



*Minority Shareholder
Protection in China's
Top 100 Listed Companies*

Roman Tomasic and Neil Andrews
School of Law
Victoria University

ACESA, Melbourne, July 2006

Is the protection of minority shareholders important ?

Economists such as Rafael La Porta and his colleagues have argued that the legal environment for the protection of minority shareholders will be important in determining the size and extent of a country's capital markets.

In China, the protection of minority shareholders is officially regarded as a major regulatory objective of those responsible for controlling the securities market.

This is especially so in regard to Chinese listed companies.
BUT, in practice, the position of minority shareholders in these companies is not well protected.

Our research sought to examine the extent of minority shareholder protection in China's leading companies

- ❖ This paper is based on funding from an ARC Discovery Grant and reports on findings from an empirically based study of corporate governance in China's top 100 listed companies.
- ❖ The study examined a broader range of corporate governance issues including the problem of minority shareholder protection.

Major issues

- ❖ **Major challenges in achieving better protection for minority shareholders arise from:**
- ❖ (i) the size of the majority block holdings held by the State in most Chinese listed companies;
- ❖ (ii) the low priority that is in practice given to the protection of minority shareholder interests by controllers (as reflected in the high number of related party transactions);
- ❖ (iii) the perceived sense of powerlessness of minority shareholders;
- ❖ (iv) the inadequacy of civil remedies that are available under PRC law ;
- ❖ (v) and the weak position of independent directors.

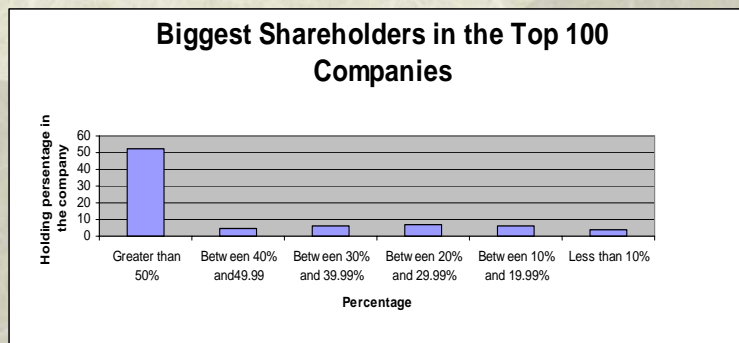
Fieldwork Locations in China

Top 100 PRC Companies: Project Interviews

City	Listed Companies	Professionals, Academics and Independent Directors	Regulators	Subtotal
Beijing	17	12	3	32
Shanghai	19	8	5	32
Hong Kong	7	7	6	20
Shenzhen	7		3	10
Qingdao	4			4
Jinan	3			3
Chongqing	2			2
Nanjing	2			2
Guangzhou	2		1	3
Subtotal	63	27	18	108

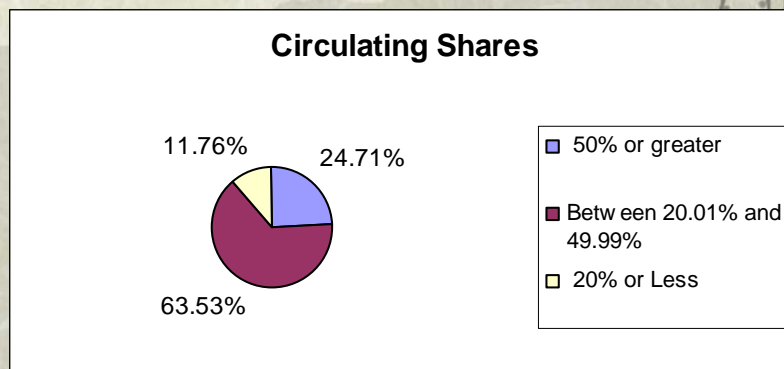
Shareholding Distribution

Biggest Shareholders in the Top 100 Companies



- ❖ Note: The first figure may be bigger as state shares may be fragmented between central and provincial governments

Circulating Shares in Companies Listed on Shanghai & Shenzhen Stock Exchanges



Doing fieldwork in China

- ❖ We undertook interviews ourselves, accompanied by one of our Chinese speaking colleagues;
- ❖ We laid the groundwork for the interviews through developing links with key government agencies; this is a story in itself;
- ❖ Interviews were set up by telephone before we left Australia; There were few refusals;
- ❖ We undertook to protect the identity of interviewees and not attribute quotes to their companies;
- ❖ Many wanted us to return and debrief them.

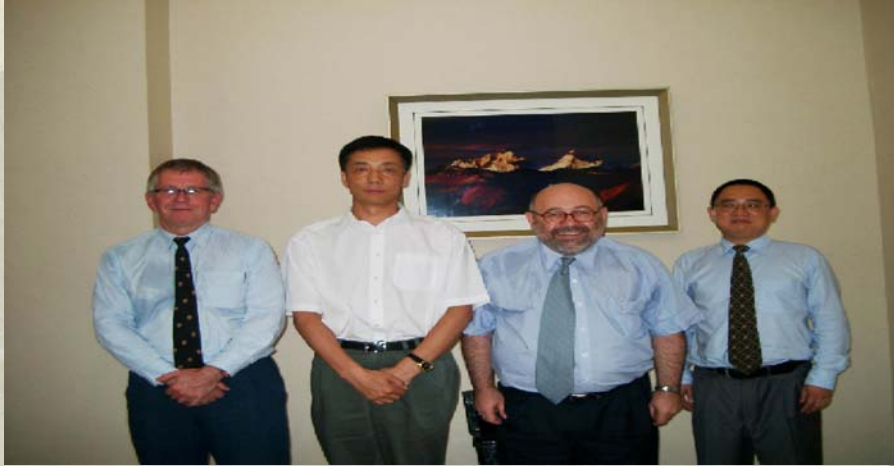


❖ Visit to Shenzhen Stock Exchange to meet Director Zhang and Ms. Dai

Visit to Shanghai



*Post-interview meeting with Shenzhen
CSRC director:*



Building Guanxi



Vice-Minister Duan, PRC Ministry of Justice



Chairman Jia and Zhu ShaoPing, NPC Finance and Economic Committee



With Gao Xi Qing, Vice Chair, PRC National Council for Social Security Fund and former CSRC Vice-Minister



PRC Minister of Justice, Zhang Fusen



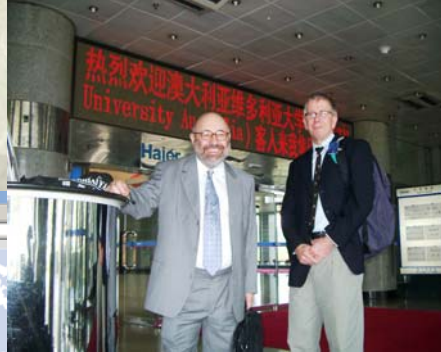
Beijing & Qingdao



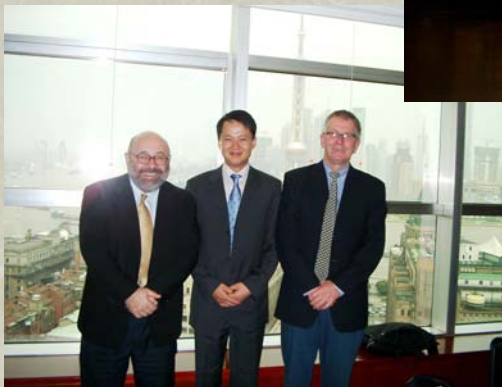
Tsingtao Beer



Qingdao, Haier



After interview with Mr Liu, Vice-Chairman of Shanghai Shenhua Company



With Co-Chief of Shanghai Shenhua Company

Gap Problem in Chinese Law

- ❖ The legal system is still poorly developed;
- ❖ There has been much law reform in recent times, but implementation is a problem;
- ❖ The law in the books and the law in action;
- ❖ Problem of regulatory power (CSRC & Stock Exchanges vs Companies);
- ❖ Dominance of the State;
- ❖ Dominance of the Party over Law.

CSRC ~Code of Corp Gov follows OECD

- ❖ CSRC principles regarding the protection of minority shareholders in listed companies:
- ❖ “1.A listed company shall establish a corporate governance structure sufficient for ensuring the full exercise of shareholders’ rights.

CSRC ~Code of Corp Gov follows OECD

- ❖ CSRC principles regarding the protection of minority shareholders in listed companies:
- ❖ 2. The corporate governance structure of a company shall ensure fair treatment toward all shareholders, especially minority shareholders. All shareholders are to enjoy equal rights and to bear the corresponding duties based on the shares they hold.

Regulatory action follows OECD

- ❖ CSRC principles (cont):
- ❖ “3. Shareholders shall have the right to know about and the right to participate in major matters of the company set forth in the laws....
- ❖ 4. Shareholders shall have the right to protect their interests and rights through civil litigation or other legal means in accordance with laws and administrative regulations....”

CSRC Code continues

- ❖ “19.The controlling shareholders owe a duty of good faith toward the listed company and other shareholders. The controlling shareholders of a listed company shall strictly comply with laws and regulations while exercising their rights as investors, and shall be prevented from damaging the listed company’s or other shareholders’ legal rights and interests, through means such as assets restructuring, or from taking advantage of their privileged position to gain additional benefit.”

Shanghai Stock Exchange

- ❖ “[The]..shareholding structure of Chinese companies is problematic. First, the institution for implementing state shareholder’s rights is unsatisfactory. Either the government exerts too much influence on listed companies and the company’s objective is affected by political considerations, or there is a lack of monitoring on the shareholders, resulting in insider control in the form of misuse of company assets and [pursuit] of private objectives.”

PRC Company Law 2005

- ❖ Article 1 of the PRC Company Law provides that this Law was enacted in order to “protect the legitimate rights and interests of companies, shareholders and creditors...”
- ❖ Art 4 of the Company Law provides that the “shareholders of a company shall, according to law, enjoy such rights of owners as benefiting from assets of the company, making major decisions and selecting managerial personnel.

Shareholder remedies

- ❖ Art 153 which allows shareholders to bring **group actions** before the people’s court where damage has been caused “to the interests of any shareholders of the company” by any illegal action by a director or senior officer of the company
- ❖ Art 150, states: “If the directors, supervisors and senior executives violate the laws, administrative regulations or the articles of association of the company in performance of their functions and thus cause loss to the company, **they shall be liable for compensation.**

❖

Limited Participation Rights

- ❖ The PRC Company Law also provides rights to participate in the corporate governance of the company, such as through the shareholders meeting (Arts 37 ff);
- ❖ the limited rights of shareholders to inspect company books (Art 34); and, through independent directors who have recently been given legal status (by Art 123) and particular responsibilities to protect the interests of minority shareholders .

PRC Securities Law (2005)

- ❖ Art 4 of the Securities Law speaks of the parties involved in the issuing and trading in securities having “equal status” and having to adhere to “the principles of voluntariness, compensation and good faith.”
- ❖ Art 15 also provides that unless otherwise approved by the general meeting of shareholders, funds raised by the company through the issue of shares must be used for the purposes set out in the prospectus .

Securities Law (cont)

- ❖ Art 20 of the Securities Law requires that any documents prepared for the issue of securities must be “truthful, accurate and complete.”
- ❖ One of the most common problems in the listing of Chinese companies has been the use of inaccurate or fabricated information to support the listing or share issue, such as the use of false company accounts. Public shareholders obviously suffer from practices such as these.

Securities law (cont)

- ❖ The Securities Law also contains a number of provisions (Arts 73-76) regarding insider trading by such persons as directors and senior executives of the company; insider trading is obviously more likely to benefit corporate controllers and insiders.

Legal Rhetoric and Reality

- ❖ Based on fieldwork with regulators and officers from China's top 100 listed public companies, the actual position of minority shareholders is much weaker than either government rhetoric or legal rules would suggest.
- ❖ This paper will illustrate this by reference to data derived from face to face interviews conducted by the authors .

Stakeholders in China's top 100

- ❖ Minority shareholders are very low on the list of stakeholders
- ❖ Major shareholders are state agencies
- ❖ The Party plays a central role
- ❖ The Government is also seen as a major stakeholder
- ❖ [see quotes on pp 8 and 9]

Stakeholders

- ❖ a very senior former regulator saw dominant stakeholders as being:
- ❖ “The Party, the government, their employees and their shareholders (in that order).”

Stakeholders (3)

- ❖ • “Of course, it is the controlling shareholders and then institutional investors. Individual shareholders have a very low interest...” (Company secretary, Beijing);
- ❖ • “The priority is given to the majority shareholder or the government...After that, the strategic investors, if any, and then minority shareholders” (accounting partner in international accounting firm, Beijing);
- ❖ • “For the management, it is important for them to know what the big shareholders want...” (company secretary, technology company, Shenzhen).

Government as main player

- ❖ • “The most important stakeholder is the government represented by the parent company” (international accounting firm partner, Beijing);
- ❖ • “The dominant shareholder is the government in most listed companies...The Chinese government does not want to loose its grip of the companies” (financial journalist, Shanghai);
- ❖ • “The most important is the government and then the investors” (senior company officer, Guangzhou);

Nature of state as owner (1)

- ❖ SASAC at Central Government level
- ❖ Provincial government
- ❖ Etc
- ❖ Most State owned shares are non tradeable
- ❖ - note recent “split share” reforms due to criticism

SSX on State as owner (2)

- ❖ The Shanghai Stock Exchange in 2003 noted that:
 - ❖ “A prominent characteristic of Chinese listed companies is an overwhelmingly large percentage of non-tradeable shares, which represent about 2/3 of all the listed company’s combined equity. The tradeable shares represent the remaining 1/3. A majority of listed company’s non-tradeable shares are 60%-80% of their total number of shares. A few companies have more than 90% shares not tradeable. About 6% of all the listed companies have more than 40% of their total equity in tradeable shares. Only 0.4% of all listed companies have only tradeable shares. On average, the larger the size of the company, the higher the percentage of state shares, which demonstrates that large listed companies are essentially state-owned.”

Consequences of State domination

❖ Ambiguity in State’s Role

- Serving two masters
- Both referee and judge
- Wearing two hats

This dualism leads to timidity on part of management

Priority is given to major shareholders :

A Shanghai based listed company officer bluntly described this situation when he said:

“big shareholders still decide everything.”