Does State/Private Ownership Affect the Relationship between Top Management Compensation and the Default Risk of Firms? Evidence from the Chinese Stock Market

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ABSTRACT

Despite the Chinese economy having achieved an extraordinary rate of growth over recent decades, accompanied by the absorption of considerable amounts of foreign investment, the laws pertaining to business in China have clearly failed to keep pace with the country's market growth. It is therefore important for investors to carefully assess the associated risks in what is now considered to be the most important of all emerging markets; thus, in this study, we set out to examine the relationship between default risk and top management compensation in the Chinese stock market. Our results reveal that lower levels of top management compensation are accompanied by a greater likelihood of default. Furthermore, in addition to studying the relationship for the full sample, we divide the sample into two sub-groups, state-owned enterprises (SOEs) and privately-owned enterprises (POEs), and find that whilst the negative relationship between top management compensation and the default risk of firms persists for POEs, such a relationship is not discernible within SOEs.

Keywords: Default risk; Top management compensation; State-owned enterprises.