)	0.3106 (0.61)
FIRST_OWN	-0.0005*** (-3.52)	-0.0004 (-0.37)
MANAGE_OWN	0.0000 (0.23)	-0.0000** (-2.51)
LEV	-0.0508*** (-4.55)	-0.3888*** (-4.27)
ROA	-0.1097** (-2.44)	-1.0743*** (-2.95)
LNBOARD	0.0070 (0.58)	-0.0133 (-0.14)
GROWTH	0.0033** (2.11)	-0.0064 (-0.49)
Industry	YES	YES
YEAR	YES	YES
_cons	-0.0102 (-0.21)	0.3974 (0.98)
N	4400	4400
r2	0.1389	0.0217
F	16.0534	2.2188

Notes: This table reports the effect of independent directors on controlling shareholders' tunnelling. FRESID equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel1 and Tunnel2 to measure the controlling shareholders' tunnelling behaviour, Tunnel1 is the ratio of net fund occupation by the controlling shareholder to total asset, and Tunnel2 is computed as cash dividend per share divided by the net incomes. Idp is measured as independent directors scaled by total directors. The sample period is from 2004 to 2017. See Table1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

Columns (1) and (2) in *Table 6* show that the coefficients for $Idp \times FRESID$ are both negative and significant at 5% levels, suggesting that a higher percentage of independent directors on the board can efficiently monitor business activities and limit the expropriation of minority shareholders.

3.3.4 The Effect of the Shareholder Balance Mechanism

SBM (shareholder balance mechanism) can limit the controlling shareholders' tunnelling motivation and limit their entrenchment of minority shareholders through competition among several largest shareholders (Maury, Pajuste, 2005; Bennedsen, Wolfenzon, 2000). Attig *et al.* (2013) and Young *et al.* (2008) have documented that a better shareholder balance mechanism can effectively monitor the controlling shareholders and restrain their incentive to grab private benefits. Boateng and Huang (2017) also find that the contestability of non-controlling large shareholders decreases fund occupation from the controlling shareholders. Thus, we expect SBM will lessen the controlling shareholders' tunnelling behaviour. To fully examine the effect of the shareholder balance mechanism, we divide our sample into two groups according to the median of SBM adjusted by industry. And *Table 7* displays the results.

Table 7. The effect of the shareholder balance mechanism

	(1) Tunnel1_{t+1}	(2) Tunnel2_{t+1}
FRESID	0.0268*** (3.22)	0.2055*** (2.98)
Sbm	-0.0038 (-1.10)	0.0185 (0.65)
Sbm×FRESID	-0.0188* (-1.70)	-0.1685* (-1.84)
CONTROL_OWN	0.0000 (0.14)	0.0029*** (2.67)
CHAIRMAN	-0.0086 (-1.32)	0.0723 (1.33)
GDP_GROWTH	0.0383 (0.52)	0.3860 (0.63)
FIRST_OWN	-0.0006*** (-4.13)	-0.0008 (-0.65)
MANAGE_OWN	-0.0000 (-0.18)	-0.0000** (-2.36)
LEV	-0.0467*** (-4.17)	-0.4195*** (-4.53)
ROA	-0.0734 (-1.63)	-1.1221*** (-3.03)
LNBOARD	-0.0068 (-0.70)	0.0048 (0.06)
GROWTH	0.0027* (1.76)	-0.0060 (-0.46)
Industry	YES	YES

Table 7 (continuation). The effect of the shareholder balance mechanism

	(1) Tunnel1_{t+1}	(2) Tunnel2_{t+1}
YEAR	YES	YES
PROVINCE	YES	YES
_cons	0.0372 (0.92)	0.3614 (1.08)
N	4400	4400
r2	0.1669	0.0248
F	11.7719	1.4988

Notes: This table reports the effect of independent directors on controlling shareholders' tunnelling. FRESID equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel1 and Tunnel2 to measure the controlling shareholders' tunnelling behaviour, Tunnel1 is the ratio of net fund occupation by the controlling shareholder to total asset, and Tunnel2 is computed as cash dividend per share divided by the net incomes. Idp is measured as independent directors scaled by total directors. The sample period is from 2004 to 2017. See Table 1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

Table 7 shows that the coefficients on $Sbm \times FRESID$ are both negative and statistically significant, indicating that family firms with higher shareholder balance mechanisms, can curb the controlling shareholders to expropriate more private benefits through fund occupation and dividends expropriation.

4. Robustness Checks

In this part, we change tunnelling measures and use Tunnel3 computed as the ratio of the sum of receivables, other receivables, and prepayments to total assets and Tunnel4 equals cash dividend per share divided by earnings per share to run the regression again. And the findings above remain robust in Table 8.

Table 8. Robustness checks for foreign residency rights and tunnelling

	(1) Tunnel3_{t+1}	(2) Tunnel4_{t+1}
FRESID	0.0112** (2.33)	0.2876** (2.44)
CONTROL_OWN	0.0003*** (2.58)	0.0036 (1.34)
CHAIRMAN	-0.0235*** (-4.38)	-0.1320 (-1.00)
GDP_GROWTH	0.0080 (0.15)	0.0251 (0.02)
FIRST_OWN	-0.0008*** (-6.25)	-0.0011 (-0.38)
MANAGE_OWN	-0.0000 (-1.13)	-0.0000 (-0.72)
LEV	0.1406*** (15.19)	-0.4770** (-2.09)
ROA	0.0217 (0.57)	-1.9303** (-2.08)

Table 8 (continuation). Robustness checks for foreign residency rights and tunnelling

	(1) Tunnel3_{t+1}	(2) Tunnel4_{t+1}
LNBOARD	0.0007 (0.09)	0.0423 (0.21)
GROWTH	0.0027** (2.13)	-0.0192 (-0.61)
Industry	YES	YES
YEAR	YES	YES
_cons	0.0688** (2.12)	0.6691 (0.84)
N	4900	4900
r2	0.2439	0.0085
F	37.2590	0.9911

Notes: This table presents robust tests on the influence of foreign residency rights on tunnelling. The independent variable FRESID equals one if the firm's controller has foreign residency rights, and zero otherwise. And we construct Tunnel3 and Tunnel4 as alternatives to measure the controlling shareholders' tunnelling behaviour, Tunnel3 is the ratio of the sum of receivables, other receivables, and prepayments to total asset, and Tunnel4 is computed as cash dividend per share divided by earnings per share. The sample period is from 2004 to 2017. See Table1 for variable definitions. Significance at the 10%, 5%, and 1% levels is indicated by *, **, and ***, respectively.

Source: own calculations.

Columns (1)-(2) in *Table 8* show that family firms with foreign residency rights incline to tunnel the firm using fund occupation and cash dividends.

Conclusion

Recently, the migration of family firm entrepreneurs has become a public issue. Though scholars have examined its impact on corporate fraud, auditor selection, or capital structure (Chen *et al.*, 2018; Kong *et al.*, 2018; Yang *et al.*, 2019; Lu *et al.*, 2020; Hou, Liu, 2020), little attention was paid to the relationship between foreign residency rights and tunnelling. Based on the sample of Chinese family firms listed in the Small and Medium-sized Board and Second-board Market from 2004 to 2017, this paper investigates the impact of controlling persons with foreign residency rights on their tunnelling behaviour. And we mainly find that: 1) Family firms with foreign residency rights are more likely to tunnel the firm through fund occupation and cash dividends. 2) The higher disparity between cash flow and control rights, the higher possibility of controlling shareholders' expropriation. 3) For firms located in a better institution environment, with a higher proportion of independent directors or a better shareholder balance mechanism, this positive relationship is weakened.

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KONTROLIUOJANČIŲŲ AKCININKŲ REZIDAVIMO UŽSIENYJE TEISIŲ EKONOMINIAI REZULTATAI: ĮRODYMAI IŠ KINIJOS

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SANTRAUKA

Šiame straipsnyje nagrinėjamas teisės gyventi užsienyje poveikis tuneliavimui. Pasitelkus kruopščiai atrinktus 2004–2017 m. duomenis apie Kinijos šeimų įmones kontroliuojančius asmenis, kurie turi teisę gyventi užsienyje, nustatyta, kad šios įmonės yra siejamos su didesne nusavinimo paskata, jos labiau linkusios perkelti pelną ir turtą iš įmonių jas kontroliuojančių asmenų naudai, užimdamos fondus ir išmokėdamos dividendus grynaisiais pinigais. Šis efektas stiprėja didėjant pinigų srautų ir kontrolės teisių atskyrimui, o mažėja tada, kai įmonės įsikūrusios palankesnėje institucinėje aplinkoje turi didesnę nepriklausomų direktorių skaičių arba tinkamesnę akcininkų pusiausvyros mechanizmą. Šis tyrimas papildė literatūros darbus apie ekonominius rezultatus, susijusius su faktinėmis valdytojų teisėmis gyventi užsienyje, taip pat rodo, kad Kinijos reguliavimo institucijos turėtų skirti daugiau dėmesio šiam fenomenui.

REIKŠMINIAI ŽODŽIAI: teisė gyventi užsienyje, tuneliavimas, Kinija.

Appendix 1**Table 2A. Sample distribution**

Panel A Distribution of residency rights							
	Year	Number of residency rights	Percentage	Column percent			
	2004	1	0.120	0.120			
	2005	2	0.240	0.360			
	2006	2	0.240	0.600			
	2007	3	0.360	0.950			
	2008	6	0.720	1.670			
	2009	15	1.790	3.460			
	2010	33	3.940	7.400			
	2011	54	6.440	13.84			
	2012	76	9.070	22.91			
	2013	99	11.81	34.73			
	2014	106	12.65	47.37			
	2015	128	15.27	62.65			
	2016	142	16.95	79.59			
	2017	171	20.41	100			
	Total	838	100				
Panel B Industry distribution of residency rights							
Industry		Number	Percentage				
B	Mining	2	0.24				
C1	Food and beverage, clothes, and fur	53	6.33				
C2	Petroleum, chemistry, rubber and plastic, Medical and biological products, Wood, Furniture, Papermaking, and printing	218	26.01				
C3	Machinery, Equipment, Metal and Non-metal, Electronic	371	44.27				
C4	Instruments, Other manufacturing	32	3.82				
D	Electricity, Heat, Gas, and Water Production and Supply	6	0.72				
E	Construction	21	2.51				
F	Wholesale and Retail	15	1.79				
G	Transportation, Storage, Postal Service	1	0.12				
I	Information Transmission, Software, and Information Technology Services	73	8.71				
J	Finance	2	0.24				
K	Real Estate	11	1.31				
L	Leasing	3	0.36				
M	Scientific research and technological service	6	0.72				
N	Water Conservancy, Environmental, and Public Facilities Management	15	1.79				
R	Culture, Sports, Entertainment	9	1.07				
Total		838	100				
Panel C Summary statistics of main variables							
variable	N	mean	sd	p25	p50	p75	max
Tunnel1	6337	0.0600	0.120	0	0.0600	0.120	0.600
Tunnel2	6360	0.250	0.880	0.0400	0.110	0.270	32.37

Tunnel3	6347	0.1883	0.1112	0.1098	0.1693	0.2477	0.8477
Tunnel4	6360	0.5592	2.1652	0.1777	0.3294	0.5889	100
FRESID	6274	0.100	0.300	0	0	0	1
Market	3484	0.4960	0.500	0	0	1	1
Idp	6350	0.3758	0.0536	0.3333	0.3333	0.4286	0.6667
Sbm	6360	0.5013	0.5000	0	1	1	1
CONTROL OWN	6261	37.68	15.48	25.62	36.35	48.93	84.21
CHAIRMAN	6360	0.900	0.300	1	1	1	1
GDP GROWTH	6360	0.100	0.0400	0.0800	0.100	0.110	0.260
FIRST OWN	6360	33.28	13.55	22.62	31.70	42.12	86.49
MANAGE OWN	6360	0.0870	0.1300	0.0800	0.0510	0.1100	0.2000
SIZE	6358	20.78	1.080	20	20.70	21.44	25.96
LEV	6360	0.320	0.180	0.180	0.300	0.440	1.040
ROA	6360	0.0500	0.0500	0.0300	0.0500	0.0800	0.390
LNBOARD	6350	2.100	0.180	1.950	2.200	2.200	2.710
GROWTH	6209	0.260	1.190	0.0300	0.170	0.350	84.99

Notes: Table 2A presents summary statistics of foreign residency rights and main variables. Panel A shows the yearly distribution of residency rights, Panel B reports the industry distribution of foreign residency rights. Panel C presents summary statistics of the main variables. The sample period is from 2004 to 2017. All variables are defined in Table 1.

Source: own calculations.