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State Minority Ownership and Financial Reporting Quality: Evidence from China's Private Sector

Fuyun Zhu, Jing Chen

School of Economics and Management, Shaanxi University of Science and Technology, Xi'an, Shaanxi, 710021, China

Abstract: This paper investigates the impact of state-owned capital participation on the quality of accounting information in private enterprises. The study finds that an increase in the level of state-owned capital participation contributes to improving the quality of accounting information in private enterprises. Mechanism tests indicate that curbing asset stripping by major shareholders, reducing operational risks are key channels through which state-owned capital participation improves the quality of accounting information in private enterprises. These findings contribute to a deeper theoretical understanding of mixed-ownership reform in private enterprises, whilst also providing valuable insights for promoting improvements in corporate accounting information quality.

Keywords: State-owned Capital Participation; Accounting Information Quality; Major Shareholder Asset Stripping; Operational Risk; Governance Standards.

1. Introduction

Accounting information not only provides a historical reflection of a firm's operational results and financial performance but also reflects market participants' expectations regarding the firm's future development. Its quality determines, to a certain extent, the economic activities of market participants and further influences the long-term stable development of capital markets. High-quality accounting information helps alleviate the problem of information asymmetry between firms and investors (Francis et al. 2008) [1], guides investors towards rational decision-making, and promotes the optimal allocation of market resources, thereby enhancing the operational efficiency of both firms and capital markets.

Within China's economic system, private enterprises are a vital force in driving economic growth, creating employment, generating tax revenue and stimulating innovation. However, compared with state-owned enterprises, private enterprises face numerous challenges in their development. In terms of financing, due to factors such as their relatively low market standing and credit discrimination, private enterprises are prone to difficulties in accessing finance and high borrowing costs (Cull et al. 2015) [2]. In terms of corporate governance, private enterprises have relatively weak oversight mechanisms, and agency problems are particularly pronounced. More crucially, compared to the policy-driven and social functions undertaken by state-owned enterprises, private enterprises are driven by a stronger profit motive; these practical constraints collectively give rise to a potential tendency for private enterprises to seek excess returns through means such as information manipulation and earnings management. Against this backdrop, exploring pathways to improve the quality of accounting information and effectively enhancing the quality of accounting information in private enterprises has become a pressing practical need.

Existing research has analysed the factors influencing accounting information quality from both internal and external perspectives. Regarding internal factors, studies have found that a company's digital transformation helps to improve accounting information quality (Zhenjie Li et al. 2025) [8], whilst the allocation of digital assets reduces information quality (Zhi Yang et al. 2025) [9]. Furthermore, the application of artificial intelligence within enterprises (Tongshu Yang et al. 2025) [10], an increase in social media coverage (Jackie et al. 2025) [3] and executives' legal backgrounds (Shan Zhang et al. 2024) [7] can all enhance the quality of accounting disclosures. With regard to external factors, big data-driven tax supervision (Yan Zhou et al. 2025) [11], administrative audit supervision (Hui Chen et al. 2024) [12] and capital market liberalisation (Yifu Zhang et al. 2024) [13] all contribute to improving the quality of accounting information.

Against the background of accelerating economic globalization and the continuous transformation of China's economy, the reform of the economic system has been steadily deepened. As one of the core initiatives, mixed-ownership reform plays a critical role in revitalizing market dynamics and improving the efficiency of resource allocation. Since the Third Plenary Session of the 18th CPC Central Committee in 2013 formally proposed to vigorously develop the mixed-ownership economy, a series of supportive policies have been released, which have greatly promoted the cross-integration of capital with different types of ownership.Thus, a systematic analysis of the impact of state-owned capital participation on private enterprises is of great significance. This not only helps further validate the actual effects of state-owned capital but also aids in exploring effective institutional arrangements to promote the healthy development of the private economy.

When state-owned capital is introduced into private enterprises, it affects both resource allocation and corporate governance structures, thereby having a far-reaching impact on enterprise development. On the one hand, the participation of state-owned capital helps enhance the credit reputation and financial strength of private enterprises, thereby effectively alleviating credit discrimination and financing constraints (Cull et al., 2015) [2]. Leveraging these advantages, private enterprises are more likely to accelerate their digital transformation (Chen Zhe et al., 2024) [14], improve labor-capital efficiency (Ni Bangling et al., 2025) [15], and enhance their risk resilience (Gao Lihui et al., 2025) [16]. On the other hand, differences between state-owned shareholders and private enterprises in terms of operational characteristics and development objectives may give rise to more severe principal-agent conflicts and governance issues. These problems may reduce management efficiency (Dong Yan et al., 2022) [18] and undermine corporate profitability(Zhang Yufei et al., 2025) [17]. Given this double-edged sword effect, this paper focuses on the central question: Can the participation of state-owned capital improve the quality of accounting information in private enterprises? Through which channels does this effect operate, and what constraints does it face? Currently, the existing literature has not provided sufficient and clear answers to these questions; therefore, further research is urgently needed.

2. Theoretical Analysis

2.1. State-Owned Capital Participation and Accounting Information Quality

The quality of corporate accounting information is primarily reflected in earnings management practices. As the most critical insiders within a firm, managers and controlling shareholders possess both the ability and the incentive to manipulate earnings in order to maximise their own interests. Managers, seeking to improve the company's performance in order to secure remuneration incentives, may artificially adjust financial statements to meet target requirements. Controlling shareholders, in turn, may manipulate corporate earnings to secure excess returns, thereby encroaching upon the interests of minority shareholders. State capital participation, through equity dilution and the appointment of directors, supervisors and senior management (hereinafter referred to as 'directors, supervisors and senior management') to participate in corporate governance, can curb the earnings manipulation behaviour of managers and controlling shareholders.

A higher stake held by state-owned shareholders introduces a more balanced distribution of power among existing equity participants, thereby preventing any single large shareholder from exercising unilateral control over accounting policy choices (Shleifer and Vishny, 1997) [4]. In parallel, after acquiring an equity interest, state-owned investors typically dispatch their representatives to serve as directors or supervisors on the board and supervisory committees. The interests embodied by these state-appointed insiders serve as a counterbalance to the original controlling faction, ensuring that key accounting decisions are subject to collective deliberation rather than the discretion of a single party. This institutional arrangement effectively curtails the possibility of manipulating financial information at the very stage where decisions are made.

Furthermore, the supervisory framework governing state-owned assets imposes compliance requirements on financial operations that are substantially more rigorous than those typically faced by private investors. Once state capital secures a stake, the private enterprise is compelled to adopt a more standardized accounting system, which in turn constrains the space available for profit manipulation. In addition, external audit firms tend to apply more exacting scrutiny to companies with state-owned equity participation, further narrowing the avenues through which earnings can be distorted—whether by concealing transactions or fabricating business activities.

2.2. Analysis of the Mediating Mechanisms Through Which State Capital Participation Affects Accounting Information Quality

(1) Curbing Asset Stripping by Major Shareholders

From the perspective of corporate governance, the directors, supervisors and senior executives appointed by state-owned shareholders following their investment can serve as a governing force with practical supervisory and decision-making capabilities. Appointed directors can participate directly in major board decisions, conducting professional reviews and vetoing self-serving decisions by the original shareholders that may involve asset stripping through related-party transactions or the misappropriation of funds; appointed supervisors, meanwhile, focus on financial oversight and compliance reviews. By auditing financial statements and monitoring the implementation of internal controls, they can promptly detect and prevent the original shareholders or management from concealing asset-stripping activities through irregular accounting practices (Jiang et al. 2010) [5];Appointed senior executives can standardise the company's financial accounting processes at the day-to-day operational level, thereby preventing the original management from colluding with major shareholders to carry out irregular accounting practices associated with asset stripping, such as the misappropriation of funds and the channelling of benefits. Intervention across multiple levels—decision-making, supervision and execution—can effectively reduce asset stripping by the original shareholders, curb the controlling shareholder's encroachment on the interests of the company and minority shareholders, alleviate agency problems at the governance implementation level, and further restrict the scope for asset stripping by major shareholders.

A significant curbing of asset stripping by major shareholders will promote alignment of the interests of all shareholders. When the former controlling shareholder is unable to profit through asset stripping, and management is unable to collude in manipulating performance figures to secure short-term gains, all parties will focus more on the long-term value growth of the enterprise, thereby reducing instances of financial statement fraud that harm the company's long-term development in pursuit of short-term gains from asset stripping. At the same time, a standardised governance structure and effective oversight mechanisms will also make the processes of financial statement preparation, auditing and disclosure more transparent, reducing the scope for financial statement manipulation designed to conceal asset stripping and thereby achieving a significant improvement in the quality of accounting information.

(2) Reducing Operational Risks

Backed by the financial and policy support of the state, state-owned capital faces far less financial pressure and operational risk than private enterprises. Through its unique advantages, state-owned capital's equity participation will empower and support private enterprises across three key dimensions, thereby reducing operational uncertainty and promoting their stable development.Firstly, in response to the financing difficulties commonly faced by private enterprises, equity participation by state-owned capital effectively serves as a 'credit enhancement' for the enterprise. This not only helps the enterprise secure financing support—such as low-interest bank loans and bond issues—more readily, but also reduces the risk of operational disruption caused by cash flow difficulties (Faccio et al. 2006) [6], thereby sparing the enterprise from having to passively scale back production or forgo development opportunities under financial pressure;Secondly, regarding policy and compliance risks, state-owned enterprises have long been deeply rooted in the market and possess a more precise understanding of industry regulatory policies, industrial guidelines and compliance requirements. Following the acquisition of a stake by state-owned capital, through participation in decision-making and the provision of policy interpretation, state-owned enterprises can help private enterprises standardise their business practices in advance, thereby avoiding risks such as fines or production suspensions arising from misinterpretation of policies or non-compliant operations, and stabilising business expectations;Thirdly, in responding to changes in the market environment, state-owned capital is often backed by vast industrial chain resources and a stable customer network. It can build bridges of cooperation for private enterprises, helping them expand sales channels and connect with high-quality suppliers, thereby reducing operational risks arising from lost orders or sharp fluctuations in raw material prices, and making business operations more resilient.

With a substantial reduction in operational risks, a solid foundation is laid for improving the quality of private enterprises' accounting information.Under high operational risk, some private enterprises may manipulate accounting information—through fictitious transactions, profit manipulation or the concealment of liabilities—to mask losses, maintain investor confidence or meet financing thresholds; once operational risks are reduced, the enterprise's operating conditions become more stable, eliminating the need to rely on financial fraud to embellish financial statements, thereby significantly reducing the incentive for accounting misrepresentation.

3. Conclusion and Recommendations

This paper aims to examine whether state-owned capital participation has a positive impact on the quality of accounting information in private enterprises. The findings confirm that an increase in the proportion of state-owned capital holdings is associated with a significant improvement in accounting information quality. Through an analysis of mediating mechanisms, the results further indicate that higher levels of state-owned equity participation help curb asset stripping by major shareholders and reduce overall operational risk, thereby promoting improvements in accounting information quality.

Based on the above findings, this paper offers the following policy recommendations.

(1) Governments should optimise the system for targeted empowerment and policy coordination regarding state capital participation. On the one hand, in regions where market supervision systems are not yet fully developed and for private enterprises whose core business is technological innovation, efforts to facilitate engagement with state capital should be intensified. Through equity diversification reforms, professional governance resources should be introduced to address shortcomings in internal corporate oversight.On the other hand, fiscal support policies should be linked to corporate compliance with information disclosure requirements, with greater financial support provided to enterprises that present accurate financial data and have sound internal control mechanisms, thereby creating a dual effect combining 'policy incentives' and 'compliance constraints'. At the same time, a dynamic regulatory mechanism for enterprises with state-owned capital participation should be established to guide state-owned shareholders in assisting private enterprises to build long-term governance mechanisms through standardised decision-making processes and strengthened financial oversight, thereby alleviating operational uncertainty and improving the quality of information disclosure at its root.

(2) Private enterprises, for their part, should seize the opportunity presented by equity optimisation to refine their internal management systems. Those that have not yet engaged leading professional audit firms can use the opportunity of state capital participation to restructure their accounting processes, establish standardised financial management systems and reduce scope for human manipulation of information; they should also strengthen the development of their core management teams by recruiting professionals in finance and risk management or conducting specialised training, thereby enhancing management's ability to ensure financial compliance and aligning with the supervisory requirements of state shareholders; They should proactively strengthen engagement with professional market intermediaries to ensure unimpeded information flow and utilise external expertise to enhance transparency; simultaneously, by leveraging the resource advantages of state-owned capital, they should optimise strategic planning and risk management systems, stabilise business outlooks, reduce incentives for information manipulation arising from short-term operational pressures, and safeguard the authenticity and reliability of financial data.

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