Research on the Protection of Minority Investors' Rights and Interests by Special Shareholding Structure

Institutional Analysis on Science and Technology Innovation Board with Registration System

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Abstract—In 2018, President Xi Jinping announced at the opening ceremony of the First China International Import Exposition that China would launch a science and technology innovation board with a registration system to allow companies of special shareholding structure and red-chip enterprises that meet the relevant requirements to be listed here. It is also an effective way to prevent the enterprises from being hostile takeover and protect the rights and interests of entrepreneurship team in decentralized equity era. However, in this mode, ordinary voting shareholders and special voting shareholders share the risk of enterprise operation, but it is difficult to restrict the management's "breach of faith" by transferring their decision-making rights. And science and technology innovation board will experiment registration system that adheres to the market orientation and the checks of intermediary agencies, and reduces the administrative interference of the government in the field of issuance audit, which obviously lower the entry threshold. Therefore, there are many potential risks in the stock market, and also a lack of adequate protection mechanism to enable minority investors to better enjoy the dividends of enterprise development. This paper intends to analyze the potential risks of listing with special shareholding structure on science and technology innovation board and to put forward risk prevention measures from perfecting information registration system, and to put forward special shareholding structure on science and technology innovation board with a registration system to allow companies, giving pre-revenue companies, red chips enterprises, special shareholding structure enterprises etc. the opportunity to go public and broadening access.

The pilot of registration system is a major innovation in the establishment of science and technology innovation board. By streamlining and optimizing the current issuance conditions, shortening the audit cycle, the original government audit supervision will be transferred to give full play to the decisive role of market, reducing administrative intervention and improving the issuance efficiency. As an important step to promote the reform of Chinese Security Market, the pilot of registration system optimizes the issuing conditions of new shares through flexible and orderly institutional arrangements to provide capital market support for technological start-ups and alleviate the financing difficulties of enterprises. Secondly, it innovates the supervision mode of listing and trading in China's securities market, upgrades the principles and system design of supervision and management of China's capital market. Chinese government makes positive preparations to reduce the outflow of high-quality enterprises and enhance the ability of the securities market to serve the real economy [1].

The special shareholding structure established based on the "unequal voting rights" is a system designed to prevent the company from being maliciously acquired and helps to safeguard the rights and interests of investors. It effectively maintains the control right of entrepreneurship team, makes them focus on business innovation, and effectively avoids the excessive interference of foreign shareholders in company affairs [2].

But behind the innovativeness and growth of science and technology start-up enterprises is the uncertainty of development prospects. The threshold of profit level for the companies ready to go public has been gradually reduced, even without substantive threshold, and only the information disclosed is subject to review by China Securities Regulatory Commission. Therefore, compared with the approval system, the market-oriented IPO pricing system, the brand-new
market trading system and the rapid delisting system in the process of the implementation of science and technology innovation board substantially increase the investment risk of investors. At the same time, entrepreneurship team of company with special shareholding structure is expert in technology than management, and the increase of management's control over the enterprise can easily lead to "moral hazard". Therefore, in order to promote the role of science and technology innovation board and the healthy development of China's securities market, it is necessary to control the management risk of companies equipped with special shareholding structure under the registration system and establish a reasonable and effective mechanism to protect the legitimate rights and interests of investors.

II. ADVANTAGES OF SPECIAL OWNERSHIP STRUCTURE OF LISTED COMPANIES IN SCIENCE CREATIVE BOARD

Most of the companies ready to go public on science and technology board are new generation information technology, advanced equipment, new materials, new energy, energy conservation and environmental protection, biomedicine and other high-tech industries and strategic emerging industries. The core idea and the technology of entrepreneurship team is an important condition for enterprises to maintain innovation ability and sustainable development. However, after several rounds of financing activities, it is inevitable to lead to the dilution of entrepreneurship team equity. In order to protect their control rights over the company and prevent excessive interference by foreign investors, more and more new enterprises take the inherent advantages of the special shareholding structure and take full measures to provide institutional guarantee for the sustainable and stable development of the company.

A. Special Shareholding Structure Reflects the Change of Shareholders' Demands

Shareholder's claim has changed from "homogenization" to "heterogeneity", and gradually "one-share-one-vote" has lost its theoretical hypothesis. It is based on the "homogeneity" of shareholders, which is manifested in the homogeneity of shareholders' purposes, interests and abilities. However, this hypothesis has gradually lost its theoretical basis: there are multi-dimensional conflicts of interest among shareholders, which is often manifested as a direct conflict; at the same time, due to the difference of shareholders' identity, major shareholders may exploit the interests of minority shareholders; secondly, it is difficult for shareholders to maintain consistency in the purpose of maximizing the company's interests; finally, shareholders' knowledge structure and rational analysis ability are in significant differences [3].

The "heterogeneity" of shareholders' claims is manifested in the multi-level deviations in the performance of corporate control and economic rights acquisition. With such differences, people need to construct a new ownership structure and highlight differences in the design of the right proportion and its dimension.

B. Special Shareholding Structure Caters to the Company's Development Demands

The special shareholding structure based on "unequal voting rights" is a good system design to prevent the invasion of foreign investors, which can effectively prevent the company from being maliciously acquired and maintain the control of entrepreneurship team.

1) Reducing the cost of controlling the company by entrepreneurship team: Under the special shareholding structure, the voting rights of special shares are more than common shares, so entrepreneurship team does not need to accumulate a large number of common shares to obtain corporate control, reduce the pressure of capital flow for centralized control, and reduce the risky cost of holding shares.

2) Reducing the cost of decision-making and improving the efficiency of decision-making: The uncertainty of economic development situation makes investors and entrepreneurship team deviate in predicting the direction of development. Because of the differences in knowledge structure and analytical ability, shareholders of companies will have great differences and conflicts on interest in internal decision-making, and the decision-making itself has a technical threshold. If some shareholders' conservative shortcomings and misjudgments lead to improper operation of enterprises, they will cause huge losses.

3) Resisting the risk of acquisition and maintaining internal stability: For the sake of short-term interests, shareholders who have the right to make proposals in enterprises sometimes lack long-term strategic planning and will influence the direction of decision-making, which may lead to factional competition for control of enterprises. Marked by the "knock-on" of "barbarians outside the door" such as Vanke's internal Baoneng System, China Resources System and Shenzhen Metro from the beginning of 2015, China's capital market has quietly entered the era of "decentralized equity", while the special shareholding structure has shown an institutional advantage in maintaining entrepreneurship team's control over the company and resisting the acquisition risk.

III. HARM ANALYSIS OF IMPROPER USE OF SPECIAL SHAREHOLDING STRUCTURE UNDER REGISTRATION SYSTEM

Under the special shareholding structure, the asymmetry and separation of control rights and earnings rights can help entrepreneurship team control the company, but if not well used, it will lead to improper consequences. Although company resolution is the collective will in name, it is the will of majority shareholders, especially major shareholders, which does not mean that the rights and interests of all investors are safeguarded. This special shareholding structure makes it difficult for capital to restrain control rights [4]. The high freedom of entrepreneurship team easily leads to the increase of agency costs, weakens the supervision and management of the company, and makes the rights and interests of minority investors suffer from great
loss, increase their investment risk, and weaken their enthusiasm for investing.

A. Risks Aroused from Information Asymmetry

In market transactions, when it is difficult and costly for one side of the market and the supervisor to obtain information from the other, the information they grasp is often in an asymmetric state. However, the difference of knowledge structure between two sides and the low binding force on each other's behavior after the transaction are concluded often lead to the asymmetry of information content, and the time difference between the two sides of the information transaction when contacting information will lead to the loss of the rights and interests of the information disadvantaged parties due to the asymmetry of information acquisition time.

1) Investors lack investment reference indicators: The profitability indicators in the listing conditions of the company have been diluted, and the indicators reflecting investors' expectations and business conditions with market value as the core have been introduced. The government does not adjudicate the issuing qualification of the company and the qualification of going public is completely examined by the market. Although this lowers the threshold of the company's listing, the market needs to equip with the ability to identify and support the risk. Most of the prospectuses disclosed by the company are lengthy and full of professional terms, which is not easy for the investors to understand. Investors also lack important indicators to carry out investment activities and predict the sustainability of enterprises, which can easily lead to wrong investment behavior.

2) The moral hazard of entrepreneurship team increases: Entrepreneurship team controls the generation and disclosure of information, lacks the supervision of external market and other shareholders, and will instruct accountants to provide false financial information or conceal some information for unreasonable purposes, which will artificially lead to unreasonable pricing of IPO and abnormal fluctuation of stock price. At the right time, if entrepreneurship team arbitrages regardless of stock price fluctuations, it will damage the rights and interests of investors and destroy the order of the securities market.

3) Investors are prone to misestimate the value of enterprises because of the increased risk of speculation: The proportion of individual investors in Chinese Security Markets is high, lacking complete trading knowledge. In Chinese Security Markets, there are high turnover rate and obvious speculative motivation. Because of the unrestricted price range in the 5 days after the listing of the company and the ratio will be relaxed to 20%, it will lead to great changes in earnings. If investors enter the market at some point for speculative purposes and lack of accurate judgment of the company due to the disclosure of information, it is easy to cause huge investment losses and suppress the enthusiasm of follow-up investment.

B. There Is a Lack of Internal Restraint Mechanism, and the Risk of Internalization of Enterprise Profits Has Increased Sharply

Under the special shareholding structure, the minority investors' shares and voting rights are low, and there is no effective system to protect their legitimate rights and interests. Moreover, the independent director system of Chinese listed companies is imperfect, which makes it difficult to effectively supervise entrepreneurship team and safeguard the rights and interests of minority investors within the company.

1) The independent directors of Chinese listed companies are mostly the will of the major shareholders or entrepreneurship team: Under the special shareholding structure, the control right of the company is centralized. Entrepreneurship team essentially overrides the general meeting of stockholders or the board of directors and has a higher voice on the selection of independent directors. Through the "birth" mechanism of independent directors, the conclusion can be drawn that most of them are subsidiaries of major shareholders, not defenders of the interests of minority investors.

2) Independent directors can't get real information of enterprises in time: Independent directors are independent of shareholders and do not serve in the company. The information obtained mainly comes from the management of the company, which is likely to be distorted or untimely. In this way independent directors cannot effectively play the role of decision-making and supervision of the operation and management of the enterprise.

3) Independent directors lack time to participate in the operation of enterprises: Independent directors are mostly sociologists or retired government officials. Even if they have relevant knowledge background, they usually lack practical experience in business management. Being independent directors in the listed companies in China are often part-time jobs. They lack sufficient time and energy to participate in business operations and cannot give full play of their functions.

C. Lawsuit Legal Mechanism Is Defective, and the Cost of Investor's Rights Protection Is High

The establishment of science and technology innovation board is accompanied by a strict delisting system, with short delisting time and high speed. If enterprises constitute fraudulent issuance, illegal disclosure of major information or other major illegal acts, the huge losses faced by investors will be difficult to recover after the termination of listing. However, the representative litigation system adopted in China is not smooth in solving securities disputes in the field of group rights and interest's infringement cases.

Because of the imperfect capital market of China, there are many civil disputes about securities fraud in China's capital market caused by false statements. But due to legislative procedures and investors' awareness of safeguarding rights, it's difficult to guarantee the rights of
minority investors. The number of courts is limited, so they are confronted with great litigation pressure and insufficient judicial resources in dealing with disputes. Our country pursues the principle of "who advocates and who evidences". If minority investors recourse for investment losses, they need to provide sufficient irregularities information to the court and bear all the burden of proof.

In China, minority investors often hold lower shares while the litigation cost is too high and the probability of winning the lawsuit is small, it usually results in the give-up for their rights. Listed companies are faced with small amount of compensation and low cost of illegal activities, which can hardly deter their illegal activities.

IV. MECHANISMS FOR PROTECTING MINORITY INVESTORS

According to the data from the annual report of China Securities Registration and Settlement Co. Ltd. in 2017 [5], the number of investors in China at the end of the term is about 13,398.03 million, of which natural investors is about 13,362.21 million, accounting for more than 99% of all. Individual investors in China are scattered, lack of expertise and experience and are not familiar with the company's production and operation. It is often speculative, blind and irrational of them to choose a company for investment activities. Therefore, if an illegal interest alliance is formed between entrepreneurship team and the major shareholders in the special shareholding structure, minority investors will suffer from great loss. Therefore, in order to achieve the balance of investors' interests, it is necessary to establish a series of systems to control the investment risk of minority investors easily caused by the inequality of voting rights.

A. Establishing and Improving the Information Disclosure System of Listed Companies

China's securities market has a relatively late start, a short development time, and is in a transitional period. The information disclosure system of enterprises is imperfect and needs to be improved urgently. Many listed companies' information disclosure is delayed, inadequate and incomplete [6], which provides a time lag for "illegal transactions". China's securities regulatory authorities should improve the information disclosure system to provide a sound institutional guarantee for investment activities.

1) Clarifying the obligation of information disclosure of listed companies and improving the quality of information disclosure: The focus of supervision on listed companies by Securities Regulatory Authority should be transferred from paying attention to profitability to safeguarding the legitimate rights and interests of investors. So the companies should publish the necessity, impact and existing implementation of adopting special shareholding structure in their public listing plans and prospectus before they go to public. Information disclosure should adhere to the principle of simplicity and clarity, eliminate lengthy and vague information disclosure, and highlight key contents. As well as paying attention to effectiveness, the information disclosure should fully express existing risks and be easy for investors to understand. Only in this way can the companies widely and comprehensively accept the supervision of the securities market, the news media and the public. Transparency, accuracy, simplicity and focus of information disclosure will increase the cost of data fraud of listed companies and facilitate the disclosure of complete and accurate information, which does great help to assist the minority investors in making decisions.

2) Giving full play to the supervision function of audit institutions: Audit institutions should maintain their independence and impartiality, ensure the fairness and objectivity of audit content, and do not make false and misleading statements. At the same time, Securities Regulatory Authority should strengthen the supervision and management of Certified Public Accountants so as to facilitate minority investors to obtain authoritative and true information.

3) Strengthening the punishment is in urgent need to carry out as well as raising the cost of violation of regulations: The Securities Regulatory Commission should make detailed provisions on the content of information disclosure and penalty measures of listed companies, increase the penalty intensity for violations and timely punishment, eliminating the phenomenon that the benefits earned by illegal means far exceed the penalty cost. Implementing these measures can produce good restraint effect to companies' behavior and achieve punishment effect.

B. Adding "T Plus 0" Trading System

For the purpose of restraining excessive speculation and avoiding settlement risk, China's newly-established science and technology board still adopts the "T+1" trading system. However, this trading system makes the liquidity and turnover of the securities market poor and hinders minority investors from hedging risks by trading other securities products. It also lacks fairness and restrains investment enthusiasm.

1) The "T plus 0" trading system should be piloted on science and technology innovation board, and the corresponding price limit should be applied: This will give minority investors the opportunity to stop losses in time and control investment risks reasonably, and reduce the market low activity and liquidity problems caused by the high entry threshold of investors.

2) The management system of real-time detection should be implemented: For institutional investors who have advantages in capital holding and shareholding, people should strictly monitor the number of their transactions and the frequency of turnover, so as to prevent them from looting minority investors by using the advantages of capital and shareholding, and solve the difficulty of financing caused by rampant speculation, so as to provide more adequate financial support for the development of science and technology enterprises.
C. Strengthening the Implementation of Self-discipline Supervision System

In 2001, China's Securities Regulatory Commission published the Guidelines on Establishing Independent Director System in Listed Companies, which stipulates that at least one third of the board members are independent directors, and that independent directors have the duty of good faith and diligence towards listed companies and all shareholders. Its purpose is to enable independent directors to assume the responsibility of supervising shareholders and provide advisory services.

1) Promoting the independence of the selection process of independent directors: The selection of independent directors and the source of their salaries should not be decided by the major shareholders of listed companies alone. Minority investors should have the right to speak in the process of selecting independent directors, and the avoidance team system should be adopted appropriately. The government and Securities Regulatory Authority should intervene appropriately, implement the salary incentive policy of independent directors that links performance appraisal with remuneration, and that their salary is consistent with the rights and interests of shareholders. When they are no longer attached to the major shareholders or entrepreneurship team and avoid the path dependence of cronyism, independent directors would give full play of their functions.

2) The threshold for the selection of independent directors should be established: In order to improve the system of independent directors in China, it is necessary to clarify the requirements of working experience, educational background and professional knowledge at the beginning of the election. Some independent directors are needed to master the experience of financial review to ensure that they can provide effective suggestions for the development of enterprises and carry out scientific supervision. It is also necessary to measure the time arrangement to ensure that independent directors can pay attention to the operation and development of listed companies for a long time. In addition, the minimum time requirement for independent directors to perform their duties and the minimum attendance rate of the board of directors are also needed to improve the system guarantee for independent directors to fully perform their duties.

D. Supplementing and Perfecting the Restraint Mechanism of Laws and Regulations

1) Increasing the supply of existing litigation system: The model litigation system plays a role in resolving the problems of joint implementation and the characteristics of group disputes [7]. When the legal facts of the application for demonstration litigation in securities fraud cases are the same and the number exceeds a certain amount, the system of demonstration litigation should be initiated; the court should select the demonstration litigation cases, respect the party's autonomy, abide by the standards, and enhance the court's decision persuasion; the court should hear the demonstration cases for public announcement, and then examine whether the subsequent application for participation in the trial of the cases has any validity. The issue of common facts should be decided whether to be included in the scope of the trial, and the expanded effect of the judgment should be determined to avoid duplicate trials on them in similar cases. In the subsequent trial of model cases, relevant judgments can be made with appropriate reference to precedents.

2) Establishment of dispute mechanisms to deal with securities fraud: Improving the liability regulation and relief mechanism of securities fraud compensation in China is an important measure to protect the rights and interests of minority investors. The restitution of unjust enrichment is the theoretical root of the securities fraud compensation mechanism [8] and it is compulsory. The fund compensation system is used to protect the rights and interests of minority investors. Based on the compensation paid by listed companies, accountable directors and executives in the process of investor reconciliation, the fines imposed by China Securities Regulatory Commission on the above-mentioned subjects and the financial support of the government, Compensation Fund had better remedied the difference between the investor's earnings and the actual earnings as the criteria [9]. Such case compensation funds should not be affected by the priority of the bankruptcy. The use of Compensation Fund to compensate investors for losses promotes the implementation of damages, further establish the investors' rights and interests relief mechanism, and protect the legitimate rights and interests of minority investors.

V. CONCLUSION

China has made drastic reforms in the capital market to make reasonable arrangements for retaining high-quality enterprises, attracting the return of unicorns, improving financing capacity and promoting the high-quality development of China's economy so as to form good market expectations. The implementation of special shareholding structure in China's capital market is a new experience, which helps corporate governance, prevents the risk of hostile takeover due to dilution of equity, enables entrepreneurship team to control the company, and promotes the orderly development of the enterprise. However, the weakening of supervision and discourse power of minority investors brought by the special shareholding structure threatens the rights and interests of the company. Therefore, Chinese government should not only provide a good platform for the development of listed companies, but also effectively supervise the behavior of them, protect the rights and interests of minority investors through system construction, so as to effectively promote the pilot of registration system on science and technology creation board.
REFERENCES


