

Research on Ownership Structure and Minority Investors Protection

Based on the Perspective of Ownership Restriction

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Abstract—Ownership structure is in the basic position of corporate governance. Reasonable ownership structure can promote the improvement of corporate governance, and protect the interests of minority investors. Minority investors are the main source of market circulation funds and play an important role in the development of listed companies. However, minority investors tend to be disadvantaged and their legitimate interests cannot be effectively protected, which seriously affects their enthusiasm for investment. According to the actual situation in our country, “one share being overwhelming big” has long been regarded as the fundamental reason why the interests of minority investors cannot be effectively guaranteed. Ownership restriction can effectively restrict the controlling shareholder invading the interests of minority shareholders. This paper mainly explores the protection of minority shareholders from this perspective.

Keywords—ownership structure; ownership concentration; ownership restriction; minority investors protection

I. INTRODUCTION

LLSV (2000) points out that in most countries of the world, the main problem of agency problem is no longer the problem between shareholders and managers, but the conflict of interests between major shareholders and minority shareholders [1]. For the controlling shareholders, ownership concentration is one of the important corporate governance mechanisms. It enables the controlling shareholders to supervise the managers and motivate the managers to work hard to improve company value. As the research goes on, many scholars found the controlling shareholders tend to use the asymmetric ownership structure to encroach on the interests of minority shareholders in the case of ownership concentration, resulting in supervising effect and entrenchment effect.

The emergence of the theory of ownership restriction is of great help to improve this situation. The study of ownership restriction was valued since twentieth Century 90s. In recent years, there has been a surge in the research on the theory of “ownership restriction” in China. Ownership restriction can effectively restrict or even eliminate the behavior of major shareholders to encroach on the company's funds or assets, consequently protecting the interests of minority shareholders. Based on the analysis of ownership structure, from the perspective of ownership restriction, this paper compares and

values theoretical research about the protection of minority investors.

II. VIEWPOINTS COMPARISON OF OWNERSHIP STRUCTURE

A. International Viewpoints of Ownership Structure

There are two conflicting viewpoints on the theory of ownership structure in the West: Shleifer & Vishny thought that ownership concentration is more conducive to improving the profitability and market reaction ability than ownership dispersion [2]. On the one hand, controlling shareholders impose potential takeover threats on management. It can have a good deterrent effect on the managements' behavior, and have a better inhibitory effect on the management to damage the interests of shareholders for their own interests. It can also effectively curb the phenomenon of “free ride” under the condition of ownership dispersion. On the other hand, controlling shareholders have the ability to obtain all kinds of information in the market. And the effective supervision and management of the managers can greatly reduce the loss caused by “asymmetric information”. However, Demsetz et al (1985) came to the opposite conclusion for the same problem. They believed that the dispersed ownership structure is better than the centralized ownership structure [3]. They thought the interests of controlling shareholders and minority shareholders are often inconsistent. When the external supervision is not obvious, the controlling shareholders generally sacrifice the interests of minority investors in pursuit of their own interests.

Many scholars adhere to the second conclusion, that is, ownership concentration is negatively related to the protection of the interests of minority investors. LLSV (2000) drew the conclusion: ownership dispersion is better for the protection of minority investors' interests; and concentrated ownership can result in poor investor protection [4]. Therefore, the key factor of modern corporate governance is to maintain a reasonable concentration of ownership to protect investors' interests.

B. Domestic Viewpoints of Ownership Structure

Chinese research on ownership structure started late and achieved fewer results. The main representatives are Jingyong Chen and Kemin Wang, which are based on the research framework of Jensen and Professor Meckling. They combined

Becker classic theory of “crime and punishment”. On this basis, they studied the effects of different investor protection on the behavior constraints and corporate performance under different ownership structure. By constructing a model, it is proved that the effect of ownership structure on corporate performance is influenced by the protection of investors' interests [5].

In conclusion, although ownership concentration can supervise managers and restrain the “free ride” phenomenon under the condition of ownership dispersion, the controlling shareholders will infringe on the interests of minority shareholders. At present, there is a phenomenon of ownership concentration in most countries of the world. Enterprises should strengthen the protection of minority shareholders.

III. AGENCY PROBLEM AND WAYS OF EMBEZZLEMENT

A. Agency Problem in Ownership Concentration

In the centralized market environment, the controlling shareholders have relative or even absolute controlling rights, which can decide the composition of the board of directors and the choices of managers. Managers usually are controlling shareholders or persons who are closely related to controlling shareholders. So the will of controlling shareholders can be directly reflected in the management decisions for listed companies. Even choosing managers from outside markets, the managers' behavior can be well supervised because of the controlling rights of the controlling shareholders [6]. In this context, the agency problem between investors and managers has become less important under the decentralized ownership structure, and the agency problem between the controlling shareholders and minority investors has become the main problem of corporate governance.

LLSV et al. (1999) put forward “ultimate control theory” [8]. That is, the actual controller behind the direct major shareholders is the decision makers of listed companies. And the actual controller or ultimate controller controls the listed companies through the Pyramid structure, cross shareholding and different voting rights shares. They also put forward the cash flow rights and controlling rights of the ultimate controller. Cash flow rights refer to the ultimate controller can receive the cash flow ratio in dividend distribution. Controlling rights refers to voting rights of the ultimate controller, and it is the total amount of direct and indirect holdings of shares.

LLSV et al. (1999) pointed out the entrenchment effect of controlling rights. When controlling rights and cash flow rights are separated, the entrenchment effect is more obvious, and cash flow rights can inhibit encroachment and have incentive effect on corporate value [7]. Johnson and La Porta, et al. (2000) call the entrenchment effect “tunneling” [8]. It mainly refers to the controlling shareholders transfer the company's assets and profits for their own benefits. There are some different ways, including selling assets at a lower price to the listed companies which controlling shareholders have high cash flow rights, paying higher salary to the management, encroaching on the development opportunities of listed companies and even stealing directly.

B. Controlling Shareholder's Encroachment Mode

LLSV (2000) pointed out that the main means of “tunneling” include embezzlement of enterprise investment opportunities, favorable transfer prices, the use of enterprise assets loan guarantees and so on.

Regarding the embezzlement of the listed company's assets by the controlling shareholders, Zengquan Li (2004) studied the tunneling and support of controlling shareholders for the listed companies based on the capital occupation. There is a nonlinear relationship that goes up and then goes down between the shareholding ratio of the largest shareholder and the occupying capital of controlling shareholders. And the holding mode of controlling shareholders and nature of property right has important influence on capital embezzlement [9]. Lei Gao et.al (2006) studied the influence of internal and external governance mechanisms on the tunneling behavior of controlling shareholders. They found that ownership concentration intensify tunneling. Management shareholding, fund holding and product market competition can suppress tunneling. But independent directors can't restrain tunneling [10].

From the perspective of investor protection, Huacheng Wang et al. (2007) empirically studied the relationship among the nature of ultimate controlling shareholders, the separation of controlling rights and cash flow rights, and cash dividend policy based on “ultimate control theory”. It is found that the distribution propensity of cash dividend of listed companies with group control is lower than those without group control. The tendency and intensity of cash dividend distribution of state-controlling companies is lower than that of private holding companies [11].

IV. OWNERSHIP RESTRICTION

A. The Definition of Ownership Restriction

Ownership restriction means that a few large shareholders possess controlling rights. Large shareholders restrain each other, so it is difficult for any large shareholder to manipulate decisions of the company. It can prevent corporate insiders from pillaging the company's benefits.

B. The Relationship between Ownership Restriction and Legal Protection

There are internal and external protection mechanisms for protecting minority investors. Ownership restriction is an internal mechanism, and legal protection is an external mechanism. Since LLSV introduced legal protection into the field of corporate governance, the academic circles have reached a consensus on the important role of law in corporate governance. Yifeng Shen et al. (2007) [12] and Donghua Chen (2008) [13] pointed out that China's legal protection level of investors is increasing year by year, but still in a low level, especially the poor law execution. Therefore, it is particularly important to strengthen the internal mechanism to protect the interests of minority investors in the case of not ensuring the efficiency of law enforcement. In general, the internal and external protection mechanisms mutually reinforce.

C. International Viewpoints on Ownership Restriction

There are two different opinions on the relationship between investor protection and ownership restriction in the international theoretical research. LLSV (1999) believed that the existence of multiple major shareholders is an alternative to the lack of legal protection. Bloch and Hege (2001) argued that multiple major shareholders are substitutes for decentralized equities in the environment of weak investor protection. They draw a conclusion by model analysis that ownership restriction often exist in environments with relatively high investor protection. If the level of investor protection is low, the increase of controlling shareholders' stock will recede investor protection. However, when the level of investor protection is relatively high and the competition of controlling rights is fierce, the increase of controlling shareholders' stock is more conducive to the protection of investors [14].

D. Domestic Viewpoints on Ownership Restriction

Domestic research on the theory of "ownership restriction" focuses on three points: first, how about the situation of ownership restriction of listed companies; second, what kind of ownership structure is more beneficial to the promotion of enterprise value between "ownership restriction" and "one share being overwhelming big"; third, what is the role of "ownership restriction" in corporate governance. For example, Yongxiang Sun and Zuhui Huang (1999) thought that "ownership restriction" has outstanding advantages compared with the "highly concentrated" and "highly dispersed". Under the condition of "ownership restriction", the stock is relatively concentrated, and the second-largest and third-largest shareholders can restrict the controlling shareholder. Ownership restriction plays an important role in the merger, acquisition, agency competition, management incentive and supervision of the company. Besides, it also helps to improve the overall value of the company.

From the perspective of China's listed companies, there are different views on the impact of ownership restriction. The empirical research of Yongxiang Sun and Zuhui Huang (1999) shows that the ownership proportion of the largest shareholder is inverse U-type with the company's Tobin's Q. And higher ownership concentration and ownership restriction are conducive to improve company value [15]. Xinyuan Chen and Hui Wang (2004) also found the positive effect of ownership restriction [16]. The research of Ying Du and Liguang Liu (2002) found that ownership concentration has a significant inverse U-type relationship with corporate performance [17]. chong'en Bai (2005) concluded that the ownership proportion of the largest shareholder is negatively correlated with the company value. And it is U-type rather than inverted U-type. Besides, ownership restriction has a positive impact on company value [18]. From the perspective of the ultimate controller, Liping Xu (2006) investigated ownership concentration and ownership restriction of listed companies in China and their impact on the company performance. The research shows that there is a positive relationship between ownership concentration and company performance, but excessive ownership restriction has a negative impact on corporate performance [19]. Weixing Cai and Minghua Gao (2010) examined the relationship between ownership structure and tunneling by using the related

transaction data of Chinese listed companies in 2007. They found that the ultimate shareholders had more shareholding and would encroach on more interests. When controlling rights and ownership are clearly separated, the ultimate shareholder will encroach on much interests of minority shareholders [20].

To sum up, the research on the impact of ownership restriction on corporate performance is far from reaching an agreement. The role of ownership restriction in the protection of minority investors is also controversial. We should realize the possibility of conspiracy among shareholders. But it can't be denied that ownership restriction can supervise major shareholders to a certain extent. In fact, shareholders' choices depend on the external legal protection. There is a U-type relationship between ownership restriction and legal protection.

V. CONCLUSION

In addition to the United States and the United Kingdom, the phenomenon of ownership concentration is widespread around the world. And the controlling shareholder can realize the separation of controlling rights and cash flow rights through the Pyramid structure, cross shareholding and different voting rights of shares.

Ownership concentration is the main problem of corporate governance in the market, and it is the agency problem between controlling shareholders and external investors. The controlling shareholders take advantage of controlling rights to tunnel listed companies and encroach on the interests of minority investors. The ways of tunneling contain: selling listed companies' assets at a lower price and providing loan guarantees to these companies which controlling shareholders has high cash flow rights; paying a high salary to the management; encroaching on development opportunities of listed companies and so on.

Internal and external mechanisms jointly play an important role in protecting the interests of minority investors. The external legal environment is the foundation, but the law is legislated by the relevant government departments and not flexible. Therefore, we should pay more attention to the role of internal ownership restriction to control the "one share being overwhelming big" and protect minority investors.

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