Taming Majority Shareholders in China:
Research on Independent Director Institution

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A Sign of Convergence?

- In 2001, Chinese Securities Regulatory Commission (CSRC) required all listed companies appointed independent directors in board.
- In 2005, China revised Company Law, first time in statute requires independent directors in listed companies.

- Independent Director Institution transplanted from U.S.

- Independent Director Institution was recognized by States Law and Courts.
- Listing Standard of NYSE.
- Sarbanes-Oxley Act of 2002.

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1. Abnormal Function of ID in China

- The Major function of Independent Director Institution in China is to monitor majority shareholders.

Qualification for ID

- The independent director or his affiliated person should not holding more than 1% shares of the company.

Role of ID

- ID should give his independent opinion to the transactions like:

- Big transaction between the company with its shareholders;
- Reorganizations;
- Public offering;
- Takeovers and tender offers;
- Related person transaction;…

Dilemma of the ID’ Role

- How can independent directors be independent from majority shareholders?

- *On if we get the majority shareholder out of the selection and election process of independent directors.*

- Why will independent directors protect the interests of minority shareholders?

- *Only if independent directors were paid to do this: the independent directors will become a profession like audit.*

Why these not become true?

- In revised Company Law 2005, only accumulative voting was provided.
- Did our government misread the role of the independent director institution?

2. Special Problem in China

- Special Problem of Corporate Governance in China:

- Looting by majority shareholders
- Majority shareholders are governments

Concentration of Ownership

1999-2003 Ownership structure of China listed companies

Total holding of all big shareholders	54.26%
Holding of the largest shareholder	45.64%

Big shareholders are holding more than 5% shares of the company

Note: the chart extracted from Xu Li-ping,Xin Yu, Chen Gong-meng, *Ownership Concentration, Outside Blockholders and Operating Performance:Evidence from China's Listed Companies*, ECONMIC RESEARCH JOUNAL,NO.1 2006.

Who Are These Majority Shareholders?

- Ultimate Shareholders of China Listed Companies in 2001

Biggest shareholder	Number of companies and proportion in all listed companies	Average holding of biggest shareholder
The State	930 84.1%	46.5%
The Private	174 15.9%	34.8%

- Note: the chart extracted from Liu Shao-jia,Sun Pei, Liu Nai-quan, *The Ultimate Ownership and Its Ownership structure:Does It Matter for Corporate Performance*, ECONMIC RESEARCH JOUNAL,NO.4 2003

Who Are These Governments?

- 2001-2003 characteristics of ultimate controllers of listed companies in China

Ultimate Controller	number	proportion
Non-government	540	21%
Central government	577	23%
Local governments	1426	56%

- Note: the chart extracted from Xia Li-jun,Fang Yi-qiang, *Government Control, Institutional Environment and Firm Value:Evidence from the Chinese Securities Market*, ECONMIC RESEARCH JOUNAL,NO.5 2005.

Why Governments Loot Listed Companies?

- Governments have multiple targets;
- Agent cost between governments and their representatives;
- Ways of restructuring SOEs for IPO make the looting more convenience.

Ways of Restructuring for IPO

- SOEs would be divided into holding company and listed company.
- Holding company's holding will not be sell on the exchange.
- Holding company held bad assets left.

Central Government

- Central Government’s looting balanced by its responsibility:

- Central government should be responsible for the capital market;
- Central government want to develop a strong capital market.

Local Governments

- Local Governments' looting have no limit:

- They are more greedy;
- They are competitors:
- They don't have any responsibility to capital market;
- They don't care for the strong capital market.

3. Taming Majority Shareholders in China

- Traditional ways to control controlling majority shareholders:

- Ex ante: minority shareholders approval;
- Ex post: fairness through court review

Central Government

- Central government want to limit the looting of local governments:

- They can do this through legislature;
- But, they don't like the ex ante way
- And they can't use ex post way

Advantages of Local Governments

- Local Governments control the local courts
- The judges are elected by local congress;
- The courts are supervised by local congress.

Advantages of ID

- Not so strict
- To do the warning role

- To control ID through:
- Training
- Strict Duty

Conclusion

- Political Structure of governments: relationship between Central and local governments

- The nature of ownership: State-owned
- The concentration structure of ownership