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股权维权主义：中国股权分置改革的证据

Shareholder Activism: Evidence from China’s Split Share Structure Reform

SVILEN TENCHEV ATANASOV

指导教师姓名： Assoc. Prof. Deng-Ta Chen

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摘 要

本文旨在研究新兴资本市场中，机构投资者作为公司治理的积极参与者所发挥的作用。2005 年发生在中国的股权分置改革为我们提供了一个理想的研究背景。在这次股权分置改革之前，上市公司的股权被高度集中在一个或者几个大股东手上，通常为国有股或者创始人家族持股，他们所持有的股份均为非流通股。与此同时，上市公司的一小部分股份被流通股股东所持有，而他们当中最大的股东是机构投资者。在这股权分置改革过程中，两类股东将会协商谈判，非流通股大股东将会对流通股股东给予赔偿来换取其非流通股获得流通的权利。为了研究机构投资者在这谈判过程中，是否发挥了作为积极有效的股东角色的作用。我们对机构投资者与赔偿方案进行了回归，来分析这两者之间的关系。本文的实证结果表明，机构投资者对于补偿方案的影响远比想象中的要复杂。没有显著的证据可以表明机构投资者对股权分置改革的赔偿方案造成了影响。因此，此研究也证实了股权维权主义在中国还存于很初期的发展阶段。

关键词：股权维权主义，中国股权分置改革，机构投资者

Abstract

The purpose of this paper is to investigate the function of institutional investors as active participants in the corporate governance of targeted companies in emerging capital markets. In 2005, the split share structure reform initiated in China and its negotiating character present us with an ideal research environment. Before the reform, the ownership structure of public companies was highly concentrated in one or several block-holders referred to as non-tradable shareholders, usually the state or the company's founding family. The other side of the negotiations table was represented by the tradable shareholders that primarily held a minority stake in the publicly traded companies and among which institutional investors were the largest tradable shares' owners. In the course of the reform, the non-tradable shareholders negotiated on a compensation plan with the tradable shareholders with the trading rights of their shares in return. To determine whether institutional investors are effective shareholder activists during the negotiations we use regression analysis that studies the relationship between institutional investors and the agreed compensation. This paper's empirical results show that the impact of institutional investors on the compensation is insignificant. There is not enough evidence to support the claim that institutional investors are influential in the reform's negotiation process. These findings provide support for the argument that shareholder activism in China is still in its infancy.

Keywords: Shareholder Activism; China's Split Share Structure Reform; Institutional Investors

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Chapter 1 Introduction

In the present study, the issue under scrutiny is the role of institutional investors in China's 2005 split share structure reform and more specifically the role of shareholder activism. Financial research on the subject has been broadly conducted for developed capital markets, U.S. to name one. In the majority of those studies, institutional investors are reported to be active participants in corporate governance.[1] However, the capital market in the U.S. is predominantly considered to have diffused corporate ownership structure and very well developed investor's protection legal framework, and its primary agency problem being the conflict of interests among investors and managers. On the other hand, La Porta et al. (1999) argue that in most emerging markets the case is quite the opposite. Emerging markets are considered to have inadequate protection for investors and the corporate ownership is concentrated. This hypothesis would convert the primary agency problem to conflict of interest between majority and minority shareholders. Thus, what is the role of shareholder activism in emerging markets? Are institutional investors active supervisors that aim to increase the per-share value of companies, or are they colluding with management and therefore expropriating wealth from minority shareholders? We believe that China's split share structure reform present us with a unique opportunity to study the role of shareholder activism in emerging markets and their position in the potential conflict between majority and minority shareholders.

The "split share structure" refers to the coexistence of tradable, floated shares and non-tradable, off the market shares. Non-tradable shares are primarily owned by the state or by legally defined entities, whereas the most influential tradable shareholders are institutional investors. This unusual split share structure can possibly lead to incentive conflicts and divergent interests between tradable and non-tradable shareholders. Furthermore, it has long been identified as the source of many corporate governance problems in China (see Chen et al. 2006; Chen et al. 2008; Feinerman, 2007). The purpose of the split share structure reform is to sort out these historical problems, as well as to improve the overall functionality of the stock market in China. Its process,

[1] Gillan and Stakrs (2000), Hartzell and Starks (2003), Gaspar et al. (2005) and Cheng et al. (2010) are some of the recent U.S. based studies on corporate managers' incentives are affected by institutional investors. Chevalier and Ellison (1997) and Mehran and Stulz (2007) represent some of the studies on conflict of interest in the U.S.

while attempting to consider all participants' perspectives, is also trying to increase the listed companies' intrinsic value. Its procedure includes a focus on the improvement of stock market institutions, the regulation of securities companies' operations and the development of modern securities products. By design, the reform's procedure is intended to essentially float the non-tradable shares on the market and limit the selling pressure on companies with high volume of state owned shares.

The key point of the reform, on which we want to focus our research, is that the non-tradable shareholders are obligated to compensate the tradable shareholders in order to obtain the right to trade with their non-tradable shares on the open market. The rationale behind the need for compensation is that non-tradable shareholders gain liquidity and the right to sell their shares at market prices, while tradable shareholders may incur losses after the implementation of the reform because the increase of A-shares on the market could result in decreased share price due to selling pressure.[2] [3] For the successful implementation of the reform, the non-tradable shareholders are to negotiate a compensation plan with the tradable shareholders that will benefit both parties. The primary bargaining chips used in the negotiation process are stock shares and future commitments.[4] The stock shares offered as compensation are the company's non-tradable shares that will be converted into tradable shares as a result of the reform. Future commitment, as described by Lewicki, Saunders and Minton (1997, p.122), is a key concept of negotiation to take a bargaining position with a pledge regarding a future intended course of action.[5] Based on the data we collected, every company's non-tradable shareholders offered shares and made at least one commitment for the time after the implementation of the reform. For an agreement to be reached, a minimum of two-thirds of the voting tradable shareholders have to accept a proposed compensation plan.

[2] Usually, illiquid securities, such as non-tradable shares, are traded at a significant price discount (see Kahl et al. 2003; Longstaff, 1995, 2001).

[3] Indeed, a loss for the tradable shareholders due to selling pressure is logical. In the long run, however, and in case the reform improves the company's governance and performance, this loss to the tradable shareholders is decreased.

[4] Table 2 in Chapter 3 reports the various different types of compensation combinations.

[5] We collect data on six common future commitments made by non-tradable shareholders during the negotiations: commitment of holding non-tradable shares (CHNTS), commitment to increase holdings (CIH), commitment of future dividends (CFD), asset injection commitment (CAI), equity incentive scheme commitment (CEIS) and other commitments (CO). We discuss future commitments further in Chapter 3.

Particularly interesting in this dynamic are the roles of the institutional shareholders and state shareholders. Prior to 2005, the state, represented by central, local governments and legal persons, is the largest non-tradable shareholder holding about half of all non-tradable shares.[6] Institutional investors, on the other hand, are the largest investors of tradable shares.[7] The non-tradable shareholders are to negotiate with the tradable shareholders over the compensation package, if the reform is to be completed. Therefore, institutional investors and state shareholders with a considerable proportion of shares ought to have a significant influence on the content of the compensation plan and outcome of the negotiations. If the institutional shareholders' interests are aligned with the interests of minority shareholders, we can argue that they will actively pursue higher compensation. Hence, minority shareholders can free ride on the institutional investors' efforts given that institutional investors look after both parties' interests (Davis and Kim, 2007). Nevertheless, we are not alone in the view that institutional investors' incentives are complex and we can often observe conflicts of interest or sometimes political pressure in situations like this (Mehran and Stulz, 2007). Institutional investors could collude with the non-tradable shareholders. If that is the case, institutional investors will not represent the tradable shareholders' interests and will not pursue more favorable compensation plan. We believe that the negotiating character of the reform and its easily quantifiable result – the compensation ratio – is offering us a unique experimental setting to empirically examine the role of active institutional investors in the corporate governance of companies in emerging markets and the part they play in this conflict of interests.

The data gathered in our study shows that the total institutional ownership holdings are negatively and statistically significantly related to the final compensation ratio. Furthermore, our findings indicate that the higher the state ownership the higher the compensation ratio is. These results present evidence for the argument that the government is motivated to complete the reform quickly and smoothly by offering relatively higher compensation. On the other hand, when testing the relationship between compensation and active shareholders, we find positive relationship, albeit statistically insignificant.[8] Moreover, we report that future commitments have negative and

[6] The term "Legal Persons" refers to domestic legal entities and institutions most of which are state-owned.
[7] For ownership composition statistics in China before the reform see Wei et al. (2005).
[8] We define active shareholders as a dummy variable that equals 1 if the company has at least one institutional shareholder with 5% or more ownership reported at the quarter preceding the announcement of the reform, and 0 otherwise. We further discuss the variables we use in Chapter 3.

statistically significant relationship with the final compensation ratio. Given that close to half of the agreed compensation plans in our sample included more than one commitments for the future coupled with the fact that the effect of active shareholders is statistically insignificant, we contend that non-tradable shareholders had the upper hand during the negotiations. The non-tradable shareholders, on average, managed to negotiate a compensation plan that included more commitments for the future rather that higher per-share value for the tradable shareholders. Thus, it seems fair to suggest that there is not enough evidence to argue that institutional investors engaged in shareholder activism by negotiating for higher compensation for the tradable shareholders.

The remainder of the paper is organized as follows. In Chapter 2 we discuss previous literature on shareholder activism, as well as on the split share structure reform. Chapter 3 describes the data sample, variables and research methodology. Chapter 4 reports the empirical results of our study and Chapter 5 concludes.

Chapter 2 Literature Review

This Chapter's goal is to review the existing literature. In section 2.1, we make a brief international overview of the previous literature written on shareholder activism. Section 2.2 discusses the inception and development of shareholder activism in the stock market in China. China's split share structure reform is reviewed in Section 2.3.

2.1 Shareholder Activism

In case shareholders are not satisfied with a company's management, they have the option of three types of actions. One is to vote with their feet – liquidating their shares in the company. Another is to choose to remain silent. Alternatively, they may decide to actively pursue their personal interest in the corporate governance of the company by influencing managerial decision-making, as suggested by shareholder activism. Hirschman (1971) summarizes these shareholder actions into three categories: exit, loyalty, and voice.

Broadly speaking, as defined by Sjöström (2008, p.142), the term shareholder activism means "the use of ownership position to actively influence company policy and practice. Shareholder activism can be exerted through letter writing, dialogue with corporate management or the board, asking questions at open sessions in general meetings, and through the filing of formal shareholder proposals".

The main purpose of a shareholder activist is to pursue an active dialogue, or in some cases confrontation, with a company's management only if the benefits offset the invested capital and time (Pozen, 1994). The type of shareholder activists can vary from small minority investors to big institutions with significant financial power. The main idea is that shareholders can efficiently monitor a company, and that certain shareholders are willing and capable of being a powerful influence on corporate governance (Monks and Minow, 1996).

Any thorough study on the internal governance of a company should attempt to understand shareholders' efforts to influence company's management. In the U.S. there are large number of empirical studies that attempt to quantify the effects of shareholder activism on targeted companies' performance, operations and governance structures. However, they appear to produce contradictory results. Strickland et al. (1996, p.321), for example, report that, "Our results.... suggest that monitoring by small shareholders is possible and that it can be successful." Smith (1996, p. 251) agrees: "Overall, the evidence indicates that shareholder activism is largely successful in changing governance structure and, when successful, results in a statistically significant increase in shareholder wealth." These statements suggest that shareholder activism is likely to improve targeted companies' overall operations, a conclusion also reached by Bizjak and Marquette (1998), Carleton et al (1998), Brav et al. (2008), Klein and Zur (2009).

Karpoff et al. (1996, p. 393), though, disagrees: "There is no persuasive evidence that [shareholder] proposals increase firm values, improve operating performance, or influence firm policies." Gillan and Stark (2000, p.303) agree: "In general, we find that activism has been relatively ineffective when measured by voting outcomes." Wagster and Prevost (1996), Wahal (1996), and Johnson et al. (1997) all report shareholder activism tends to have little impact on targeted companies. Furthermore, Gillan and Starks (2007) review a large number of empirical studies on institutional activism. They conclude that the effects of shareholder activism on targeted companies, based on the evidence provided by those studies, is mixed.

The capital market in the U.S. is predominantly considered to have diffused corporate ownership and very well developed investor's protection legal framework, and its primary agency problem being the conflict of interests between investors and managers (Becht and Mayer, 2001). However, most of the emerging capital markets manifest quite the contrary: poor investor protection and ownership concentration, where the key issue is the interest conflicts between block holders and minority shareholders (La Porta et al. 1999). Thus, shareholder activism in an emerging market environment might have a different outlook.

2.2 Shareholder activism in China

The stock market in China is a typical example of such environment. Stock markets in China were established in 1990 and have a relatively short history. A literature review of the corporate governance in Asia by Claessens and Fan (2002) outlines the limited protection of minority shareholders' rights in Asia and the agency problems exacerbated by the low corporate transparency. Companies in China, in general, have a concentrated ownership structure, limited disclosure, poor investor protection, and dependence on the banking system. Law enforcement is weak. Throughout the 1990s the majority of the tradable shares were held by individual investors (Wei et al. 2005). However, individual investors usually don't possess the required knowledge, and experience to evaluate companies and act collectively to exert significant influence on corporate governance. Institutional investors, on the other hand, typically have highly educated and well trained research and management teams that are better able to monitor and communicate with corporate management (Kim, 2003).

In China, institutional investors, in the practical meaning of the word, did not emerge until 1998. In that year four closed securities investment funds were established.[9] Their purpose was to stabilize the stock markets and initiate the introduction of new and reformed investment rules. However, at the early stages of their development, institutional investors' real role was questioned. Empirical studies argue that at the time the interests of minority shareholders were mistreated by large shareholders (Chen et al. 2006), and ultimately some of these practices resulted in harming the company value (Wei et al. 2005). Furthermore, it was reported by an article titled "Inside Stories of Funds: A Report Regarding the Analysis of Actions of Funds," published in Finance and Economics Magazine in October 2000, that funds employed matched orders, affiliated transactions, insider trading and other tactics to manipulate stock prices (Ping and Li, 2000). This article has been a tremendous influence on Chinese stock market. Its controversial nature is perhaps related to the issue of the first law in China that administers institutional investors – Law of the People's Republic of China on Securities Investment Funds – which was officially enacted on 1 June, 2004.

The notion of shareholder activism in China occurs later compared to shareholder activism in other countries. Shanghai and Shenzhen Stock Exchanges decided to permit institutions to be able to buy shares of listed companies in 1993 and 1991 respectively while American institutions' shareholdings already represent 53.3% of the American stock market value in 1990. After the introduction of the Chinese Securities Law in 1999, increasing the involvement of institutional

[9] The first security investment funds of practical meaning in China, namely Kaiyuan, Jintai, Xinghua and Anxin, that were publicly issued in the first half of 1998.

investors became one of the long-term objectives of the Chinese securities industry (Mu, 2003). In 2003, the Government's commitment to opening up the domestic securities market to foreign investors resulted in agreement allowing Qualified Foreign Institutional Investors (QFIIs) to trade with A-shares (Xi, 2006). At present, institutional investors in the securities market in China are comprised of investment funds, insurance companies, social security funds, securities companies, commercial banks and QFIIs.

Table 1
Composition of Investors

Year	Mutual Funds	QFII	Other Institutional Investors	Institutional Investors TOTAL	Ordinary Institutional Investors	Individual Investors
2005	17.20	2.26	6.20	25.66	4.52	69.82
2006	20.11	4.02	8.83	32.96	9.56	57.48
2007	26.00	1.65	4.53	32.18	16.53	51.29
2008	19.81	1.81	4.17	25.79	28.83	45.38
2009	12.72	1.41	4.34	18.47	51.53	30.00
2010	9.29	1.24	6.11	16.64	54.22	29.14
2011	7.82	1.07	6.77	15.66	57.79	26.55
2012	7.59	1.40	8.40	17.39	57.28	25.33

Table 1 reports the proportion of tradable A-Shares owned by various types of investors from 2005 to 2012 in percentages. Ordinary institutional investor is, in fact, State and Legal Persons' shareholdings, as defined by the state since 2005. QFII denotes the term "Qualified Foreign Institutional Investors". "Other Institutional Investors" includes insurance companies, securities companies, pension funds, social security funds, enterprise annuity funds, and trust companies.

Source: "Statistical Yearbook of China Securities Registration and Settlement".

Table 1 reports the stock market's investor structure in China from 2005 to 2012, the period covered by this empirical study. It illustrates the development of tradable A-shares' investor composition since the split share structure reform (we discuss the split share structure reform in details in Section 2.3). In 2005, with the beginning of the reform, all non-tradable shares start to convert to tradable shares. Until that time, state and legal persons were in possession of more than half of all non-tradable shares.[10] Since the beginning of the reform, the legal definition of state and legal person is changed to ordinary institutional investors. During that period, ordinary institutional

[10] For investor composition statistics before the reform see Wei et al. (2005).

investors' proportion of the tradable A-shares, not surprisingly, increased as their non-tradable shares became tradable, whereas the proportion of shares held by individual and institutional investors naturally decreased. By the end of 2012, Chinese Securities Regulatory Commission's efforts to assist the development of institutional shareholders resulted in 17.4% of the A-shares market being held by investment funds, marking an increase of 1.7% from the previous year. Taking into account that the proportion of tradable A-shares ownership owned by institutional investors was massively diluted due to the reform, institutional investors have grown into a major participant in the Chinese stock markets since 1998. This growth in significance is a step toward effective monitoring, but then again, how developed is shareholder activism in China?

Although the fact that research on shareholder activism in China is relatively limited, Tenev et al. (2002) argue that institutional investors lack the ability and desire to be actively engaged in corporate governance. In a paper by Chen et al. (2007), discussing the profile of institutional investors that are effectively monitoring the companies in which they hold stock, it is argued that only investors with (1) sizable shareholdings and (2) a long term investment horizon are motivated to engage in shareholder activism. Institutional investors in China are neither holders of sizable blocks of shares, nor do they have long term investment horizon. We discussed previously that the amount of institutional shareholders has been increasing, however, at company level their shareholdings proportion is relatively small. Jiang and Kim (2015) report that the median proportion of shares that an institutional investor owns in a company on average is merely 0.075% in 2012.[11] Even the 75th percentile institutional investor holds only 0.348% of a company in 2012. In other markets, where institutional investors have been reported to have an impact on corporate governance, it is mostly because the company has a diffuse ownership structure. Although minor percentage of the company, the active institutional investor holds, on average across shareholders, a sufficient amount of shares to have an impact on the company. But, as we discussed previously, in China the ownership structure is not diffuse, rather it is characterized by concentrated ownership. Furthermore, note that the most often case is that the company's controlling portion of the shares is held by either the state or the company's founding family.

[11] The statistics are at the company-investor level. The reported percentage means that an institutional investor owns 0.075% of a company on average.

Therefore, institutional investors are not likely to have enough proportion of shares to impose their ideas.

Now, let us consider point (2): a long term investment horizon. As we discussed previously, the economy in China is regarded as a developing one and its stock market can be classified as relatively volatile, therefore it is doubtful that investors in China make decisions focusing on the long run. This argument is supported by statistics on turnover. For instance, the investment funds' turnover rate in China is 291%, 243% and 202%, for 2009, 2010 and 2011 respectively.[12] In other words, the average holding period for investors in 2011 was less than six months. This turnover statistics suggest that institutional investors in China have more of a speculator behavior than of a long term investor. That is to say, institutional investors are highly unlikely to get actively involved in the corporate management, given their short term investment strategies.

However, despite the arguments that, in China, institutional investors are not motivated and lack the incentives to monitor and make an impact on companies' governance, we acknowledge the fact that there might be rare occasions and circumstances when they can provide us useful insight. One such occasion is the 2005 China's split share reform. The negotiations between non-tradable and tradable shareholders during the split share structure reform is an excellent opportunity to investigate the significance of shareholder activism in China.

2.3 China's split share structure reform

The stock market in China was launched in the 1990s with the establishment of the Shanghai and Shenzhen stock exchanges. Its primary goal was to refinance and revitalize the distressed state-owned enterprises (SOEs). Furthermore, it was aimed at imposing elements of market discipline on companies' top management. Chen et al (2008) report that the government continued to hold a large ownership stake in numerous listed companies in order to retain its control over the SOEs. At first, the controlling shareholder of those companies was a state entity. With time, however, through mergers and acquisitions, some individuals and private entities took control over many companies (Chow, 2007). The controlling shareholder, being state or private,

[12] See "http://finance.sina.com.cn/money/fund/20120406/180111764203.html".