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Article

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Foreign residency rights and companies' auditor choice

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ABSTRACT

Recently, with the migration of wealthy Chinese elites becoming increasingly prevalent, the market has come to believe that firms with controlling persons with foreign residency rights have serious agency problems. We study the impact of controlling persons with foreign residency rights on corporate audit perspective. We find that firms whose controlling persons have foreign residency rights are more likely to use high-quality auditing services, and that this behavior is more obvious in regions with lower marketization and in firms with higher separation of ownership and control. We further study the effect of firms whose controlling persons have foreign residency rights that use high-quality Big 4 auditors and find that such firms have better corporate governance and accounting performance.

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1. Introduction

Since China's reform and opening up, the country has experienced two waves of migration: the bottom-level labor migration at the end of the 1970s and the wave of people studying abroad in the 1990s. If these two waves of migration were the result of China's economic backwardness, why has a third wave of migration come about in the 21st century, when China's economic development has been remarkable and continues to grow rapidly? A difference is the new class of rich people who are obtaining residency overseas while still living in China.¹ After obtaining foreign residency rights, they continue to conduct business or work in China (Li, 2014). Many of these new rich people are controllers of listed companies in China, which means that their

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¹ According to the 2011 China Private Wealth Report issued by China Merchants Bank, "nearly 60% of the multi-millionaires surveyed have completed investment immigration or have relevant considerations. In the case of billionaires (their investable assets are more than 100 million yuan), about 27% of them have completed investment immigration."

migration not only caused a large capital outflow, but also resulted in the loss of elite talent, which directly affects the sustainability of China's economic development.

The traditional view is that increasing income and obtaining a comfortable living environment are the main reasons for migration (Freeman, 1993; Ebmer, 1994). However, Chen et al. (2013) point out that these traditional viewpoints are difficult to explain to the current wave of new migrants. The main motive of China's new rich class for obtaining foreign residency rights is to be able to flee abroad more easily to escape sanctions from domestic law after corporate violations. Since 2003, CSRC has required listed companies to disclose information on controlling shareholders' foreign residency rights to allow market investors to pay special attention to the risks of such companies. *People's Daily Online*, *China News Service*, *Phoenix Net* and *Southern Weekend* have reported news about newly wealthy immigrants and pointed out that many such new immigrants are prepared to flee the government or the market for "after-autumn accounts." Skepticism from regulators and unfavorable speculation by the media reflect external stakeholders' fear that the controller's foreign residency status will reduce the cost of encroaching on the interests of shareholders and creditors and their belief that such companies have more serious agency problems. This article focuses on how a company for which the controller has foreign residency rights addresses these concerns.

When external stakeholders suspect that company managers have agency problems, managers will actively seek a monitoring or binding mechanism to constrain their behavior. External independent auditing is one of the most important monitoring mechanisms (Jensen and Meckling, 1976). Fan and Wong (2005) show that the more serious the company's agency problems are, the more likely the company is to hire high-quality auditing services to signal to the market that it has good corporate governance. According to agency theory, the agency of a company with a controller with foreign residency rights would be widely questioned by the government and the market, motivating the company to seek a binding mechanism to signal to the market that it has good corporate governance. We examine this issue from the perspective of an external independent audit and find that companies with controllers with foreign residency rights are more likely than other companies to hire high-quality auditing services. The results still hold after we take endogenous effects into account. The group regression reveals a significant phenomenon: in regions with lower degrees of marketization and in companies with higher levels of separation of the cash flow and voting rights, companies with controllers with foreign residency rights are more likely than other companies to hire high-quality auditing services. However, when accounting irregularities occur, companies whose controllers have foreign residency rights are not more likely than other companies to hire high-quality auditing services. Most of the results above apply to countries with which China has not signed an extradition clause. Listed companies whose controllers obtained foreign residency rights before listing are more likely to choose Big 4 auditors than those whose controllers obtained foreign residency rights after listing. On this basis, we further examine the influence of such companies hiring Big 4 auditors on their corporate governance and accounting performance. The results show that those companies had better corporate governance and higher accounting performance and that they paid higher audit fees.

This is the first study of how controllers' foreign residency rights influence company audits. It enriches the literature on migration and audits and provides reference value for entrepreneurial corporate management and investors' investment decisions. First, the literature on migration phenomena mainly examines the motives behind migration, and it lacks studies of the influence of corporate controllers' migration on corporate behavior. Chen et al. (2013) find that having a controller with foreign residency rights is related to more corporate fraud, but it is also important to know how such companies respond to distrust from external markets and regulations in the face of growing migration by the wealthy elite. The results of this paper show that companies with controllers with foreign residency rights are more likely than other companies to choose Big 4 auditors to mitigate distrust from the external market. Thus, this article fills this gap in the migration literature. Second, there has been controversy regarding whether independent audits can provide sufficient corporate governance. As wealth migration is attracting increasing social attention, this paper examines the relationship between whether the company's controllers with foreign residency rights and the company's independent audit. From this new perspective, we validate the governance function of independent audits in emerging markets, based on the work of Watts and Zimmerman (1983) and Fan and Wong (2005) on audit governance roles. Third, wealthy elite migration has increased, and their trust costs in domestic entrepreneurship have

increased as their identities have changed. This article provides a way to reduce the trust cost for such entrepreneurs from the perspective of auditor choice, and provides a reference value for investors to evaluate such companies.

2. Literature review and theoretical analysis

2.1. Literature review

Furnham (1990) believes that the motives of immigrants are mainly divided into two categories. One is the desire for a better living environment, such as a better climate or cultural environment, in new countries, and the other is the desire to avoid political risk or discrimination in the original country. The former is an external force that attracts migrants, and the latter is an internal force that encourages emigration. Freeman (1993) and Ebmer (1994) point out that foreign countries' higher income is an important incentive for migrants. Hanson and McIntosh (2009) use the data for Mexican immigrants in the United States and find that the main reason for their migration is high employment pressure due to the Mexican job market's labor supply outgrowing labor demand. The number of immigrants from Mexico to the United States thus increased significantly. Boustan, Kahn and Rhode (2012) point out that residents may migrate to escape frequent local tornadoes. Chen et al. (2013) find that apart from these traditional immigration motives, the main motivation for Chinese businessmen's migration is to be able to flee abroad to avoid sanctions for corporate violations. Thus, controllers obtaining foreign residency rights presents an agency problem.

In summary, the literature mainly examines the motivations for individuals to obtain foreign residency rights from the perspectives of climate, culture, political risks, labor income and agency problems. Few studies examine the economic consequences of the controllers of companies obtaining foreign residency rights. Chen et al. (2013) find that companies whose controllers have foreign residency rights are more likely to violate regulations than other companies, and this article further examines how the controllers who have these rights influence companies' choice of auditor.

2.2. Institutional background and theoretical analysis

The 2010 "Global Politics and Security" report of the Chinese Academy of Social Sciences shows that China is becoming the world's largest exporter of migrants. At present, there are about 45 million Chinese scattered around the world, and China has the most elite expatriates in the world. The 2012 "International Chinese Immigration Report" report states, "Among entrepreneurs whose personal assets exceed 100 million yuan, 27% have already emigrated, 47% are considering immigrating. As for high-net-worth individuals with personal assets exceeding 10 million yuan, nearly 60% have completed investment immigration or had related considerations." This survey suggests that unlike the labor migration of the 1970s and the skilled migration of the 1990s, most of this migration is occurring among the new rich class, and the entrepreneurial migration discussed in this paper makes up a considerable proportion. There are profound institutional reasons for the emergence of such large-scale migration by entrepreneurs.

First, China's institutional environment enables migrating entrepreneurs to achieve greater efficiency in their enterprises' overseas investment. With the integration of the global economy, the demand for foreign operations and investment has increased significantly. However, China's Overseas Investment Management Measures (henceforth "the Measures") has severely limited Chinese enterprises' foreign investment. The Measures stipulate that central enterprises' foreign investment must be examined and approved by the provincial commercial authority and then the Ministry of Commerce, and it may even require the opinions of overseas embassies or consulates (business offices). After these procedures, it is also necessary for the enterprise to obtain certificate of approval for foreign exchange, banking, customs, foreign affairs and other related procedures. In addition to the long waiting time for each procedure, there is considerable risk that the applications will be denied. Although China's government control over foreign investment by domestic companies has eased, there are still many obstacles. If entrepreneurs migrate, they can invest in those countries as citizens to avoid this tedious process. Although certain procedures are required for migrating entrepreneurs obtaining

nationality to invest, it is still much easier than investing as a Chinese citizen.² Receiving countries could consider adopting high-quality immigration to bring in capital and promote their own economic growth. Thus, loose and preferential incentive policies have been generally implemented for entrepreneur and investment migration.³

Second, China's institutional environment enables entrepreneurs to enjoy better policies after migrating, as the government gives foreign-invested enterprises more preferential policies than domestic-funded enterprises. After entrepreneurs emigrate, they are more likely to turn their company into a foreign-invested enterprise, which makes it easier to obtain more preferential policies than domestic-funded enterprises in terms of taxation, land use rights and bank loans. China's Ministry of Commerce issued guidelines in China's Foreign Investment Policy: "Foreign-invested enterprises may enjoy the benefit of two years' exempting and three years' half reduction of corporate income tax from the profit-making year; for foreign-invested enterprises encouraged by countries and locating in the central and western regions, they may extend the half reduction of income tax for three years after the expiration of the five-year tax exemption period; for export-oriented enterprises, in addition to enjoying the above two-year exemption and three-year half reduction, they can also enjoy a half reduction of income tax as long as the annual export value accounts more than 70% for the total sales of the enterprise." Each province, municipality and special economic zone has specific preferential policies for foreign investment in accordance with guidance from the central government, while the degrees of preferential policies differ by region. To attract foreign investment, local governments have much more support and more preferential policies for foreign-invested enterprises in terms of land use and bank loans than domestic-funded enterprises to attract foreign investment.

Third, a number of other factors also play roles. Chinese society believes that European and American educations are superior to China's exam-oriented education, and compared with studying abroad, the cost of sending children to school by acquiring citizenship from migration is much lower. Furthermore, China has created a great deal of pollution because of industrial development, and the environmental problems and food safety problems caused by air, water and land pollution in recent years have made the domestic ecological environment more difficult to live in.

Entrepreneurs' migration is thus related to both government-to-business control and to personal and family factors. Chinese culture has always had a tendency to show contempt for merchants and wealth, as evidenced by the community's attention to the Hurun Rich List. The public not only pays great attention to the wealth of the richest people but also speculates about how their wealth was accumulated, often assuming that wealthy entrepreneurs became successful because of illegal activities. How does the public understand private entrepreneurs' foreign residency rights in this society and culture, and how do such companies respond to this understanding? The following theoretical analysis thus incorporates the institutional background of Chinese enterprises.

2.3. Theoretical analysis

An emerging market in transition, China's capital market is poorly regulated, its law enforcement is inefficient and its financial system is imperfect. However, China has nevertheless experienced rapid economic growth. One important reason for this growth is the social relationship contract under China's Confucian culture, which compensates for the imperfections of the legal and financial systems and promotes the development of the private economic sector (Allen et al., 2005). What kind of relationship is this social contract? According to Kornai et al. (2003), paternalism theory, state-owned enterprises are more likely to be allocated resources in a government-controlled economy, which greatly increases the cost of private enterprises' access to resources. Private enterprises will thus establish political relationships with the government as part of their business strategy (Choi et al., 1999). Xin and Pearce (1996) and Luo and Tang (2009) find that China's low

² According to Djankov's survey, the establishment of a company in China requires 12 approvals, more than the average of the sample countries (10), and it requires 92 days, which is much higher than the sample average (47). In Canada, by comparison, the establishment of a company requires only two approvals and two days.

³ Although after 2016, European countries and the United States tightened their immigration policies toward China, they are still very welcoming to high-quality immigrants such as entrepreneurs.

level of legal protection, such relationships can help private enterprises obtain policy support and reduce the acquisition cost of important resources. Private firms will typically do everything possible to establish political relations with government departments to obtain privilege, resources and political protection.

China's government has concentrated power and can seek rent from enterprises (Shleifer and Vishny, 1994). When establishing political relations with the government, private enterprises will inevitably engage with rent-seeking government officials who have the power to allocate resources (Claessens et al., 2008). Herman and Wang (2002) use the findings from the World Bank and European Development Bank's 1999 survey of 3000 companies in 25 transition countries to examine the trading relationship between the government and companies in transition countries. To obtain policy support and political protection, enterprises have to pay large bribes to the government (Yu et al., 2010). The low efficiency of law enforcement leads companies to succumb to competitive pressure or greed and to engage in unethical behaviors such as rent seeking, transfer of assets and tax evasion (Cai and Liu, 2009). Such unethical behaviors by private entrepreneurs have drawn society's ire and resulted in allegations that their success is due to their "original sin."

Controllers who obtain foreign residency rights can reduce the cost of their illegal actions, as they can more easily flee from China and evade punishment after illegally transferring assets or infringing on the interests of shareholders (Chen et al., 2013). As the gap between rich and poor continues to widen and legal system has improved, social hatred toward private entrepreneurs has increased. Private entrepreneurs who have been labelled guilty of "original sin" are often treated with suspicion and are increasingly expected by the public to be targets of future punishment. Because such entrepreneurs are more likely to evade Chinese law or have lower illegal costs and are thus more likely to infringe on the interests of shareholders and to commit corporate fraud, the agency problem can be serious. Chen et al. (2013) shows that companies whose controllers have foreign residency rights are more likely to commit illegal acts than other companies. As the most important rational economic actors in the construction of the market economy, they must respond to negative evaluations and unfavorable speculation from the market. Jensen and Meckling (1976) point out that, following rational expectation theory, the agency costs from managers' opportunistic behavior are ultimately borne by agents. Therefore, when external stakeholders suspect that the company has agency problems, managers will actively look for a monitoring or binding mechanism to restrict their own behavior. External independent auditing is one of the most important monitoring mechanisms.

Since the middle of the 19th century, auditing has played an important role in relieving companies' agency problems in the U.K. and U.S. (Lee, 1971). For the audit to reduce the agency cost, the auditor must be able to find and report the manager's violation of the contract and to guarantee the independence of the audit (Watts and Zimmerman, 1983). Research shows that the independence of the audit is closely related to the size of the audit firm. The larger the firm is, the less the influence of a single customer on the firm will be, and the less likely the firm is to compromise with customers; thus, it will have a higher level of independence. A firm's size is thus representative of its professional standards and can be used as an alternative to audit quality (a common result of independence and professional competence) (DeAngelo, 1981). Francis and Wang (2008) and Wang et al. (2009) show that the use of Big 4 audit firms, international organizations with good reputations, can send high-quality audit signals to the market. Thus, from a rational economic perspective, a company whose controller has foreign residency rights has greater incentives than other companies to hire a Big 4 auditor to signal low agency costs to the market. We thus propose the following hypothesis.

Hypothesis 1. Other things being equal, companies whose controllers have foreign residency rights are more likely than others to hire a Big 4 auditor.

In addition to examining the relationship between foreign residency rights and the choice of auditor, this article further examines the influence of foreign residency rights on company audit fees. Companies whose controllers have foreign residency rights are more likely to violate the law than other companies (Chen et al., 2013). Moreover, since the third wave of wealth migration began, market investors and regulators have begun to pay special attention to companies whose controllers have foreign residency rights. Auditors must spend more energy and time assessing such companies' control risks, and the high litigation risk of such

companies also increases the auditor's litigation risk. According to audit theory, the greater the litigation risk, the more time and effort are required for auditing, and the higher the audit fees (Simunic, 1980; Simunic and Stein, 1996; Fan and Wong, 2005). Hence, we propose the following hypothesis.

Hypothesis 2. Other things being equal, companies whose controllers have foreign residency rights pay higher audit fees.

3. Research design

Based on Fan and Wong (2005) and the empirical model of Tang (2011), we use the following model (1) to test Hypothesis 1 and model (2) to test Hypothesis 2.

$$\begin{aligned} \text{Bigfour}_{it} = & \beta_0 + \beta_1 \text{Residy}_{it} + \beta_2 \text{Cv}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{Lev}_{it} + \beta_5 \text{Roa}_{it} + \beta_6 \text{Central}_{it} + \beta_6 \text{Indboard}_{it} \\ & + \beta_7 \text{Receivalbes}_{it} + \beta_8 \text{Inventory}_{it} + \sum \text{Industry} + \sum \text{Year} + \mu_{it} \end{aligned} \quad (1)$$

$$\begin{aligned} \text{Auditfee}_{it} = & \beta_0 + \beta_1 \text{Residy}_{it} + \beta_2 \text{Cv}_{it} + \beta_3 \text{Size}_{it} + \beta_4 \text{Lev}_{it} + \beta_5 \text{Roa}_{it} + \beta_6 \text{Central}_{it} + \beta_6 \text{Indboard}_{it} \\ & + \beta_7 \text{Receivalbes}_{it} + \beta_8 \text{Inventory}_{it} + \beta_9 \text{Mar}_{it} + \beta_{10} \text{Bigfour}_{it} + \sum \text{Industry} + \sum \text{Year} + \mu_{it} \end{aligned} \quad (2)$$

Based on the above theoretical analysis, we establish model (1) to test whether a company's controller has foreign residency rights is related to the company's choice of auditor. The explained variable is whether to hire a Big 4 auditor (*Bigfour*), and the main explanatory variable is whether the company's controller has foreign residency rights (*Residy*).

The data on whether the controllers of companies have foreign residency rights come from the companies' annual financial reports. In 2003, the China Securities Regulatory Commission promulgated the "Guidelines for Contents and Formats of Information Disclosure by Enterprises that Publicly Issue Securities, No. 2 – Contents and Formats of Annual Reports," which requires listed companies to disclose the controllers' foreign residency rights in the current year. We manually read companies' annual financial reports to obtain data on whether each company's controller has foreign residency rights. *Residy* equals one if the annual report indicates that the controller has foreign residency rights and zero otherwise.

Referring to the literature on company auditor choice (such as Fan and Wong, 2005; Tang, 2011), we use company size (*Size*), financial leverage (*Lev*), return on assets (*Roa*), separation of cash flow and voting rights (*Cv*), centralization of shareholding (*Central*) and board independence (*Indboard*) as control variables. In company auditing, accounts receivable and inventory require auditors with high professional qualifications to make accounting estimates and judgments (Li and Song, 2010). We believe these two factors are likely to affect whether a company chooses a Big 4 auditor. Therefore, in model (1), we control accounts receivable (*Receivables*) and inventory (*Inventory*), respectively. Considering the influence of industry and annual differences on companies' auditor choice, we also control two dummy variables, industry (*Industry*) and year (*Year*), in model (1).

We also establish model (2) to test whether a company controller having foreign residency rights is related to company audit fees. The explained variable is the audit fee (*Auditfee*), and the main explanatory variable is *Residy*, as in model (1). Two control variables are added to model (2): auditor choice (*Bigfour*) and market environment (*Mar*). Definitions of each model variable are given in Table 1.

4. Sample selection, data sources and descriptive statistics

4.1. Sample selection and data sources

This article uses non-financial listed companies whose controllers in Shanghai and Shenzhen were naturalized persons from 2005 to 2013 as the research object. The data for each company's controller come directly from the CSMAR database. After eliminating the observations with asset–liability ratios greater than 1 and those lacking data, the total number of valid observations in the final sample was 7725. Panel A of Table 2 lists

Table 1
Variable definitions.

Variables	Definitions
Bigfour	Auditor choice: Indicator that equals one if the company's auditor is Deloitte, PWC, KPMG or EY, and zero otherwise
Auditfee	Audit fee: Measured as the natural logarithm of the company's audit fees
Em	Earnings management: Indicator calculated by the Jones model
Residy	Foreign residency right: Indicator that equals one if the company's controller has foreign residency rights, and zero otherwise
Deverisdys	Category of foreign residency right: Indicator that equals one if the company's controller has foreign residency rights in a developed country, and zero otherwise
Residylist	Category of foreign residency right: Indicator that equals one if the company's controller has foreign residency rights at the beginning of the company's listing, and zero otherwise
Size	Company size: Measured as the natural logarithm of the company's total assets
Lev	Financial leverage: Measured as the company's asset–liability ratio
Roa	Profitability: Measured as net profit divided by total assets
Tobinq	Tobin's Q: Measured as market value divided by total assets
Cv	Separation of two rights: Separation of cash flow and voting rights, with indicators from the CSMAR database
Central	Centralization of shareholding: Measured as the shareholding ratio of the largest shareholder
Indboard	Independence of board: Measured as the ratio of the number of independent directors to the total number of directors
Receivables	The proportion of accounts receivable in total assets: Measured as the accounts receivable balance divided by total assets
Inventory	The proportion of inventory to total assets: Measured as the inventory balance divided by total assets
Mar	Measurement of the market environment: Indicator that equals one if the company is located in Beijing, Shanghai, Tianjin, Guangdong Province, Zhejiang Province or Jiangsu Province, and zero otherwise
Export	Dummy variable: Indicator that equals one if the company has overseas business in a certain year, and zero otherwise
Fict	Measured as the natural logarithm of the number of new contracts signed by China's economic groups with foreign businessmen in certain years in the region in which the company is located
Fraud	Dummy variable: Indicator that equals one if the company has accounting irregularities, and zero otherwise
Industry	Industry dummy variable
Year	Annual dummy variable

the specific distribution of samples from an annual perspective: For 2005–2013, there are 442, 460, 526, 604, 680, 996, 1231, 1397, and 1389 samples, respectively. The observed values increase annually, which is consistent with the development trend of China's capital market. Panel B of Table 2 lists the distribution of the samples in various industries. In our sample, companies from the manufacturing industry account for the largest proportion, 66.25%, followed by the information technology industry and the real estate industry, which account for 9.42% and 5.46%, respectively. Overall, these characteristics are consistent with the distribution of listed companies in China. Panel C of Table 2 lists the distribution of foreign residency rights of the controllers of the sample companies: 9.94% of company controllers have foreign residency rights, while 90.06% do not. Of the 768 controllers who have the rights, 45.96% obtained the rights before their companies were listed, while 54.04% obtained them afterward. This article also uses winsorization (1%) to deal with extreme values of the relevant variables. The company's financial data and corporate governance structure data are taken from the CSMAR database. Since 2003, the China Securities Regulatory Commission has asked companies to disclose whether their controllers have foreign residency rights. Hence, by reading the relevant information in the sample companies' annual reports, we obtain data for *Residy*.

Table 3 shows the distribution of overseas residences of the controllers of private listed companies in China. As the table shows, during 2005–2013, Hong Kong, Canada, Australia and the U.S. had relatively large number of controllers who had obtained foreign residency rights. As of 2013, the Philippines and Australia had signed extradition clauses with China (in 2001 and 2007, respectively).

4.2. Descriptive statistics

Table 4 reports the descriptive statistics of the variables, and Table 4A presents the descriptive statistics for all of the samples. The average value of the auditor choice variable (*Bigfour*) is 0.019, which means that among the companies whose controllers are naturalized persons, fewer than 2% selected a Big 4 auditor. We divide the

Table 2
Sample distribution.

<i>Panel A: Year</i>											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total	
Quantity	442	460	526	604	680	996	1231	1397	1389	7725	
Percentage	5.72%	5.95%	6.81%	7.82%	8.80%	12.89%	15.94%	18.08%	17.98%	100%	
<i>Panel B: Industry</i>											
										Quantity	Percentage
Mining										82	1.06%
Electricity, Heat, Gas and Water Production and Supply										78	1.01%
Electronic										516	6.68%
Real Estate										422	5.46%
Textile, Clothing, Fur										368	4.76%
Machinery, Equipment, Instruments										1591	20.60%
Construction										165	2.14%
Transportation, Storage, Postal Service										74	0.96%
Metal, Non-metal										586	7.59%
Wood, Furniture										66	0.85%
Agriculture, Forestry, Animal Husbandry, Fishery										162	2.10%
Wholesale and Retail										358	4.63%
Other Manufacturing										117	1.51%
Petroleum, Chemical, Plastic										823	10.65%
Food Manufacturing										290	3.75%
Water Conservancy, Environmental and Public Facilities Management										200	2.59%
Culture, Sports, Entertainment										58	0.75%
Information Transmission, Software and Information Technology Services										728	9.42%
Pharmaceutical and Biological Products										567	7.34%
Paper and Printing										195	2.52%
Miscellaneous										279	3.61%
Total										7725	100.00%
<i>Panel C: Foreign residency rights</i>											
										Quantity	Percentage
Company whose controller has foreign residency rights (<i>Residy</i> = 1)										768	9.94%
Company whose controller does not have foreign residency rights (<i>Residy</i> = 0)										6957	90.06%
Controller obtained the rights before the company's listing (<i>Residylist</i> = 0)										353	45.96%
Controller obtained the rights after the company's listing (<i>Residylist</i> = 1)										415	54.04%

entire sample into a group of companies for which the controller has foreign residency rights (Table 4B) and a group of companies for which the controller does not (Table 4C). Comparing and analyzing the difference between auditors selected by the two groups (Table 4D), we find that 4.2% of the former chose a Big 4 auditor, while 1.6% of the latter chose a Big 4 auditor. As the comparison and analysis in Table 4D indicate, this difference is significant. That companies whose controllers have foreign residency rights are more inclined to choose a Big 4 auditor than other companies is consistent with the above theoretical expectations. The audit fee variable (*Auditfee*) is the natural logarithm of the actual audit fees. From Table 4D, we can see that whether comparing the average or the median of audit fees, companies whose controllers have foreign residency rights pay significantly more audit fees than other companies, which is also consistent with the above theoretical expectations. As Table 4A shows, the average asset–liability ratio (*Lev*) of all of the sample companies is 40.7%, and the median is 57.5%. The index suggests that the asset–liability ratios of China's companies are generally high.

We find that the average and median asset–liability ratios of the companies whose controllers have foreign residency rights are 38.4% and 35.1%, respectively, while those of the companies whose controllers do not are 40.9% and 40.7%, respectively (Table 4B). There are significant differences in the average and median

Table 3
Nationality distribution of foreign residency rights.

Nationality	Quantity	Percentage	Has signed an extradition clause with China?
Argentina	4	0.52	No
Australia	72	9.38	Yes (2007-9-6)
Macao	13	1.69	No
Belize	14	1.82	No
Germany	5	0.65	No
The Philippines	8	1.04	Yes (2001-10-30)
Gambia	2	0.26	No
Guinea-Bissau	3	0.39	No
Canada	116	15.10	No
Malaysia	2	0.26	No
America	66	8.59	No
Taiwan	65	8.46	No
Hong Kong	206	26.82	No
Singapore	36	4.69	No
New Zealand	19	2.47	No
Indonesia	14	1.82	No
England	4	0.52	No
Others	119	15.49	No
Total	768	100.00	

asset–liability ratios between the two groups, indicating that the asset–liability ratios of companies whose controllers have foreign residency rights are significantly lower than those of the other companies. In Table 4A, the average return on assets (*Roa*) for all of the companies is 4.3%, and the median is 7.3%. In Table 4B, the average and median returns on assets of companies whose controllers have foreign residency rights are 5.0% and 4.8%, respectively, while those of the other group are 4.2% and 4.3%, respectively. Table 4D also shows significant differences in the means and medians of *Roa* for both groups, which means that the *Roa* values of companies whose controllers have foreign residency rights are significantly higher than those of other companies. Company size (*Size*) is measured as the natural logarithm of a company's total assets. From the values and comparisons of the means and medians in Table 4D, we find no significant difference in company size between the two groups. We select three important indicators of corporate governance: centralization of shareholding (*Central*), board independence (*Indboard*) and separation of cash flow and voting rights (*Cv*). Table 4A indicates that the average for *Central* for all of the companies is 34.1% and the median is 43.5%, which suggests that companies' centralization of shareholding is relatively high and that many companies have controllers who are large shareholders. From Table 4B, the average and median of *Central* for companies whose controllers have foreign residency rights are 36.5% and 33.7%, respectively, while those for companies that do not are 33.8% and 30.9%, respectively. These differences are significant (Table 4D), indicating that the centralization of shareholding by companies whose controllers have foreign residency rights is significantly higher than that of the other group. As shown in Table 4A, the average and median of board independence (*Indboard*) for all of the companies are 36.8% and 40.0%, respectively, which is consistent with the rule that at least one third of the members of the board of a listed company should be independent. Table 4B shows that the average and median of *Indboard* for companies whose controllers have foreign residency rights are 36.9% and 33.3%, respectively, while those of the other group are 36.8% and 33.3%, respectively. The differences in *Indboard* and *Cv* for the two groups are not significant. The descriptive statistics for company size (*Size*), accounts receivable (*Receivables*) and inventory (*Inventory*) variables are also reported in Table 4. The differences in these variables between the two groups are not significant.

5. Empirical analysis

First, we analyze the correlation coefficient of each variable and then examine the relationship between whether the company's controller has the foreign residency rights and the company's auditor choice from a

Table 4
Descriptive statistics.

	Mean	Variance	Minimum	Median	Maximum
<i>Panel A: All samples</i>					
<i>Bigfour</i>	0.019	0.018	0.000	0.000	1.000
<i>Auditfee</i>	13.167	0.249	9.210	13.459	16.098
<i>Cv</i>	6.745	66.117	0.000	12.412	28.834
<i>Size</i>	21.185	1.041	14.937	21.777	25.133
<i>Lev</i>	0.407	0.049	0.000	0.575	0.999
<i>Roa</i>	0.043	0.004	−0.372	0.073	0.209
<i>Central</i>	0.341	0.021	0.090	0.435	0.770
<i>Indboard</i>	0.368	0.003	0.111	0.400	0.556
<i>Receivables</i>	0.117	0.010	0.000	0.170	0.528
<i>Inventory</i>	0.170	0.024	0.000	0.214	0.721
<i>Mar</i>	0.592	0.242	0.000	1.000	1.000
<i>Panel B: Companies whose controllers have foreign residency rights (Residy = 1)</i>					
<i>Bigfour</i>	0.042	0.040	0.000	0.000	1.000
<i>Auditfee</i>	13.317	0.236	11.918	13.305	15.239
<i>Cv</i>	6.694	72.217	0.000	1.952	28.834
<i>Size</i>	21.171	1.158	15.577	21.072	24.686
<i>Lev</i>	0.384	0.057	0.016	0.351	0.999
<i>Roa</i>	0.050	0.004	−0.372	0.048	0.209
<i>Central</i>	0.365	0.025	0.090	0.337	0.770
<i>Indboard</i>	0.369	0.003	0.111	0.333	0.556
<i>Receivables</i>	0.117	0.011	0.000	0.094	0.528
<i>Inventory</i>	0.190	0.036	0.000	0.129	0.721
<i>Mar</i>	0.781	0.171	0.000	1.000	1.000
<i>Panel C: Companies whose controllers do not have foreign residency rights (Residy = 0)</i>					
<i>Bigfour</i>	0.016	0.016	0.000	0.000	1.000
<i>Auditfee</i>	13.150	0.248	9.210	13.122	16.098
<i>Cv</i>	6.751	65.453	0.000	2.961	28.834
<i>Size</i>	21.186	1.028	14.937	21.092	25.133
<i>Lev</i>	0.409	0.048	0.000	0.407	0.994
<i>Roa</i>	0.042	0.004	−0.372	0.043	0.209
<i>Central</i>	0.338	0.021	0.090	0.309	0.770
<i>Indboard</i>	0.368	0.003	0.111	0.333	0.556
<i>Receivables</i>	0.117	0.010	0.000	0.097	0.528
<i>Inventory</i>	0.168	0.023	0.000	0.130	0.721
<i>Mar</i>	0.571	0.245	0.000	1.000	1.000
	ΔMean = B – C	T-value	ΔMedian = B – C	Z-value	
<i>Panel D: Differences in the average and median</i>					
<i>Bigfour</i>	0.026***	5.024	0.000***	5.016	
<i>Auditfee</i>	0.167***	8.338	0.182***	8.509	
<i>Cv</i>	−0.057	−0.186	−1.009	−0.601	
<i>Size</i>	−0.015	−0.394	−0.020	−0.134	
<i>Lev</i>	−0.026***	−3.032	−0.056***	−3.484	
<i>Roa</i>	0.008***	3.3305	0.005***	3.563	
<i>Central</i>	0.026***	4.751	0.028***	3.871	
<i>Indboard</i>	0.000	0.192	0.000	0.248	
<i>Receivables</i>	0.000	0.078	−0.004	−0.900	
<i>Inventory</i>	0.022***	3.743	−0.001	−0.627	
<i>Mar</i>	0.210	11.338	0.000***	11.246	

Note: *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively.

holistic perspective, considering the seriousness of the agency problem, the nations for which foreign residency rights have been obtained and the time of obtaining foreign residency rights. We also examine the additional audit costs related to the company controller's foreign residency rights. Finally, we examine

the effects of these companies' hiring of Big 4 auditors on their corporate governance and accounting performance.

5.1. Correlation coefficient analysis

Appendix A reports the results of the correlation coefficient analysis of each variable. The correlation coefficient between the foreign residency right variable (*Residy*) and the company's auditor choice variable (*Bigfour*) is positively correlated at the 1% level of significance. This preliminarily verifies Hypothesis 1, which states that companies whose controllers have foreign residency rights are more likely than others to hire Big 4 auditors. The correlation coefficient between the foreign residency right variable (*Residy*) and the audit fee variable (*Auditfee*) is positively correlated at the 1% level of significance, which means that Hypothesis 2, which states that companies whose controllers have foreign residency rights pay higher audit fees, has been initially verified. Appendix A also shows that many control variables are significantly related to auditor choice or audit fee (*Bigfour* or *Auditfee*); moreover, almost all of the correlation coefficients between them are less than 0.5. These results suggest that our regression model to control these variables produces reliable empirical conclusions, and serious multicollinearity is unlikely to affect the results.

5.2. Regression analysis

5.2.1. Foreign residency rights and auditor choice: A holistic perspective

Table 5 reports the regression results for the relationship between whether the company's controller has foreign residency rights and auditor choice. In regression (1), the coefficient of the foreign residency right variable (*Residy*) is significantly positive, which means that a company whose controller has foreign residency rights is more likely to choose a Big 4 auditor than other companies. To check the robustness of the conclusion, regression (2), for which the year, industry and assets are closest to each other, pairs each company whose controller has foreign residency rights with a company whose controller does not, and then uses a paired sample for the regression analysis. The coefficient of the variable *Residy* is still significantly positive, which is consistent with the result of regression (1). This suggests that the empirical results in Table 5 verify the theoretical expectations that companies whose controllers have foreign residency rights are more likely than others to hire Big 4 auditors.

Table 5
Foreign residency rights and auditor choice: A holistic perspective.

Variable	(1) Whole sample Bigfour		(2) Paired sample Bigfour	
<i>Intercept</i>	-55.122***	(-9.17)	-52.002***	(-4.60)
<i>Residy</i>	0.909**	(2.02)	1.884***	(2.87)
<i>Cv</i>	-0.014	(-0.59)	-0.048*	(-1.66)
<i>Size</i>	1.571***	(6.50)	1.393***	(2.86)
<i>Lev</i>	-1.352	(-1.41)	0.105	(0.06)
<i>Roa</i>	7.270*	(1.88)	19.894***	(3.86)
<i>Central</i>	2.487**	(2.23)	1.656	(1.02)
<i>Indboard</i>	1.673	(0.43)	-2.664	(-0.44)
<i>Receivables</i>	2.991*	(1.90)	0.690	(0.25)
<i>Inventory</i>	-3.036**	(-2.34)	-2.345	(-1.49)
<i>Industry</i>		Yes		Yes
<i>Year</i>		Yes		Yes
<i>Pseudo. R²</i>		0.282		0.436
<i>N</i>		7725		1536

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1% respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters. Bold values in Table is to highlight the main explanatory variables.

Table 6
Foreign residency rights and auditor choice: An agency cost perspective.

Variable	(1) Mar = 1 Bigfour	(2) Mar = 0 Bigfour	(3) Cv = 0 Bigfour	(4) Cv > 0 Bigfour	(5) Fraud = 0 Bigfour	(6) Fraud = 1 Bigfour
<i>Intercept</i>	−49.880 ^{***} (−7.69)	−83.655 ^{***} (−7.18)	−66.222 ^{***} (−7.17)	−52.300 ^{***} (−7.25)	−53.899 ^{***} (−8.74)	−63.740 ^{***} (−6.39)
<i>Residy</i>	0.353 (0.61)	1.305[*] (1.72)	0.854 (0.98)	0.982[*] (1.88)	1.045 ^{**} (2.13)	0.701 (1.12)
<i>Cv</i>	0.014 (0.49)	−0.089 ^{**} (−1.97)			−0.006 (−0.25)	−0.028 (−0.70)
<i>Size</i>	1.217 ^{***} (4.31)	3.048 ^{***} (5.72)	2.778 ^{***} (6.22)	1.361 ^{***} (4.83)	1.496 ^{***} (6.04)	1.978 ^{***} (4.87)
<i>Lev</i>	−0.497 (−0.41)	−4.943 ^{**} (−2.41)	−4.463 ^{***} (−2.95)	−1.206 (−1.16)	−1.041 (−0.90)	−2.070 (−1.58)
<i>Roa</i>	3.609 (1.51)	8.817 (0.77)	8.943 [*] (1.86)	7.758 [*] (1.87)	8.201 [*] (1.91)	4.596 (0.86)
<i>Central</i>	3.317 ^{**} (2.34)	1.918 (0.98)	1.945 (1.21)	3.134 ^{**} (2.31)	2.422 ^{**} (2.21)	3.325 [*] (1.89)
<i>Indboard</i>	5.757 [*] (1.68)	−16.035 ^{***} (−3.09)	3.092 (0.56)	2.395 (0.53)	3.648 (0.92)	−4.992 (−1.00)
<i>Receivables</i>	3.395 (1.56)	3.034 (1.10)	6.168 ^{**} (2.13)	3.217 [*] (1.77)	2.959 (1.47)	3.556 [*] (1.88)
<i>Inventory</i>	−5.113 ^{***} (−2.88)	0.502 (0.30)	−3.915 (−1.42)	−3.196 ^{**} (−2.13)	−3.886 ^{***} (−2.72)	−1.193 (−0.82)
<i>Industry</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>Pseudo. R²</i>	0.251	0.588	0.412	0.292	0.277	0.391
<i>N</i>	4291	3434	1875	4605	5216	2509

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters.

Bold values in Table is to highlight the main explanatory variables.

Table 7

Foreign residency rights and auditor choice: Extradition clauses and time of obtaining foreign residency rights.

Variables	(1) Countries with an extradition clause Bigfour	(2) Countries without an extradition clause Bigfour	(3) Company whose controllers have foreign residency rights Bigfour
<i>Intercept</i>	−54.595*** (−9.14)	−56.901*** (−9.43)	−55.845*** (−3.33)
<i>Residy</i>	0.941** (1.97)	0.885 (0.79)	1.931* (1.66)
<i>Residylist</i>			
<i>Cv</i>	−0.015 (−0.62)	−0.009 (−0.32)	−0.066* (−1.69)
<i>Size</i>	1.564*** (6.49)	1.591*** (6.53)	1.691** (2.06)
<i>Lev</i>	−1.285 (−1.32)	−1.957* (−1.87)	1.833 (0.64)
<i>Roa</i>	6.925* (1.77)	4.758 (1.06)	26.846*** (4.23)
<i>Central</i>	2.424** (2.13)	3.400*** (2.83)	−0.208 (−0.09)
<i>Indboard</i>	1.718 (0.44)	1.912 (0.43)	−5.010 (−0.61)
<i>Receivables</i>	2.862* (1.79)	3.649* (1.88)	−3.130 (−0.91)
<i>Inventory</i>	−3.000** (−2.29)	−3.140* (−1.91)	−1.823 (−0.94)
<i>Industry</i>	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes
<i>Pseudo. R²</i>	0.282	0.273	0.509
<i>N</i>	7652	7030	768

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters.

Bold values in Table is to highlight the main explanatory variables.

5.2.2. Foreign residency rights and auditor choice: An agency cost perspective

We divide the samples into two groups according to the degree of marketization (Table 6): the group in regression (1) has a high degree of marketization ($Mar = 1$) and less serious agency problems, while the group in regression (2) has a low degree of marketization ($Mar = 0$) and more serious agency problems. The results show that the coefficient of the variable *Residy* is significantly positive for the group with low marketization but is not significant for the group with high marketization. We next divide the sample into two groups according to the degree of separation of voting and cash flow rights (Table 6): the group in regression (3) has a low degree of separation ($Cv = 0$) and less serious agency problems, while the group in regression (4) has a high degree of separation ($Cv > 0$) and more serious agency problems. The coefficient of the variable *Residy* is significantly positive in the group with a high degree of rights separation, but that for the group with low separation is not significant. Then, we divide the sample into two groups according to whether there are violations in the company's year (Table 6): the group in regression (5) has violations ($Fraud = 1$) and the group in regression (6) does not ($Fraud = 0$). The results show that the coefficient of the variable *Residy* is significantly positive in the group with no violations but not significant in the group with violations, which suggests that when companies already have serious agency problems, companies with controllers with foreign residency rights are more likely to hire a Big 4 auditor, and only companies that have not violated regulations will send signals of good governance to the public by hiring a Big 4 auditor.

5.2.3. Foreign residency rights and auditor choice: Extradition clauses and the time foreign residency rights were obtained

The Philippines signed an extradition clause with China in October 2001, and Australia signed in September 2007. Regression (1) of Table 7 excludes the observations for companies whose controllers obtained foreign residency rights from the Philippines and Australia. The regression result shows that the coefficient of the variable *Residy* is significantly positive, and regression (2) of Table 7 excludes the observations for companies whose controllers obtained foreign residency rights from countries that did not sign extradition clauses with China. The regression results show that the coefficient of the variable *Residy* is not significant, which indicates that the various regions in which companies' controllers obtained foreign residency rights affect companies' auditor choices in different ways. If the countries in which company controllers obtained foreign residency rights have extradition clauses with China, market participants believe that these companies' cost of illegality is almost as high as that of domestic entrepreneurs, so whether they have such foreign residency rights does not significantly affect the companies' auditor choice. In contrast, when countries in which companies' controllers obtained foreign residency rights do not have extradition clauses with China, market participants believe that such companies' cost of illegality is significantly lower than that of domestic companies, which prompts such companies to hire high-quality auditors to signal good corporate governance to the market. Regression (3) of Table 7 includes the sample companies whose controllers have foreign residency rights and distinguishes between whether these rights were obtained before or after the company was listed. The coefficient of *Residylist* is significantly positive, which indicates that companies whose controllers

Table 8
Foreign residency rights and auditor choice: Overseas business.

Variables	(1) Bigfour	(2) Bigfour	(3) Bigfour	(4) Bigfour
<i>CONSTANT</i>	-55.070*** (-9.14)	-30.350*** (-3.07)	-57.982*** (-9.41)	-55.320*** (-9.20)
<i>Residy</i>	0.918** (2.04)	2.370** (2.29)	0.830* (1.78)	0.850* (1.85)
<i>Export</i>	0.454 (1.29)			0.350 (0.98)
<i>Residy × Export</i>				0.678 (0.69)
<i>Cv</i>	-0.014 (-0.58)	-0.063 (-0.81)	-0.008 (-0.35)	-0.014 (-0.57)
<i>Size</i>	1.568*** (6.47)	0.618 (1.44)	1.690*** (6.82)	1.569*** (6.50)
<i>Lev</i>	-1.382 (-1.44)	1.052 (0.40)	-1.656 (-1.59)	-1.397 (-1.45)
<i>Roa</i>	7.129* (1.83)	4.693 (0.59)	6.498 (1.55)	7.093* (1.82)
<i>Central</i>	2.517** (2.25)	4.290 (1.33)	2.432** (2.11)	2.569** (2.27)
<i>Indboard</i>	1.703 (0.44)	-15.920*** (-2.67)	2.567 (0.63)	1.663 (0.43)
<i>Receivables</i>	3.064* (1.95)	-6.253 (-0.88)	3.573** (2.21)	3.082* (1.95)
<i>Inventory</i>	-3.075** (-2.34)	-5.409 (-1.53)	-2.828** (-2.08)	-3.081** (-2.34)
<i>Industry</i>	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes
<i>Adj. R²</i>				
<i>N</i>	7725	537	7188	7725

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters.

Bold values in Table is to highlight the main explanatory variables.

obtained foreign residency rights before listing are more likely to choose a Big 4 auditor than those whose controllers obtained such rights after listing.

5.2.4. Foreign residency right and auditor choice: Overseas business

Controllers of private enterprises may also pursue overseas identities to expand their overseas business, and their companies may employ Big 4 auditors to reduce information asymmetry in overseas transactions. That is, companies' overseas business may contribute to the empirical results presented above. To eliminate this concern, we control the export business variable (*Export*) in regression (1) of Table 8 and find that the coefficient of the variable *Residy* remains significantly positive. We then divide the entire sample into two groups: companies with overseas business groups in regression (2) and companies without overseas business groups in regression (3) (Table 8). The results show that the coefficients of the variable *Residy* of the two groups are both significantly positive. Regression (4) in Table 8 includes an interaction between the overseas business variable and the foreign residency rights variable (*Residy* * *Export*), and the results show that the interaction item is not significant. The results thus suggest that there is a significant positive correlation between foreign residency rights and a company's likelihood of hiring a Big 4 auditor regardless of whether the company has an overseas business. That is, whether the company has an overseas business or not does not affect the above conclusions.

Table 9
Foreign residency rights and auditor choice: Endogenous analysis.

Variable	(1) Residy	(2) Bigfour
<i>CONSTANT</i>	-1.628 (-0.77)	-56.560*** (-8.89)
<i>RESIHAT</i>		8.321*** (3.08)
<i>Fict</i>	0.136** (2.17)	
<i>Export</i>	-0.272 (-0.94)	
<i>Gov</i>	1.295*** (3.89)	
<i>Cv</i>	0.006 (0.49)	0.001 (0.02)
<i>Size</i>	-0.158* (-1.83)	1.567*** (6.36)
<i>Lev</i>	-0.213 (-0.47)	-0.901 (-0.85)
<i>Roa</i>	0.903 (0.75)	5.487 (1.28)
<i>Central</i>	0.866 (1.30)	2.394** (2.03)
<i>Indboard</i>	-1.792 (-1.20)	1.777 (0.37)
<i>Receivables</i>		2.259 (1.12)
<i>Inventory</i>		-4.479*** (-3.07)
<i>IND</i>	Yes	Yes
<i>YEAR</i>	Yes	Yes
<i>Adj. R²</i>	0.101	0.310
<i>N</i>	6395	6395

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters.

Bold values in Table is to highlight the main explanatory variables.

5.2.5. Foreign residency rights and auditor choice: Endogenous analysis

Considering that our empirical results may be endogenous to the needs of the company's overseas business, we perform a regression test in Table 9 using an instrumental variable, which is the natural logarithm of the number of new contracts signed by China's economic groups with foreign businessmen in a certain year in the region in which the company is located. Regression (1) in Table 9 uses the instrumental variable of the natural logarithm of the number of new contracts signed by China's economic groups with foreign businessmen in a certain year (*FICT*) and other control variables to test the variable *Residy*. The results show that the coefficient of the instrumental variable (*FICT*) is significantly positive. We then use the fitted value of the variable *Residyhat* from regression (1) to regress auditor choice in regression (2), and we find that the coefficient of *Residyhat* is significantly positive after the influence of this endogeneity has been controlled, which suggests that the companies whose controllers have foreign residency rights are more likely to choose a Big 4 auditor than other companies.

5.2.6. Foreign residency rights and auditor fees

Table 10 reports the regression results on the relationship between whether a company's controller has foreign residency rights and audit fees. Regression (1) tests the entire sample and shows that the coefficient of the variable *Residy* is significantly positive. Regression (2) excludes the observations for companies whose controllers obtained foreign residency rights after listing and shows that the coefficient of the variable *Residy* is significantly positive. Regression (3) excludes observations for companies whose controllers obtained foreign residency rights before listing and shows that the coefficient of the variable *Residy* is significantly positive. We then divide the sample into two groups according to the degree of separation of two rights: the group in regres-

Table 10
Foreign residency rights and auditor fees: Multivariate regression analysis.

Variable	(1) Auditfee	(2) Auditfee	(3) Auditfee	(4) Auditfee	(5) Auditfee
<i>Intercept</i>	7.185*** (29.77)	6.951*** (25.59)	7.213*** (27.65)	8.148*** (20.34)	6.714*** (23.76)
<i>Residy</i>	0.129*** (4.94)	0.123*** (3.93)	0.160*** (4.19)	0.130*** (3.41)	0.125*** (3.87)
<i>Bigfour</i>	0.680*** (8.33)	0.679*** (8.10)	0.714*** (7.94)	0.505*** (2.92)	0.723*** (8.37)
<i>Cv</i>	0.001 (0.62)	0.001 (0.73)	0.000 (0.40)		
<i>Size</i>	0.272*** (23.54)	0.277*** (23.07)	0.271*** (23.03)	0.234*** (13.40)	0.290*** (21.81)
<i>Lev</i>	0.141*** (3.08)	0.143*** (2.98)	0.137*** (2.91)	0.103 (1.34)	0.165*** (3.02)
<i>Roa</i>	0.032 (0.29)	0.074 (0.64)	0.049 (0.43)	-0.086 (-0.49)	0.079 (0.60)
<i>Central</i>	0.034 (0.57)	0.032 (0.52)	0.067 (1.08)	0.114 (1.35)	-0.038 (-0.50)
<i>Indboard</i>	-0.078 (-0.55)	-0.093 (-0.64)	-0.063 (-0.43)	-0.109 (-0.56)	-0.094 (-0.52)
<i>Receivables</i>	0.149 (1.64)	0.154* (1.68)	0.159* (1.72)	-0.058 (-0.42)	0.308*** (2.78)
<i>Inventory</i>	-0.113* (-1.68)	-0.113 (-1.55)	-0.115* (-1.70)	-0.082 (-0.73)	-0.088 (-1.12)
<i>Industry</i>	Yes	Yes	Yes	Yes	Yes
<i>Year</i>	Yes	Yes	Yes	Yes	Yes
<i>Adj. R²</i>	0.482	0.482	0.485	0.383	0.543
<i>N</i>	6786	6354	6404	2700	14086

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5% and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters. Bold values in Table is to highlight the main explanatory variables.

Table 11

The economic consequences of hiring a Big 4 auditor for companies with foreign residency rights: Earnings management and accounting performance.

Variables	(1) Em ^a	(2) Roa
<i>Intercept</i>	0.175*** (6.36)	−0.348*** (−11.62)
<i>Bigfour</i>	0.004 (0.66)	0.004 (0.53)
<i>Residy</i>	−0.004 (−1.33)	0.001 (0.36)
<i>Bigfour * Residy</i>	−0.022** (−2.38)	0.028** (2.31)
<i>Size</i>	−0.005*** (−4.57)	0.020*** (14.07)
<i>Lev</i>	0.042*** (7.69)	−0.129*** (−21.15)
<i>Tobinq</i>	0.002** (2.43)	0.011*** (8.19)
<i>Central</i>	0.028*** (4.24)	0.038*** (5.45)
<i>Indboard</i>	0.011 (0.70)	−0.025 (−1.40)
<i>Industry</i>	Yes	Yes
<i>Year</i>	Yes	Yes
<i>Adj. R²</i>	0.076	0.244
<i>N</i>	6789	7600

Note: (1) The values reported in brackets are T-statistics; (2) *, ** and *** indicate significance levels of 10%, 5%, and 1%, respectively; (3) Standard errors are adjusted by heteroskedasticity and company clusters.

^a When earnings management calculated by the modified Jones model is used as the dependent variable, the results still hold.

sion (4) with a high degree of separation and serious agency problems and the group in regression (5) with a low degree of separation and less serious agency problems. The regression analysis indicates that the coefficients of the variable *Residy* for both groups are significantly positive. The regressions above consistently indicate that companies whose controllers have foreign residency rights pay higher audit fees than other companies.

5.2.7 The economic consequences of hiring a Big 4 auditor for companies whose controller have foreign residency rights: Earnings management and accounting performance

Regression (1) in Table 11 examines the impact of hiring a Big 4 auditor on corporate governance (earnings management) for companies whose controllers have foreign residency rights. The results show that the coefficient of the variable *Residy* is negative, while the interaction term between the variable *Residy* and the variable *Bigfour* is significantly negative. These findings indicate that hiring a Big 4 auditor enables companies whose controllers have foreign residency rights to reduce earnings management and show better corporate governance. Regression (2) in Table 11 examines the impact of hiring a Big 4 auditor on the accounting performance of companies whose controllers have foreign residency rights. The results show that the coefficient of the variable *Residy* is positive and that the coefficient of the interaction term between the variable *Residy* and the variable *Bigfour* is significantly positive, which indicates that hiring a Big 4 firm motivates companies whose controllers have foreign residency rights to perform better.

6. Conclusions and implications

China's rapid economic growth since the reform and opening up has brought about many wealth-creation opportunities. At the same time, the lack of protections for property rights and the deterioration

of the ecological environment have led to an increase in the outflow of elites who create wealth. These positive and negative effects have altogether led many wealthy elites to work in China while obtaining the foreign residency rights. Considering the current environment of wealthy migrants in Chinese society, this paper focuses on controllers of Chinese listed companies who have obtained foreign residency rights, examining the relationship between these foreign residency rights and the companies' audits. The result shows that companies whose controllers have foreign residency rights are more likely to hire Big Four auditors than other companies, and this result remains valid after endogenous effects are considered. According to the degree of marketization and the degree of separation of voting and cash flow rights, we divide companies into two groups. We find that companies whose controllers have foreign residency rights are more likely than other companies to hire Big 4 auditors when they have serious agency problems; however, when companies already have accounting irregularities, companies whose controllers have foreign residency rights are not more inclined to hire Big 4 auditors. This means that only companies without irregularities will signal good corporate governance to the public by hiring Big 4 auditors. Market participants believe that companies whose controllers have foreign residency rights in countries with extradition clauses with China have a cost of illegality that is almost as high as that of domestic entrepreneurs, so whether they have such foreign residency rights does not significantly affect their companies' auditor choice. However, market participants believe that the cost of illegality for companies whose controllers have foreign residency rights in countries that do not have extradition clauses with China is significantly lower than that of domestic companies, and such companies therefore hire high-quality auditors to signal good corporate governance to the market. Companies whose controllers obtained foreign residency rights are more likely to choose a Big 4 auditor than those who obtain such rights after listing. We also examine the cost of using an external independent auditor as a binding mechanism to send signals, and we find that companies whose controllers have foreign residency rights paid higher audit fees than other companies. Finally, we examine the impact of hiring Big 4 auditors on corporate governance and the accounting performance of companies whose controllers have foreign residency rights, and we find that firms hiring Big 4 auditors show better corporate governance and higher accounting performance than firms that do not.

Our findings have a number of implications. The lack of protection mechanisms for property rights and the deterioration of the ecological environment have led to an increase in the outflow of wealth elites, resulting in not only a loss of important talent from China's developing market economy but also a huge loss of capital. [Chen et al. \(2013\)](#) find that companies whose controllers have foreign residency rights are more likely to defraud investors, and we find that such companies will pay higher audit fees to enhance their reputation. Although we find that hiring external independent auditors can alleviate the agency problems of such companies, the regulatory authorities should address the root of the problem, strengthening the legal system to protect private property rights, improving the law enforcement of the securities market and strengthening the protection of the ecological environment.

Finally, because the number of people who have foreign residency rights but work or operate a business in China is growing, as is their influence on China's economic development, a number of issues should be addressed in future research. For example, it would be interesting to learn how such companies finance themselves and make investment decisions. It would also be worthwhile to study how market investors and creditors evaluate the accounting quality of such companies and how they price such companies' assets.

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Appendix A. Correlation analysis

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13
1. <i>Bigfour</i>	1												
2. <i>Residy</i>	0.057***	1											
3. <i>Cv</i>	0.041***	-0.002	1										
4. <i>Mar</i>	0.053***	0.128***	-0.056***	1									
5. <i>Size</i>	0.159***	-0.004	0.173***	0.018	1								
6. <i>Lev</i>	0.033***	-0.034***	0.171***	-0.121***	0.328***	1							
7. <i>Roa</i>	0.054***	0.038***	-0.027**	0.112***	0.062***	-0.356***	1						
8. <i>Central</i>	0.075***	0.054***	0.219***	0.079***	0.163***	-0.032***	0.133***	1					
9. <i>Indboard</i>	0.003	0.002	-0.098***	0.027**	-0.027**	-0.066***	0.014	0.063***	1				
10. <i>Receivables</i>	0.003	-0.001	-0.08***	0.131***	-0.129***	0.019*	-0.038***	-0.011	0.002	1			
11. <i>Inventory</i>	-0.008	0.043***	0.091***	0.003	0.27***	0.4***	-0.064***	0.103***	-0.011	-0.167***	1		
12. <i>Opinion_2</i>	-0.013	-0.002	-0.009	-0.071***	-0.188***	0.179***	-0.294***	-0.091***	-0.031***	0.015	-0.07***	1	
13. <i>Auditfee</i>	0.279***	0.101***	0.105***	0.181***	0.636***	0.196***	0.065***	0.133***	-0.003	-0.052***	0.133***	-0.069	1

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