DO AUCTIONS MATTER?

ASSESSING THE CHINESE AUCTION PROMOTION INSTITUTION OF TAKEOVER LAW

Charlie Xiaochuan Weng*

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* Associate Professor, University of New South Wales Faculty of Law; former Oriental Scholar Chair Professor of Law at Shanghai Jiao Tong University.

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Abstract

This research examines the traditional wisdom of takeovers and relevant regulations. Generally, takeovers have a value adding effect, but need to be regulated in order to curb excesses. Auction promotion rules are efficient in maximizing social wealth and reducing non-value maximizing takeover deals when shareholders are confronted with a coercive offer. China has adopted such a rule. However, the application of the rule is far from satisfaction. The rule is not only ineffective in terms of its application ratio, but also reinforces controlling shareholders' powers, which makes minority shareholders more vulnerable to controlling shareholders' expropriation.

This research first conducts an empirical study on Chinese shareholder distribution in listed firms. Based on these up-to-date results, this article then analyzes, from an agency problem perspective, the utilities of different types of controlling shareholders in the market. This paper concludes that the current auction promotion rule, namely the "5% rule," is not efficient in light of the common Chinese ownership structure. An ex ante announcement institution is suggested in order to compensate for the defaulting functions due to the deactivation of the rule. Finally, this paper introduces an opt-in legislation mode for the minority companies with dispersed shareholder distributions.

I. INTRODUCTION

Takeovers is a quintessential corporate law topic that attracts attention from both academics and professionals in industry. Voluminous legal and economic literature focus on finding an optimal takeover law model.[1] The discussion on the best takeover institution became heated when the takeover market was booming.[2] Market dynamics significantly influence the design of takeover

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[1] *See, e.g.*, Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843 (1993) (talking about the dynamics of takeover of law and political economy in the United States).

[2] Take US academia as an example. In 1980s and 1990s, takeover law research was the major discussion field for the most important corporate scholars. *See, e.g.*, Frank Easterbrook & Daniel Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982); Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*. 35 STAN. L. REV. 51 (1982); Lucian Bebchuk, *The Case for Facilitating Tender Offers*, 95 HARV. L. REV. 1028 (1982); Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation*, 9 YALE J. ON REG. 119 (1992).

institution. Although Professors Hansmann and Kraakman did conclude that corporate laws in different jurisdictions share many similarities,[3] takeover law is probably an inevitable exception.[4] Understanding the differences across jurisdictions entails extensive and detailed research on political interests, ownership structures and law enforcement, all of which may explain the diversity.[5]

The general purpose of takeover law is almost amorphous. Even if shareholder protection serves as a broad explanation, there exist fierce debates as to which group of shareholders should be protected: those of the bidders or those of the targets?[6]

The starting point of the debate is how to maximize social wealth.[7] To be sure, the institutional avenues for maximizing social wealth through takeover vary, given the fact that corporate law in most cases maximizes social wealth through minimizing the costs incurred by agency problems, which differs from country to country because of diverse ownership structures.[8] Despite this institutional diversity, it seems that maximizing social wealth should be one of the main legislative purposes of takeover law.[9] National interests (or political interests under the cover of public interests), being protected through administrative takeover review, tax law, or antitrust law, also cannot be neglected. In order to achieve the aforesaid purposes, legislatures in different jurisdictions need to stipulate takeover regulations in light of specific national conditions.

It has been two decades since the first national stock exchange was established in China[10] and the landscape of the Chinese capital market has changed significantly since.[11] In the first decade after the establishment, state owners were almost omnipresent among listed

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[3] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 441 (2001).

[4] *See* David Skeel & John Armour, *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation,* 95 GEO L.J. 1727 (2007).

[5] For some considerations of precaution in unifying takeover laws are mentioned by Roberta Romano, *supra* note 2, at 121–22.

[6] *See, e.g.,* Lucian Bebchuk, *The Case for Facilitating Tender Offers*, 95 HARV. L. REV. 1028, 1034 (1982).

[7] Gilson, *supra* note 2.

[8] *See, e.g.,* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2009).

[9] Except for the channel effect takeover invites (channel tax benefits to corporate gains), takeover generally promotes social wealth. *See, e.g.,* Bebchuk, *supra* note 2, at 26.

[10] For details on the establishment of both exchanges, *see*, *e.g.*, PENG BING (彭冰), ZHONGGUO ZHENGQUAN FAXUE (中国证券法学) [CHINESE SECURITIES LAW] (2d ed. 2007); *see also* YUAN JIAN (袁剑), ZHONGGUO ZHENGQUAN SHICHANG PIPAN (中国证券市场批判) [CRITICISM ON CHINA'S CAPITAL MARKET] (2004).

[11] *Id.*; *See also* Charlie Xiaochuan Weng, *Chinese Shareholder Protection and the Influence of the US Law: the Idiosyncratic Economic Realities and Mismatched Agency Problem Solutions*, 40 SEC. REG. L.J. 401 (2013) (mentioned the ownership structure and its history).

companies.[12] After the state-owned share reduction reform and State-owned Enterprises (SOEs) reform, the portion of state-owned shares has declined sharply.[13] Despite these changes, SOEs are still dominant in the two exchanges: the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE).[14] Meanwhile, these changes have nevertheless complicated the market composition and provided market forces that were conducive to marketization reform.[15]

To be sure, it was the State Council (SC), the highest administrative authority in China, which initiated the economic reform and the "Open Gate Policy" at the end of the 1970s.[16] SC purports to transition the Chinese economy from inefficient planned economy mode to market economy mode.[17] This achievement, of course, is outstanding.[18] The administrative-power-oriented-transformation model, however, invited a chronic disease for the later Chinese reforms: Path Dependency.[19] It is unlikely that any reform thereafter could be successful without the support of administrative power. Thus, the development of capital markets requires administrative involvement.[20] So far, onerous administrative approval procedures are widespread in the primary and secondary securities markets, and are not conducive to China's marketization.[21] Without the market supervisory authority's "rubber stamp," many fundamental operations are illegal or even criminal.[22] Admittedly, this path dependency is indispensible in fueling Chinese reform, yet sometimes it not only distorts markets but also eclipses

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[12] *See* Yuan, *supra* note 10.
[13] *See* Weng, *supra* note 11.
[14] *See* Weng, *supra* note 11.
[15] *See* Weng, *supra* note 11.
[16] WU JINGLIAN (吴敬琏) & MA GUOCHUAN(马国川), CHONGQI GAIGE YICHENG: ZHONGGUO JINGJI GAIGE ERSHI JIANG (重启改革议程：中国经济改革二十讲) [REACTIVATING FROM ISSUES: 20 LECTURES ON CHINESE ECONOMIC REFORM] (2013).
[17] *Id.*
[18] LI YINING (厉以宁), ZHONGGUO JINGJI GAIGE FAZHAN ZHILU (中国经济改革发展之路) [ECONOMIC REFORM AND DEVELOPMENT: THE CHINESE WAY] (2010).
[19] *See, e.g.*, Charlie Xiaochuan Weng, *Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to the Harmonious Society*, 25 COLUM. J. ASIAN L. 180, (2012) (discussing the manifestation of pro-government in Chinese corporate law and effects of path dependency on legislation and enforcement).
[20] WANG AN (王安), GUYE TIANXIA: ZHONGGUO ZHENGQUAN SHICHANG SANSHI NIANJI (股爷天下：中国证券市场三十年记) [MR. STOCK'S KINGDOM: A MEMORANDUM FOR THE DEVELOPMENT OF CHINESE SECURITIES MARKET IN THE PAST 30 YEARS] (2011).
[21] Chen Su (陈甦), *Shangfa Jizhi zhong Zhengfu yu Shichang de Gongneng Dingwei* (商法机制中政府与市场的功能定位) [*The Roles of Government and Market in Commercial Law*], 5 ZHONGGUO FAXUE (中国法学) [CHINA LEGAL SCIENCE] 41, (2014).
[22] Take public offering as an example; it requires CSRC's approval. Otherwise, it is crime that could receive death penalty. *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2013, effective Jan. 1, 2016) art. 10 (Chinalawinfo).

characteristics of the market economy. We, therefore, have to seriously consider the State's interests in designing new takeover institutions to keep them viable within China's path dependent context.

In the past, hostile takeovers hardly happened.[23] The highly concentrated ownership structure and rigid hostile takeover law chilled the takeover market in China.[24] The possible reason for the rigid and mismatched takeover law might be the same as for China's Asian neighbors (such as Korea)- pressure from international financial institutions.[25] However, this rigidity did not mean that there were no takeovers at all. Friendly takeovers were quite frequent in the past. From 2010 to 2014, Chinese capital market has seen more than 18,000 mergers and acquisitions involving listed companies.[26] In a capital market with more than 2000 listed companies, the total should be a sufficient evidence showing the vitality of the takeover market. Despite these facts, we still need to ask whether Chinese takeover law works well or not. According to the aforementioned purposes of takeover law, did the law maximize social wealth? Did the takeover law properly represent national interests?

It seems that auctions in control transactions is the crucial and optimal method to maximize social wealth, even if there were different points of view.[27] Chinese takeover law, as a transplanted legal institution, is not an exception to the auction promotion paradigm.[28] There are institutions in the law providing for crucial delay, which is indispensable for promoting auctions.[29] Meanwhile, past empirical research informs us that the existence of auction-related regulations is not necessarily associated with the occurrence of auctions.[30] Although there were a lot of auctions happening, these occurrences do not mean that the law is maximizing social wealth.

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[23] Peng, *supra* note 10.

[24] Weng, *supra* note 19.

[25] Hyeok-Joon RHO, M&A in Korea: Increasing Concern for Outside Shareholders (2015) (unpublished manuscript) (on file with the author).

[26] Listed firms can be either or both sides of the deal. This also includes tender offer and asset mergers. If you look at the exchange trade, the case number may drop down to single digital. This is because exchange trade incurs excessive cost and not efficient.

[27] *See* Frank Easterbrook & Daniel Fischel, *The Proper Role of a Target's Management to a Tender Offer*, 94 HARV. L. REV. 1161, 1175–80 (1981); *see also* Easterbrook & Fischel, *supra* note 2.

[28] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (2014) art. 86 (Chinalawinfo). *See also* Shangshi Gongsi Xinxi Pilu Guanli Banfa (上市公司信息披露管理办法) [Administrative Measures for the Disclosure of Information of Listed Companies] (promulgated by China Sec. Reg. Comm'n, Jan. 30, 2007, effective Jan. 30, 2007) art. 3 & 4 (Chinalawinfo).

[29] Peter Cramton & Alan Schwartz, *Using Auction Theory to Inform Takeover Regulation*, 7 J.L. ECON. & ORG. 27 (1991).

[30] Romano, *supra* note 2, at 159–60; *see also* John Pound, *The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence*, 30 J.L. & ECON. 353 (1987).

To be sure, regulations promoting auctions chill takeovers.[31] Therefore, excessive delay also incurs social costs. This article focuses on the auction promotion issue in Chinese takeover law and analyzes the efficacy of it. As a Socialism country with strong state presence, China presumably has a law that sufficiently, if not excessively, protects its national interests. In the process of analyzing auction promotion, it becomes necessary to also consider administrative review, one of the many reasons for delay.

Part II of the article examines the traditional wisdom of takeover and regulations. It explores the logic behind takeover regulations and the rationales of auction promotion regulations. Further, part III analyzes the landscape of the Chinese takeover market and showcases an updated research on the ownership structure of listed firms. Meanwhile, China's auction promotion rule is discussed in this part in order to provide a clear picture and a starting point for further normative study. In Part V, the research justifies the necessity of deactivating the auction promotion rule from the value-maximizing perspective. Also, an alternative solution, namely the announcement institution, is introduced for compensating the positive functions of the auction promotion rule. Finally, the research believes that deactivating the auction promotion rule while still leaving it available for companies to opt in would be efficient for the companies with dispersed ownership structures, although such companies only constitute a minority across Chinese listed firms.

II. The Theories Of Takeover And Takeover Law

Before we discuss the efficacy of Chinese takeover law from the auction promotion perspective, it is useful to reflect on the theoretical aspects of takeovers and takeover law generally. After all, Chinese law, especially Chinese law related to commerce, is a creature of legal transplantation. Since 2000, China has joined the bandwagon of transplanting US commercial law institutions.[32] The admiration of US economic achievements, more or less, may be the main reason driving this transplantation.[33] In order to evaluate the law, we have to look into the theoretical foundations of the institutions.

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[31] *Id*. at 159; *see also* Jo Watson Hackl & Rosa Anna Testani, *Second Generation State Takeover Statutes and Shareholder Wealth: An Empirical Study*, 97 YALE L.J. 1193 (1988).
[32] *See* Weng, *supra* note 11.
[33] *See* Weng, *supra* note 11.

A. Why do we launch takeovers?

Takeovers have received sufficient attention from the economics academia. They have been discussed for decades since the 1980s. Empirical research has already proved that there is a significant price jump when a takeover deal is in position.[34] Also, takeover is one of the major solutions to a chronic problem of corporate law: agency cost reduction.[35] Therefore, value adding takeovers are generally considered a positive activity in capital markets.

Professor Roberta Romano did outstanding work to consolidate, from a legal scholar's perspective, the explanations of takeovers in the past literature.[36] She believes that the explanations of takeovers can be divided into two major categories: value maximizing and non-value maximizing explanations.[37] Non-value maximizing explanations show that the value increases in takeovers are merely simple wealth transfers from acquirers to targets. The most frequently seen examples are diversification, self-aggrandizement, free cash flow problems and hubris issues.[38] They all center on the negative cash flow acquisitions initiated by either irresponsible or self-interested executives in order to maximize their own interests instead of the shareholders' utility. The only reason for launching these inefficient acquisitions is for the benefit of the management.[39] Therefore, it seems that if a given takeover case falls into this category, the law is supposed to curb it rather than encourage it.

The other piece of the dichotomic theory is value-maximizing explanations.[40] These explanations can further be categorized into two sub-types: expropriation and efficiency explanations .[41] The expropriation argument ascribes the value addition to the tunneling effect, which means that tunneling others' value to the takeover participants, rather than creating new value, is the reason for the value jump.[42] The sources of the value being siphoned include

[34] Gregg A. Jarrell, James A. Brickley & Jeffry M. Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP., Winter at 49 (1988); Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence,* 11 J. FIN. ECON. 5 (1983).
[35] KRAAKMAN ET AL., *supra* note 8.
[36] Romano, *supra* note 2.
[37] *Id.* at 152.
[38] The detailed explanation can found in Professor Romano's paper, for instance, Diversification argument shows that manager-controlled firm more likely to engage in diversifying mergers than owner-controlled firm, because takeover is a good way to diversify the managers' portfolio, which otherwise won't be diversified. *Id.* at 146–52.
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.* at 133–42.

bondholders, employees, consumers, competitors, and the fisc.[43] Takeover deals simply increase shareholders' wealth through taking advantage of tax policy, for example.[44] Under this theory, takeovers equate to "stealing" value from the fisc for a small group of people.[45] These explanations, even if receiving slightly more research support than the non-value maximizing explanations, still face compelling counterarguments, which significantly affect the their credibilities.[46]

The most compelling argument for takeovers is the efficiency argument. The efficiency argument seems to support the idea that takeovers usually add value for the takeover parties.[47] Generally, the additional value accrues from synergy gains and reduction of agency costs.[48] The typical examples of operating synergy gains are economies of scale (cost advantages that organizations acquire due to size and operation), economies of scope (lowering average costs by consolidating complementary resources), and consolidation of excessive management resources.[49] Redeployment of capital between the takeover parties, of course, is another example of synergy gains from a financial perspective.[50] Agency costs reduction is from the managerial side rather than operation and finance side. Separation of ownership and control is one of the major contributions of modern corporate law.[51] The separation nevertheless invites information asymmetry between the managers (agents) and the shareholders (principals).[52] Managers by nature take advantage of the asymmetry to maximize their utilities, thus creating agency costs. It has been proved that firms with low Tobin's Q Ratios are more likely to be taken over.[53] Consequently, after takeover, the original target

[43] *Id.*; *see also* Richard Green & Eli Talmor, *The Structure and Incentive Effects of Corporate Tax Liabilities*, 40 J. FIN. 1095, 1102–03 (1985); Paul Asquith & Thierry A. Wizman, *Event Risk, Covenants, and Bondholder Returns in Leveraged Buyouts*, 27 J. FIN. ECON. 195 (1990); Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES, at 33.

[44] Romano, *supra* note 2, at 133–36.

[45] Romano, *supra* note 2, at 133–36.

[46] For instance, some scholars through empirical research prove that tax consideration is not the major concern of takeover. Alan J. Auerbach & David Reishus, *The Impact of Taxation on Mergers and Acquisitions*, in MERGERS AND ACQUISITIONS 69, 81 (ALAN J. AUERBACH eds., 1988).

[47] Romano, *supra* note 2, at 125–33.

[48] Romano, *supra* note 2, at 125–33.

[49] Romano, *supra* note 2, at 126.

[50] J. FRED WESTON, KWANG S. CHUNG & SUSAN E. HOAG, MERGERS, RESTRUCTURING AND CORPORATE CONTROL 97–98, 197 (Prentice Hall, 1990).

[51] KRAAKMAN *ET AL.*, *supra* note 8, at 1–14.

[52] Michael C Jensen & William H Meckling, Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure 3 J. Fin. Econ. 305 (1976).

[53] RANDALL MOREK, ANDREI SHLEIFER & ROBERT W. VISHNY, CHARACTERISTICS OF TARGETS OF HOSTILE AND FRIENDLY TAKEOVERS, IN CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 101 (ALAN J. AUERBACH eds., 1988). Tobin's Q Ratio is the ratio between a physical asset's market value

management are often replaced.[54] Therefore, in order to avoid being taken over, managements have to work hard to maximize the value of a firm.[55] Thus, agency costs decrease because of the existence of takeover markets and the possibility of being taken over. However, the law should not be involved too much in takeovers with an agency cost reduction purpose, because the value of the target does not differ across potential acquirers. Rather, in the synergy gains scenario, the law promoting the match of reciprocally complementary firms is efficient, according to the goal of maximizing social wealth.[56] It has independent (or firm specific) value among bidders. Of course, this discussion has already entered into the second topic of this section: how to protect and promote the function of takeovers?

B. Why Auctions?

As mentioned in the previous section, takeovers should be encouraged as long as they bring synergy gains or reduces agency costs. It seems that, besides government policies, legal strategy plays a crucial role in supporting the performance of takeover markets.[57] Generally, more restrictive takeover regulations have a greater negative stock price effect than less restrictive ones.[58] The efficacy of takeover auction institutions is hard to evaluate and even harder to be proved with empirical research.[59] The reason for the latter is that the optimal policy is a function of the auction environment.[60] There are two prototypical auction environments: common value and independent value.[61] Given the fact that the assets of the target may generate different synergy gains after takeover, in a synergy gains scenario, the value addition of the takeover deal is a case-by-case

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and its replacement value. The difference means the quality of intangible assets including the quality of management. It is one of the ways to measure management performance.

[54] Romano, *supra* note 2, at 130; *see also* Eugene P.H. Furtado & Vijay Karan, *Causes, Consequences. and the Shareholder Wealth Effects of Management Turnover: A Review of the Empirical Evidence*, 19 FIN. MGMT. 60 (1990); James P. Walsh, *Top Management Turnover Following Mergers and Acquisitions*, 9 STRATEGIC MGMT. J. 173 (1988).

[55] Of course, management may also utilize the anti-takeover methods to entrench themselves from being taken over. They might be facing the charge of breach of fiduciary duties and other legal institutions which punish them for not considering shareholders' interests, however.

[56] Cramton & Schwartz, *supra* note 29, at 28–30. "Reciprocally complementary firms" means that the firms, from either corporate governance or finance perspective, can add value to each other by providing resources that is not available to the counterpart before a deal. For instance, a firm in great need of cash with sophisticated sales conduits can be the "reciprocal complementary firm" to the one that has excessive cash and is desperately looking for retailors to sell its excessive inventories.

[57] Romano, *supra* note 2, at 177.

[58] Romano, *supra* note 2, at 177.

[59] Hackl & Testani, *supra* note 31; Pound, *supra* note 30. Professor Romano also notices that the connection between the regulations and value change in the takeover market is even harder to be proved. Romano, *supra* note 2, at 160.

[60] *See* Cramton & Schwartz, *supra* note 29.

[61] *See* Cramton & Schwartz, *supra* note 29.

issue.[62] Meanwhile, a common value takeover case means that the value of the target is the same across bidders.[63]

The auction institution in takeover law is widely discussed in some common law jurisdictions where the ownership structures of most companies are dispersed.[64] This popularity arises because target shareholders in those jurisdictions, when pressured by unsolicited tenders, are unable to act in concert to provide necessary delay.[65] Without necessary delay, the target shareholders' premium decreases, and the social wealth brought by the takeover decreases accordingly. [66] Of course, some scholars opine that auctions might reduce an acquirer' attempt to search targets, because if the bidder fail in the auction, it has to assume the search costs for nothing.[67] However, this worry seems unwarranted, given that search costs are not excessive and can be recouped by selling positions acquired previously at relatively low prices.[68] Given the fact that eliminating the auction institution would probably shift the takeover premium to the acquirer significantly, those who launch searches for targets will receive personal gains that could push the number of takeover searches to excessive levels.[69] Additionally, from the agency cost reduction perspective, regulatory delay is helpful not only in hostile takeover scenarios but also in friendly takeover ones.[70] Such delay can effectively curb managerial opportunism.[71] Most important of all, promoting takeover auctions can improve allocative efficiency, which means auctions are conducive to transferring the target's assets to the most productive user.[72] In sum, promoting auctions in takeovers has a value increasing effect. Therefore, auctions should be encouraged in control transaction cases. One premise of this conclusion, of course, is that shareholders cannot coordinate efficiently.

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[62] *See* Cramton & Schwartz, *supra* note 29, at 38–45.
[63] *See* Cramton & Schwartz, *supra* note 29, at 33–38.
[64] *See, e.g.*, Gilson, *supra* note 2.
[65] Bebchuk, *supra* note 2, at 25.
[66] *See* Gilson, *supra* note 2, at 24–25; Ron Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 870–75 (1981).
[67] *See, e.g.*, Easterbrook & Fischel, *supra* note 2.
[68] Bebchuk, *supra* note 2, at 31–34.
[69] For instance, the gains of the acquirer, without auction, will be higher than social gains. The margin can be the value shifted from the target's shareholders. Meanwhile, the management by nature prefer to expansion. Therefore, some non-value-maximizing takeover cases might be launched. Bebchuk, *supra* note 6, at 1046–48; *see, e.g.*, Marris & Mueller, *The Corporation, Competition, and the Invisible Hand*, 18 J. ECON. LITERATURE 32, 40–45 (1980).
[70] Bebchuk, *supra* note 2, at 46.
[71] Bebchuk, *supra* note 2, at 46.
[72] Gilson, *supra* note 2, at 63–65.

However, some scholars go too far on promoting takeover auctions, arguing that auctions be encouraged in all takeover cases.[73] After all, auctions incur high transfer costs.[74] If auctions cannot add value to specific deals and save social resources, auctions should not be launched in the first place. As mentioned before, the takeover environments can be categorized into two types: common value takeover and individual takeover.[75] In common value scenario, the value of the target is supposedly the same to all potential bidders. Therefore, it seems that introducing an auction will not add extra value to the deal. Instead, an auction would invite extra transfer costs. Intuitively, the law nevertheless should encourage auctions if the synergy gains are the major takeover consideration, because auctions make sure that the control of the target goes to the bidder who can maximize the synergy gains.[76] To be sure, it is very hard to find, in the real world, a signal takeover case showing only one type of auction environment. The target, of course, in most cases, has excessive agency costs to be reduced by the successful bidder, while the bidder eventually will find a way to make good use of the target assets.

III. REALITIES OF TAKEOVER MARKETS AND LAW: AN EMPIRICAL PERSPECTIVE

A. The market: An absolute controlling shareholder and actual controller dominant market

Academics deeply believe that ownership structure, or the shareholder distribution, is the most important factor in the determination of agency problems.[77] Further, the legal institutions tackling the accurately identified agency problems are the key elements of efficient corporate law.[78] There has been a long-term belief that ownership structures should be divided into two types: concentrated and diffused ones.[79] This dichotomy, however, might oversimplify the difference among the ownership structures across countries.[80] In order to provide a convincing explanation of Chinese

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[73] *See, e.g.*, Cramton & Schwartz, *supra* note 29.
[74] Cramton & Schwartz, *supra* note 29, at 45.
[75] Cramton & Schwartz, *supra* note 29, at 28–30.
[76] Cramton & Schwartz, *supra* note 29, at 50–51.
[77] Ron J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, HARV. L. REV. 1641.
[78] *See*, *e.g*., Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta *et al.*, *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta *et al.*, *Law and Finance*, 6 J. POL. ECON. 113 (1998); Rafael La Porta *et al.*, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).
[79] Gilson, *supra* note 77, at l643.
[80] Gilson, *supra* note 77, at l643.

shareholder distribution, we, therefore, need to think small. The complete evaluation of variants should include politics, initial conditions, laws and also efficiency.[81]

There is literature showing a monolithic feature in corporate ownership: all countries in the world have concentrated ownership structures except for the United States and the United Kingdom.[82] Nonetheless, it would be arbitrary to conclude that China shares the same feature. After all, the relevant research was based on the 1990s' Chinese capital market, which was very much underdeveloped and starkly different from the status quo.[83] It is thus necessary to reexamine the ownership composition of Chinese corporations.

This research first examines the shareholder distribution issue from an empirical perspective. Becht's standard categorizes big block holders into two classes: ≥50% block holders (Absolute Controlling shareholders, "ACS") and ≥25% block holders (Relative Controlling shareholders, "RCS").[84] According to the securities law the disclosure requirement of the China Securities Regulatory Commission ("CSRC"), listed companies must disclose the top 10 block holders in the firm.[85] Therefore, it is not too difficult to find out who the block holders are. Chart 1 shows that 19.01% of listed companies have block holders whose proportion equals or exceeds 50%. 50.88% of listed companies report block holders whose positions exceed 25%, but not 50%, of the shares. 30.11% of listed companies lack said block holders. This fact positions China away from traditional concentrated ownership structure countries on the spectrum of shareholder disposition. And it also shows the change of the ownership structure in the past two decades compared with the

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[81] Gilson, *supra* note 77, at l643.

[82] *See, e.g.*, BRIAN CHEFFINS, CORPORATE OWNERSHIP AND CONTROL (PP4 2008); *see also* MARCO BECHT & COLIN MAYER, INTRODUCTION TO THE CONTROL OF CORPORATE EUROPE (Fabrizio Barca & Marco Becht ed., 2001); Stijn Claessens, Simeon Djankov & Larry H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365 (2002); La Porta, Lopez-de-Silanes & Shleifer, *supra* note 78; Jeremy Grant & Thomas Kirchmaier, *Who Governs? Corporate Ownership and Control Structures in Europe* (June 7, 2004) (unpublished manuscript), http://ssrn.com/abstract=555877; Richard Mitchell, Anthony O'Donnell, Ian Ramsey & Michelle Welsh, *Shareholder Protection in Australia*, 38 MELB. U.L. REV. 69 (2014).

[83] Stijn Claessens, Simeon Djankov & Larry H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000); Faccio & Lang, *supra* note 82; La Porta, Lopez-de-Silanes & Shleifer, *supra* note 78.

[84] According to the valid Chinese laws and regulations, listed companies cannot issue duo-class shares. Therefore, shareholding proportion is enough to prove the control.

[85] *See* Shangshi Gongsi Xinxi Pilu Guanli Banfa (上市公司信息披露管理办法) [Administrative Measures for the Disclosure of Information of Listed Companies] (promulgated by China Sec. Reg. Comm'n, Jan. 30, 2007, effective Jan. 30, 2007) art. 21 (Chinalawinfo).

figures reached by previous research[86]: the number of ACS declined from 67% to 19.01%.[87]

The benchmark of RCS is controversial, because even if a shareholder owns 25% of the shares, there is still the possibility of bigger shareholders. The controlling shareholder definitions, according to Chinese corporate law, are as follows:

"…A proprietary shareholder means a shareholder whose capital contribution accounts for more than 50 percent of the total capital of a company with limited liability or the amount of the shares who holds accounts for **more than 50 percent** of the total amount of the shares of a company limited by shares; **and** a shareholder, although the amount of his capital contribution or the proportion of the shares he holds is less than 50 percent, whose voting rights enjoyed on the basis of the amount of capital contribution made or the number of shares held are enough to have a **vital bearing on the resolutions** of a shareholders assembly or a shareholders general assembly."[88]

Given the fact that there is no dual-class share issuance in Chinese main board market for the time being, acquiring normal shares becomes the most important way to get control. It is also true that shares less than 50% still can ensure control, as long as the total volume of outstanding shares is too large for any individual to acquire over 50%. Considering the average share volume of Chinese listed companies, CSRC set 30% as the benchmark for control power.[89]

According to the CSRC's definition of RCS, the ownership structure of Chinese listed companies does not seem too much different from that under Becht's approach. As shown in Chart 2 and graph 2, the RCS number, of course, significantly declined due to the higher benchmark. About one tenth of the listed companies became ones without RCS only because of the 5% rise in the benchmark. Nevertheless, this figure no longer matters because CSRC demands the disclosure of *de facto* controllers in listed companies' annual reports.[90]

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[86] BECHT & MAYER, *supra* note 82 (in the research, it concluded that East Asia had more than 67% block holders whose proportions are more than 50%).

[87] *Id.*

[88] *See* Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July. 1, 1994, amended Dec. 28, 2013) art. 217 (Chinalawinfo).

[89] Chart 2 and Graph 2 showcase statistical results employing 30% standards. It shows how many companies will be affected if CSRC stick to the 30% standards. *See* Shangshi Gongsi Shougou Guanli Banfa (上市公司收购管理办法) [Measures for the Administration of the Takeover of Listed Companies] (promulgated by China Sec. Reg. Comm'n, May. 17, 2006, effective Sep. 1, 2006, amended Oct. 23, 2014) art. 84 (Chinalawinfo).

[90] *See* Shangshi Gongsi Xinxi Pilu Guanli Banfa (上市公司信息披露管理办法) [Administrative Measures for the Disclosure of Information of Listed Companies] (promulgated by China Sec. Reg. Comm'n, Jan. 30, 2007, effective Jan. 30, 2007) art. 21 (Chinalawinfo).

Indeed, Chinese corporate and securities laws also create a very unique notion of a controlling shareholder: actual controller.[91] There used to be a specific definition of actual controller, but it was abolished in the current laws and regulations.[92] actual controller refers to an individual or legal person who controls the firm even without a valid share proportion.[93] Moreover, CSRC requires listed firms to disclose an actual controller in their annual report.[94] Intuitively, knowing the exact control landscape is indispensable for assessing auctions and other takeover law institutions. Therefore, this research put actual controller into consideration in order to understand the significance of controlled firms in China. Chart 3 clarifies that over one third of companies originally recognized as non-controlled ones are in fact controlled by some non-block holders. The fact that 96.65% of listed companies are controlled companies showcases the strong preference for control in major Chinese companies. It seems the most straightforward, albeit two-fold, explanation to this phenomenon is: a) the socialist Chinese government feels it necessary to keep control of the economy; meanwhile, b) entrepreneurs are afraid of being separated from control, because China has problems with law enforcement. Losing control increases the chance of being expropriated by other investors with control power.[95]

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[91] *See* Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July. 1, 1994, amended Dec. 28, 2013) art. 217 (Chinalawinfo).

[92] It is the same as the definition of controlling shareholder. CSRC and the Exchanges are using abstract notion rather than specific explanations in defining AC. *See* Shanghai Zhengquan Jiaoyisuo Gupiao Shangshi Guize (上海证券交易所股票上市规则) [Rules Governing the Listing of Stocks on Shanghai Stock Exchange] (promulgated by Shanghai Stock Exchange, Oct. 17, 2014, effective Nov. 16, 2014) §18, art. 18.1 (Chinalawinfo).

[93] *Id.* "Valid share proportion" refers to enough share proportion to control a company, such as 51%.

[94] *See* Shangshi Gongsi Xinxi Pilu Guanli Banfa (上市公司信息披露管理办法) [Administrative Measures for the Disclosure of Information of Listed Companies] (promulgated by China Sec. Reg. Comm'n, Jan. 30, 2007, effective Jan. 30, 2007) art. 21 (Chinalawinfo) (An annual report should contain: (1) the basic information of the company; (2) the main accounting data and financial indicators; (3) the information abouth the issuance and changes of corporate stocks and bonds, the total amount of stocks and bonds by the end of the reporting period, total number of shareholders, as well as the shares held by the 10 biggest shareholders; (5) the information about the appointment of directors, supervisors and senior managers, changes of the shares held by them, as well as their annual remunerations; (6) the report of the board of directors; (7) the discusions and analyses of the management team; (8) the major events occurring within the reporting period and their influence on the company; (9) the full texts of the financial accounting statements and audit report; and (10) other matters prescribed by the CSRC.).

[95] *See, e.g.*, La Porta, Lopez-de-Silanes & Shleifer, *supra* note 78; Rafael La Porta *et al.*, *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); Rafael La Porta *et al.*, *Law and Finance*, 106 J. POL. ECON. I 113 (1998); Rafael La Porta *et al.*, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997).

B. Features of the block holders: less influential state owners and various controlling shareholders' idiosyncratic utilities

The second question that is relevant to the evaluation of Chinese takeover regulations is: how do the controlling shareholders act to benefit themselves? Controlling shareholder systems often create the most effective known mechanism for ameliorating agency costs caused by information asymmetries.[96] Because of the proximity and low information cost, controlling shareholders can spot problems earlier than minority shareholders and have incentives to supervise the management so that the managerial agency cost can be diminished.[97] This cost control is the typical function of controlling shareholders according to past literature. Chinese controlling shareholders nevertheless may be different from the ones in capitalist countries. After all, today's corporate China evolved from a state-owned system where the state owner was omnipotent.

Chart 3 explains the features of Chinese controlling shareholders. If the controlling shareholder, including the actual controller, is either the state[98] or state-owned enterprises (where the state owns more than 50% of the controlling shareholder), the firm has the state as a controlling shareholder. In the 1990s', almost all the firms listed on China's exchanges were state-owned. Still, before 2007, the state still owned more than 75% of listed firms.[99] The proportion of state-owned firms, however, is now far smaller than before, only amounting to 41.49%. Private shareholders have drastically taken over the controlling shareholder positions, becoming the major controlling shareholder type in China, amounting to 54.90%. Besides, 55 listed companies are controlled by foreign investors. Even if these companies only accounts for 2.64%, the implication of the low representation of foreign controlling shareholder is worth discussing. Either foreign investors do not want to be the controlling shareholders, or it is too hard for them to get control. It is very difficult for foreigners to acquire control of listed companies. First, the State Council maintains a long list of sensitive industries in which foreign investors are forbidden from becoming shareholders. Second, control acquisition is subject to many administrative

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[96] *See, e.g.*, Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147 (2002); John J. McConnell & Henri Servaes, *Additional Evidence on Equity Ownership and Corporate Value*, 27 J. FIN. ECON. 595 (1990); Randall Morck, Andrei Shleifer & Robert W. Vishny, *Management Ownership and Market Valuation*, 20 J. FIN. ECON. 293 (1988).

[97] Gilson, *supra* note 77, at 1651.

[98] State exercises its control through State-owned Assets Supervisory Administration Commission (SASAC), which is an administrative agency under the State Council. For more information about SASAC, *see* SASAC's website, http://en.sasac.gov.cn.

[99] Weng, *supra* note 11.

approvals, and foreign investors can be easily turned down at any stage of the process.

As previously mentioned, the control premium, or the private benefit of control, is the major source that compensates controlling shareholders for the expenses to minimize agency costs.[100] The controlling shareholder monitoring system, compared to legal strategies, is more efficient in terms of ameliorating agency problems.[101] The control brings both pecuniary and non-pecuniary benefits.[102] The reduction of agency costs lifts the value of a firm. The private pecuniary benefit of control should be less than the value addition brought by the reduction. It should also be more than the pro rata benefit according to the controlling shareholder's ownership proportion in a firm in order to incentivize controlling shareholders to spend extra resources to monitor the management. The premium over the pro rata benefit is the pecuniary control premium. Controlling shareholders, in a jurisdiction where shareholder protection institutions are inefficient, are able to capture more gains by violating minority shareholders' interests, however. To be sure, even if the law diminishes the legal private pecuniary benefit to almost zero, controlling shareholders still may have incentives to supervise management because of the existence of non-pecuniary gains.[103] The non-pecuniary benefit materializes, in most cases, in the form of recognition, which may or may not be converted into financial advantage.[104]

The state owner chases both pecuniary and non-pecuniary benefits. Usually they too look for economic returns. High returns showcase the work quality of the managing bureaucrats, who are in charge of the state assets. However, when there are compelling political justifications or pressures to achieve the goals of a political agenda, the state owner usually prioritizes non-pecuniary benefits. This phenomenon is prevalent in China. For instance, in July of 2015, the stock market plummeted. In order to pull up the stock index, the state ordered many SOEs, including listed companies and brokerage firms, not to short shares or sell.[105] After all, social

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[100] Gilson, *supra* note 77.
[101] Gilson, *supra* note 77.
[102] Gilson, *supra* note 77, at 1661–70; *see also* Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537, 577, 582, 586 (2004).
[103] *See, e.g.*, BRUNO S. FREY, NOT JUST FOR THE MONEY: AN ECONOMIC THEORY OF PERSONAL MOTIVATION (1997).
[104] Sweden corporations are very good examples for the point of view. Although Sweden rigid shareholder protection law reduces controlling shareholder monetary benefit to the minimum, the controlling shareholders, mainly family controllers, enjoy strong social and national recognitions. In some cases, such recognition also might affect the credibility of firms.
[105] For further information about the bailout in 2015, *see* Supervisory Agencies Orchestrated 16 bailout Measures within 6 days, http://finance.ifeng.com/a/20150705/ 13818887_0.shtml.

stabilization is a major objective on which the state expends resources, and a quickly deteriorating market can divert people's ire toward the Chinese government's social governance strategy. It is much cheaper to sacrifice some speculation profits than to clean up the messy aftermath of a stock market collapse.[106]

Chinese domestic controlling shareholders do not have social responsibilities imposed by laws and regulations.[107] They, therefore, are less restricted in capturing controlling pecuniary benefits. To be sure, Chinese corporate law provides a lot of avenues for shareholder protection.[108] Nonetheless, enforcement is the Gordian Knot standing in the way of minority shareholder protection.[109] The absence of efficient shareholder protection institutions fuels controlling shareholders' ruthless arbitrage at the expense of minority shareholders.[110] Therefore, Chinese controlling shareholders also recoup illegal gains in addition to legal premiums. Additionally, being controlling shareholder of listed companies means receiving various types of recognition, most of which can ultimately bring financial advantages for controlling shareholders. For example, given that the influence of listed firms in a given locality is significant, controlling shareholders also get a lot of recognition from local governments. This recognition helps the shareholders in negotiating favorable policies.[111] To be sure, what matters most to private controlling shareholders is pecuniary gain. It seems that even if China has an efficient legal environment, the non-pecuniary gains would still not be attractive to Chinese controlling shareholders. This lack of attractiveness is probably caused by entrepreneurs' short-termism and lack of security.[112] The private controlling shareholder,

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[106] However, this does not mean what the state did is not problematic. For example, the possible gains from short sell or loss evasion from early sell are a part of the fiscal income. Should they be sacrificed to satisfy stock market investors? How about the other shareholders' interests in the SOEs? There are a lot of unattended consequences.

[107] *See* Charlie Xiao-chuan Weng, *Shareholder Primacy in China* (forthcoming 2015).

[108] *See* Weng, *supra* note 11.

[109] *See* Weng, *supra* note 11.

[110] *See* Weng, *supra* note 11.; *see also* Wu Chengsong (吴成颂), Tang Weizheng (唐伟正) & Zhang Lijuan (张礼娟), *Zhengzhi Guanlian, Chanquan Xingzhi yu Taokong–Laizi Hushi A Gu Zhizao Ye de Jingyan Zhengju* (政治关联、产权性质与掏空——来自沪市A股制造业的经验证据) [*Political Connections, Property Rights and Tunneling: Empirical Evidence From China's SH A-share Listed Companies in Manufacturing*], 3 JINRONG PINGLUN (金融评论) [CHINA REV. FIN. STUDY] 49 (2014).

[111] *See, e.g.*, Charlie Xiao-chuan Weng, *Chinese Unbridled Incorporation Competition: The Reality of Political Economy and Competition for Corporate Charters as a Replacement*, 44 HONG KONG L.J. 247 (2014).

[112] *See, e.g.*, Wang Zhongmei (王中美), *"Fumian Qingdan" Zhuanxing Jingyan de Guoji Bijiao Ji Dui Zhongguo de Jiejian Yiyi* ("负面清单"转型经验的国际比较及对中国的借鉴意义) [*An International Comparison of Transformation Experiences of "Negative List" and Its Engagement to China*], 30 GUOJI JINGMAO TANSUO (国际经贸探索) [INT'L ECON. &TRADE RES.] 72 (2014) (talking about lower hurdles for foreign investors by launch the "negative list"); *see also* Huang Haizhou (黄海洲) & Zhou Chengjun (周诚君), *Zhongguo Duiwai Kaifang zai Xin Xingshi xia de Zhanlüe Buju* (中国

therefore, is more pecuniary-oriented than the state.

In terms of the agency problem, the foreign controlling shareholder would have been an interesting and valuable group to research. However, considering the low representation of foreign controlling shareholders[113], distinguishing them from the state and their domestic counterparts is not the linchpin of this research.

Indeed, as mentioned before, it is hard to categorize the Chinese legal environment as efficient, especially when considering that certain enforcement is usually influenced by the government power.[114] Generally speaking, the enforcement rather than the legal system itself invites inefficiency.[115] As China is an inefficient jurisdiction, controlling benefits are largely illegal and pecuniary. This means controlling shareholders can benefit at the expense of minority shareholders. This topic is important because it could provide a justification for the auction institution even if in the jurisdiction shareholders are able to coordinate to negotiate a better price in the face of a takeover threat. Transparency and competition may bring minority shareholders some protections to compensate for legal inefficiency. It is nonetheless too early to reach a conclusion to support the current auction promotion institution in China. We still need to consider some other factors, such as whether the auction benefits actually can be shared across minority shareholders.

C. Takeover auction institution and stiffened takeover market

The Chinese legislature promulgated the first securities law in 1998, and subsequently modified it in 2005 and 2013.[116] According to the first and second versions of the law, theoretically, there is an

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对外开放在新形势下的战略布局) [*China's Strategic Blueprint for Its Opening-up in the New Era*] 4 GUOJI JINGJI PINGLUN (国际经济评论) [INT'L ECON. &TRADE RES.] 23 (2013) (discussing the foreign investment control history and solution for the future).

[113] *Id*.; to be sure, the biggest hurdle is foreign currency control. Foreign investors cannot freely move their capital cross borders, *see* Mei Pengjun (梅鹏军) & Pei Ping (裴平), *Waizi Qianru Jiqi dui Zhongguo Gushi de Chongji* (外资潜入及其对中国股市的冲击) [*The Undercurrent of Foreign Capital Inflow*], 3 GUOJI JINRONG YANJIU (国际金融研究) [STUD. INT'L FIN.] 76 (2009) (talking about foreign investment in stock market is flow in secretly. It is not a normal practice to invest to be controlling shareholders).

[114] Professor Jacques deLisle correctly epitomizes: "... China remains an authoritarian state. Compared toliberal constitutional democracies, the Chinese regime is much less fettered by legal constraints on government power and offers its citizens far weaker legal rights against the state even in ordinary times and absent extraordinary threats ...". *See* Jacques deLisle, *Security First? Patterns and Lessons for China's Use of Law to Address National Securities Threats* 4 J. NAT'L SECURITY L & POL'Y 397, 398–99 (2010).

[115] *See*, *e.g.*, Cheng Bofeng (陈柏峰), *Chengzhen Guihuaqu Weijian Zhifa Kunjing Jiqi Jieshi* (城镇规划区违建执法困境及其解释) [*The Dilemma and Explanation of Illegal Buildings in Cities and Towns*], 1 Faxue Yanjiu (法学研究) [LEGAL STUD.] 20 (2015) (discussing about the enforcement problem in a comprehensive legislation environment).

[116] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo).

institution considered to be auction promoting, widely known as the "5% embargo rule."[117] Chinese securities law copied extensively from American securities law and, to some extent, went further.[118] In terms of regulations concerning auction promotion, they are a creation of China. It is fairly easy to understand why the UK and the US included auction institutions in their takeover regulations: they both have relatively dispersed ownership structures.[119] Considering the ownership structure features of the UK and US, it should be quite hard for the shareholders to coordinate in front of a takeover threat.[120] However, despite this feature, both countries' legislatures chose not to include the rule.

In terms of the length of the delay, China seems to be a firm believer in auctions or delay. It not only transplanted the relevant theory but also pushed it to the extreme: every time the bidder acquires another 5% of the target's shares, the bidder must stop and report to supervisory agencies.[121] Article 86 of China's Securities Law stipulates as follows:

> "When, through securities trading **on a stock exchange**, the shareholding of an investor, or the deemed joint shareholding of an investor and others in virtue of agreements or other arrangements, has reached **5%** of the issued shares of a listed company, the investor shall, within three days from the date on which such shareholding becomes a fact, report in writing to the securities regulatory authority under the State Council and the stock exchange, inform the said listed company of the fact and make an announcement thereof. The investor shall not continue to purchase or sell the share of the said listed company during the period of time mentioned above.
>
> When the shareholding of an investor, or the deemed joint shareholding of an investor and others in virtue of agreements or other arrangements, has reached 5% of the issued shares of a listed company, **every 5% increase or decrease** in such

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[117] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo).

[118] Weng, *supra* note 11.

[119] *See, e.g.*, BECHT & MAYER, *supra* note 82; Claessens, Djankov & Lang, *supra* note 83; Faccio & Lang, *supra* note 82; La Porta, Lopez-de-Silanes & Shleifer, *supra* note 78; Grant & Kirchmaier, *supra* note 82.

[120] Cramton & Schwartz, *supra* note 29.

[121] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo).

> shareholdings thereafter shall be reported and announced in accordance with the provisions of the preceding paragraph. During the period of report and within two days after the report and announcement, the investor shall not further purchase or sell the shares of the listed company."

Indeed, the target board is crucial in terms of carrying out an auction. If there is a delay, then there is always the possibility that the target board will use it as an opportunity to build up its takeover defenses, which is the opposite of an auction, but good for ensuring a fair price. While the stops and disclosures make a target a "beacon," attracting other potential bidders, Chinese law also requires target boards to treat all bidders fairly and equally.[122] This requirement is similar to the auction rule in Delaware law: a *de facto* obligation on the part of the board to carry out an auction once it is clear control is up for grabs.[123]

Admittedly, the 5% disclosure rule, is not unique and is widely used as a warning measure.

Although Article 86 requires trading in a stock exchange to be consistent with the "5% embargo rule," however, acquiring shares through an agreement must also conform to this rule.[124] A bidder can avoid several rounds of reporting by signing a big contract or multiple parallel contracts to acquire more than 5% of the shares. For instance, if a bidder reaches an agreement with a controlling shareholder to purchase 30% of the shares of a target, the bidder has to report only once. This is mainly because dividing a contract into many smaller contracts with 5% shares each violates contract freedom between private parties. Interestingly, at first there was no unanimously accepted reason for creating the "5% embargo rule" in China, and nowadays it is recognized as an auction promotion. An economic-political explanation could be: when the first Chinese Securities law was promulgated, almost all listed companies were state-owned, therefore, control over the transfer required various levels of bureaucratic approval. The delay, therefore, was not purely for the sake of takeover efficiency.

Under Chinese law, there are only two paths to transfer control of a listed company: a bidder can initiate a takeover by an open market operation (buying shares from exchanges) or by signing an

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[122] *See* Shangshi Gongsi Shougou Guanli Banfa (上市公司收购管理办法) [Measures for the Administration of the Takeover of Listed Companies] (promulgated by the China Sec. Regulatory Comm'n, Sep. 1, 2006, effective Oct. 23, 2014) art. 8 (Chinalawinfo).

[123] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. 506 A.2d 173 (Del. 1985).

[124] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo).

agreement with big block holders of a target.[125] The law does not allow other takeover methods, such as unanimous offer or *de facto* beginning of control transition procedures. This reduces the number of control transactions in China, as without the consent of ACS or RCS, an open market operation is the only way to gain control. Furthermore, the aforesaid two methods are not interchangeable.[126] Therefore, a bidder cannot, for example, acquire shares through an open market operation first, and then choose to contract with block holders to accomplish the deal.[127] Extremely rigid takeover regulation shapes a one-way takeover market: there are almost no successful takeover deals using an open market operation method.[128] Such method is simply too expensive. The "5% embargo rule" provides that a bidder will continuously trade in shares. Investors certainly would have bought shares for subsequent sale to the bidder, which would significantly boost takeover costs. It is quite natural, therefore, that no bidder wants to get control through an open market operation when the "5% embargo rule" is still in effect., In a country with a 5% disclosure requirement, to be sure, the arbitrage phenomenon could still exist. The Chinese version of the "5% rule" nonetheless makes the arbitrage gate much wider. For instance, a bidder in a traditional "5% rule" jurisdiction may choose to acquire a big portion of the shares of a target in a short period. Even if such operation can drastically change demand for the shares, the cost of it will still be lower than tying the hands of the bidder halfway and forcing it to wait until arbitrageurs exploit the situation.

The existence of this rule also strengthens control over current majority shareholders' trading power. The cost of takeover through exchange trading is huge. The only way for bidders to acquire control is to negotiate with controlling shareholders. At some pont Chinese legislature do not need to worry about a coercive takeover style, which would lead to excessive rewards for bidders, and thus would invite non-value maximizing deals. In fact, Chinese takeover market is a seller's market rather than a buyer's one. Without controlling shareholders' consent, bidders cannot successfully obtain control. This argument remains relevant even if the controlling shareholders hold less than 50% of the shares, as the exchange

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[125] *See* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo). *See also* Shangshi Gongsi Shougou Guanli Banfa 2014 Xiuding (上市公司收购管理办法) [Measures for the Administration of the Takeover of Listed Companies] (promulgated by the China Sec. Regulatory Comm'n, Sep. 1, 2006, effective Oct. 23, 2014) (Chinalawinfo).

[126] *See, e.g.*, Peng, *supra* note 10, at 271.

[127] *Id.*

[128] For further information on the takeover method, *see* CSRC's website, http://www.csrc.gov.cn /pub/csrc_en/.

trading method is simply too expensive to implement. Together with highly concentrated ownership structures, an auction promotion institution has a strong chilling effect on takeover market. Of course, paying higher premiums for control is an option for bidders to gain control from incumbent controlling shareholders. The premium, however, should be recouped later, once the bidder becomes the controlling shareholder. As a consequence, a new controlling shareholder typically looks for both high legal monetary gains and expropriates minority shareholders harder than its predecessor.

IV. AUCTION PROMOTION INSTITUTION: EXCESSIVE OR INSUFFICIENT?

The status quo of auction promotion institution is definitely problematic in terms of its frequency of use and excessive cost. Investors should feel free to arbitrage in markets and rules. Arbitration *per se* is not necessarily good or bad. It depends on whether arbitration decision is functional or not. The first question this part examines is whether Chinese auction promotion institution is functional or not. If not, would abolition of the rule be efficient? Some of the arguments may seem slightly tautological, because they have appeared in previous sections. However, this repetition is reasonable, given the depth and width of the study.

A. Paralyzed Open Market Takeovers and the Excessive Nature of the Auction Rule

In the past, there was virtually no takeover in which the bidder chose stock trading to acquire control. It is obvious that from the perspective of application, exchange trading way was not functional for bidders. There are two possible explanations for this phenomenon: 1) the rule *per se* is not functional; or 2) in the takeover, investors arbitrate around the rule to consider the costs. If the rule is not functional, the second possibility no longer exists and the immediate following question is: what is the effect of abolishment? In this study, the author argues that the institution is not functional. There are no traditional benefits from implementation the rules for auction promotion. Moreover, investors are avoiding the rule for cost reasons. The rule is extremely excessive.

An auction promotion rule serves two purposes: reducing the number of excessive takeovers and protecting targets' shareholders from coercive offers.[129] They both seem irrelevant to China's mostly concentrated ownership structures.[130] The excessive takeover, from a

[129] *See* Gilson, *supra* note 2; Bebchuk, *supra* note 6.
[130] Jensen & Meckling, *supra* note 52.

value-maximizing perspective, is caused by the problem managerial agency.[131] Managers intend to maximize their utility by initiating non-value maximizing takeovers.[132] Such takeovers do no good to shareholders, because there are little or no synergy gains in comparison to a well-structured and value-maximizing takeover.[133] When shareholder distribution is dispersed, firms are suffering from insufficient shareholder supervision.[134] Therefore, legislatures introduced the auction rules for the purpose of expanding the possibilities to contest in order to redistribute the takeover premium to the shareholders of the target, and not to excessively award the bidders.[135] It is difficult to launch a non-value-maximizing takeover in the first place. This difficulty arises because controlling shareholders in bidding firms simply would not permit it. Compared to their Western colleagues, Chinese controlling shareholders have more power to reduce agency problems.[136] According to China's corporate law, takeovers are not a managerial decision. It is rather an action demanding general shareholder assembly resolution.[137] Therefore, the concern about excessive takeovers seems unreasonable.

The protection of a target's shareholders from coercive offers is even less relevant to China than excessive takeover reduction. Given the fact that Chinese ownership structures are very concentrated, it is difficult to obtain the control over the listed companies though exchange trading. The absence of successful hostile takeover cases in the past can serve as convincing evidence of the the importance of obtaining the current controlling shareholders' approval.[138] The auction promotion institution increases the possibility of a contest, which is conducive to value discovery of a target firm when its shareholders fail to coordinate.[139] However, Chinese listed firms

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[131] *See* Bebchuk, *supra* note 6.
[132] *Id*.
[133] *Id*.
[134] *See* Ronald J. Gilson, *Corporate Governance and Economic Efficiency*, 74 WASH. U.L.Q. 327, 332–33 (1996); Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 332–33 (2001).
[135] *See* Bebchuk, *supra* note 6.
[136] Comparing to the Western legislation modes, Chinese corporate law is very pro-shareholder. Almost all major decisions need the resolutions from general shareholders' assembly. In list companies, controlling shareholders in most cases can call the shots. *See generally* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013) (Chinalawinfo).
[137] *Id*.
[138] Weng, *supra* note 19.
[139] Bebchuk, *supra* note 6. Of course, there is mandatory bid rule in China. However, fair price pegged with the antecedent average price of the stock instead of the offer price to the controlling shareholders. *See* Shangshi Gongsi Shougou Guanli Banfa (上市公司收购管理办法) [Measures for the

have controlling shareholders, which that eliminate the consideration of coordination. In the market, coercion of target shareholders never happens, because it is useless for acquisition of control.

The question that should not be neglected while discussing Chinese capital market regulations is minority shareholder protection. Competitiveness in bidding for control creates its advantages: for example, increasing transparency of the share price of a target firm. In terms of minority shareholder protection, a question we should ask is the following: in case when the offered price is close to the actual value of the target's share price, whether the target shareholders enjoy the premium? If not, then for everyone, except the controlling shareholder, such offer is nothing more than a reflection of the moon on water: tantalizing, but useless. Unfortunately, given the fact that no takeover has been initiated through exchange trade so far, minority shareholders have never had a chance to share the premium.[140] One might argue that the price after a contest might serve as an evidence to show the real value of a target company. Therefore, minority shareholders are able to obtain the premium in open markets. Nevertheless, in order to let minority shareholders achieve this, three requirements should be met: 1) the takeover is completed, 2) the target's value is underestimated by non-successful bidders, and 3) the uncontested price, as a rule, cannot reflect the true value of the target. After all, Chinese takeover premiums mainly come from synergy gains.[141] If there is no deal, then there will be no jump on the share price due to a synergetic effect. Additionally, without the price difference between the status quo and the true value, there is no need for further value determination. The difference in most of the cases is caused by the managerial agency problem, which is not the major issue in China. Furthermore, most takeover considerations are not just composed of cash alone. This diversity sometimes leads to problems concerning determination of the authentic value of the consideration.[142] Considering the cost of the contest institution and its efficiency, it may not be the best choice for minority shareholders' protection.

Another one jurisdiction-specific consideration relevant to the institution for auction promotion is Chinese SOEs. State controlling

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Administration of the Takeover of Listed Companies] (promulgated by the China Sec. Regulatory Comm'n, Sep. 1, 2006, effective Oct. 23, 2014) (Chinalawinfo).

[140] This is because in most Chinese listed firms, their ownership structure is highly concentrated. Therefore, the managerial agency cost has already been significantly reduced. For agency problem, see Jensen & Meckling, *supra* note 52.

[141] This is because in most Chinese listed firms, their ownership structure is highly concentrated. Therefore, the managerial agency cost has already been significantly reduced. For agency problem, *see* Jensen & Meckling, *supra* note 129.

[142] See Mara Faccio & Ronald W. Masulis, The Choice of Payment Method in European Mergers and Acquisitions, 3 J. FIN. 73 (2005).

shareholders are not always efficient in identifying a value-maximizing takeover. They bring more intangible benefits, for example, political than material ones. Their utility, therefore, is affected by company decisions in ways other than through the decisions' impact on the company's stock price. It is not surprising that the state launches many non-value-maximizing takeovers. However, this tendency is problematic for three reasons: 1) such transactions harm the interests of other shareholders of the company, 2) with the shareholder primacy principle in Chinese corporate law, non-value-maximizing decisions are illegal, and 3) these transactions do not maximize social wealth.[143] Due to the unitary takeover style, namely takeover by agreement, the state does not feel threatened by reducing non-value-maximizing takeover deals. Removing the "5% embargo rule" would provide a market power from a competition for control perspective, as will be analyzed in the following paragraph, which to some extent could force SOEs to maximize the value of their enterprises. Such maximization includes launching of a smaller number of non-value-maximizing takeovers. It seems that from SOEs' corporate governance perspective, the "5% embargo rule" auction promotion institution should be abolished.

In Part III of this research the author concludes that less than one fifth of all Chinese listed companies have ACS. It means that control of more than four fifths of listed companies are theoretically acquirable regardless of the current controlling shareholders' position.[144] The delay granted by Chinese institution for auction promotion leaves a lot of chances not only for minority shareholders but also for outsiders to arbitrage in the exchange trade process. The arbitragers can eliminate all premium produced by a takeover through drastic changes of demand and supply of the target's shares during long waiting and disclosure period. As a consequence, the "5% embargo rule" has a chilling effect on the Chinese takeover market. Furthermore, the rule enhances the current RCS's control. The reduction in takeover deals makes shareholders worse off. What is worse is that the takeover market becomes less active than it should be. From a value-maximizing perspective, the "5% embargo rule" is not efficient and does not add social wealth. In sum, abolishment would be a reasonable choice.

B. Towards a Better Institution

Taking into account maximizing social welfare and the costs and benefits of the "5% embargo rule," the rule is redundant and offers none of the traditional advantages of an auction promotion institution

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[143] *See* Weng, *supra* note 107.
[144] *See infra* Chart 2.

within China's concentrated ownership landscape.[145] Further, its "formidable" cost disables the option of exchange trading to acquire control of a listed company, which amplifies controlling shareholders' power in takeover transactions. This amplification has a negative effect on China's corporate governance. However, before considering the question of abolition we should probably think about whether there are other purported or unattended legal consequences other than the traditional ones, which such steps may have. If there are any, an alternative and improved institution is necessary, as opposed to leaving none at all.

The first function of the "5% embargo rule" beyond the theory of auction promotion is to increase transparency. The rule discloses bidders' positions to CSRC and the public so that the authorities can efficiently focus on a small number of investors. Authorities can thus allocate resources to prevent securities fraud and frivolously speculative actions targeting profits at the cost of minority shareholders.[146] This function nevertheless has been greatly shifted to other legal institutions. With the advent of the self-reporting system for block holders and the illegalization of short swing profits, improving transparency through the "5% embargo rule" no longer seems relevant.[147] Prevention of securities fraud therefore is no longer a reasonable consideration for retaining the rule. It is sensible that securities authorities keep one eye on frivolously speculative takeover deals to avoid excessive volatilities and to protect minority shareholders.[148] Thus, the basic requirement of the institution, from a supervision perspective, is that the regulators are to be informed at the beginning of the deal rather than when the takeover is already in process. As long as CSRC is duly notified and there is no sign of frivolously speculative action, the delay strategy has no association with *ex ante* market supervision.[149]

A tangency between the theory of auction promotion and minority shareholder protection might be the vote-by-foot theory. Minority shareholders are vulnerable in takeover deal, because they have no control and no say when a controlling shareholder is

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[145] *See supra* text accompanying notes 128–42.

[146] Peng, *supra* note 10.

[147] *See generally* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec 29, 1998, effective, Jan 1, 1999) (2013) (Chinalawinfo).

[148] Generally, CSRC looks into whether the bidder has any intention of infringing minority shareholders' interests in order to access the application of takeover.

[149] To be sure, CSRC has lowered the hurdles of takeover. In the first quarter of 2015, CSRC has abolished most M&A administrative approval requirements. For the time being, only backdoor listing and other very few types of takeovers need to get the approval from CSRC. *See* CSRC Further Lowers the Hurdles for M&A, http://business.sohu.com/20150424/n411850212.shtml.

manipulating the process.[150] According to traditional theories on takeover law, minority shareholders should have opportunities to share the control premium with the incumbent controlling shareholder.[151] Furthermore, if they feel uncomfortable being associated with the incoming controlling shareholders, an extraction strategy, namely vote-by-foot, should be available to them.[152] Since the companies in this research are public companies, liquidation for minority shareholders to transfer shares is enough. Suppose, it is reasonable to share control premiums among all shareholders of the company. The "5% embargo rule" provides minority shareholders many portals through which to sell their proportions to the market and share the control premium with the incumbent controlling shareholder when the share price is stimulated and repeatedly confirmed by the multiple disclosures.[153] The critical question nonetheless reduces to a simple one: should we permit previously non-associated investors to share the control premium? For instance, an investor can buy stocks after the first 5% disclosure, and sell them all after the 30% disclosure when the share price reaches its apex after the public firmly believes the bidder's resolution. The stops between each 5% create perfect windows for arbitrageurs to finish short-term operations. Obviously, it is unfair to other minority shareholders and controlling shareholders, as the association strategy is supposed to protect the interests of controlling shareholders rather than arbitragers. The institution, therefore, cannot fairly protect minority shareholders, especially when its disclosure frequency is excessively high with many unnecessary pauses. Vote-by-foot, however, should be guaranteed as takeovers can significantly affect shareholders' ownership rights.[154] As a consequence, new institution should consider notification of the shareholders, but not to incur excessive bidder costs that "cool" the takeover market. An ex ante announcement should be sufficient for this purpose. Chinese markets do not need complicated institutions with onerous pauses and redundant disclosure.

The last potential function of the rule could be state-owned asset protection. Even if the delay provided by the institution is not desirable for concentrated ownership structure companies, the SOEs

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[150] Ronald Gilson & Jeffery Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003).
[151] Klaus Hopt, *Takeover Defenses in Europe: A Comparative, Theoretical and Policy Analysis*, 20 COLUM. J. EUR. L. 249 (2014).
[152] *See* KRAAKMAN *ET AL.*, *supra* note 8, at 37–39.
[153] *See generally* Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jul. 1, 1999) (2013), art. 86 (Chinalawinfo).
[154] *See* E. Norman Veasey, *The New Incarnation of the Business Judgment Rule in Takeover Defenses*, 11 DEL. J. CORP. L. 503, 506 (1986).

may need it. As with many other bureaucratic agencies, the state assets management authorities, acting as the deciders when state resolutions are needed, are not as efficient as the private conglomerates. These authorities always need many levels of administrative approval, which may take longer than getting a controlling shareholder's approval. The "5% embargo rule" working as a delay strategy is supposed to be favorable to state controlling shareholders. However, this function is getting less important since Administrative License Law was enacted in 2003. In order to protect national interests, China established a complicated and sweeping state assets and industry specific administrative license system.[155] Helping clients navigate this system has become a major business for legal practitioners in takeover practice. Based on Administrative License Law, agencies have up to one month to review a takeover case and reach a decision.[156] The "5% embargo rule", which can only provide a 13-day delay in total, is no longer needed by the state controlling shareholders.

When considering abolishment of the "5% embargo rule," the only thing that matters is *ex ante* disclosure. The incumbent multiple disclosures during the takeover incur too many costs to make practitioners consider them practical. Considering the reality of highly concentrated ownership structures, the optimal institution, therefore, would be an *ex ante* claim system to announce the potential bidder before a takeover starts. This might help CSRC to save enforcement resources and warn minority shareholders at an early stage so that they have enough time and opportunity to consider whether to associate with the incoming controlling shareholder. Of course, this proposal is not an invention of this research. Taiwan, as a jurisdiction with very similar concentrated ownership structures to mainland China's, has an *ex ante* announcement institution without the "5% embargo rule."[157] According to the Taiwan Securities Regulations, a bidder should announce any plan that will acquire more than 20% of the outstanding shares within 50 days through exchange trading.[158] This announcement institution should be enough for minority shareholders to disenfranchise and CSRC to supervise.

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[155] *See* Xingzheng Xuke Fa (行政许可法) [Administrative Approval Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2003, effective Jul. 1, 2004) (Chinalawinfo); for more administrative approval issues, *see* the State Council's website, http://english.gov.cn.

[156] The actual delay could be longer than a month, because all evidence related, hearing, expert inspection periods are not included. *See id*. art. 42–45.

[157] SHAO QINGPING (邵庆平) *ET AL.*, SHIYONG ZHENGQUAN JIAOYI FA (实用证券交易法) [PRACTICAL SECURITIES REGULATION] (3d ed. 2013).

[158] *Id.* at 158.

Still, a very small proportion of the listed companies have dispersed ownership structures.[159] Although it would be more efficient to change the current institution, those companies with a dispersed shareholder distribution should not be neglected. Professors Hansmann and Kraakman opine, in their iconic comparative corporate law book, that modern corporate law should serve as a "menu" that provides a list of regulations for companies with different individual utilities to choose from.[160] The absence of the "5% embargo rule" can be the default setting.[161] However, companies can opt in such rule through voting by their shareholder general assemblies excluding ACS and RCS. If the minority shareholders find that the "5% embargo rule" protects their utilities, which is highly improbable with a controlling shareholder in the firm, they might opt in. Deactivating the "5% embargo rule" will activate the Chinese takeover market, and, further, minority shareholders can truly share the control premium with controlling shareholders through exchange trading.[162]

V. CONCLUSION

This research examines the traditional wisdom of takeovers and their regulations. Generally, takeovers have a value adding effect, but require regulations to curb the excesses. An auction promotion rule is efficient in maximizing social wealth and reducing non-value maximizing takeover deals when shareholders fail to coordinate in front of a coercive offer. Chinese shareholders' distribution is less concentrated than before, but controls are still desirable in such an inefficient legal jurisdiction.

Meanwhile, even if the high representation of state controlling shareholders slightly complicates controlling shareholders' typical behavior, pecuniary gains are still a major consideration in takeovers. Obviously, a market dominated by controlling shareholders does not create conditions requiring an auction promotion rule. Shareholders generally do not have to worry about effectively coordinating in China because there are many controlling shareholders. Therefore, an auction promotion rule would be inefficient. Furthermore, the overcomplicated auction promotion rule, namely the "5% embargo rule," incurs excessive costs so as to *de facto* disable the pathway of

[159] *See infra* Chart 2.

[160] *See* Kraakman et al., *supra* note 8.

[161] Default rule saves transaction cost when the majority in the market is against opting in. *See* Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 Yale L.J. 2032 (2012).

[162] It is true that China has the "mandatory bid rule" which is considered as one of the most important rules permitting shareholders to share the control premium. However, in reality, the high ratio of exemption ratio of the rule makes it de facto impossible to share control premium in most takeover case. The function and reform suggestion of Chinese mandatory bid rule is discussed in a separate paper.

taking over a firm through exchange trading. The only other function of the "5% embargo rule" besides auction promotion is to improve transparency. The reasonable solution, therefore, is to erect an *ex ante* announcement institution to inform the market and deactivate the inefficient rule. Still, in order to be efficient for a small number of firms without controllers, the embargo rule can be opted in if minorities believe it is in their best interests.

APPENDIX

Chart 1

Ownership Structure (Becht's Approach)				
Types	≥50% Block holders	≥25% Block holders	<25% Block holders	Total Firms
Firm	409	1095	648	2152
Percentage	19.01%	50.88%	30.11%	100%

Graph 1

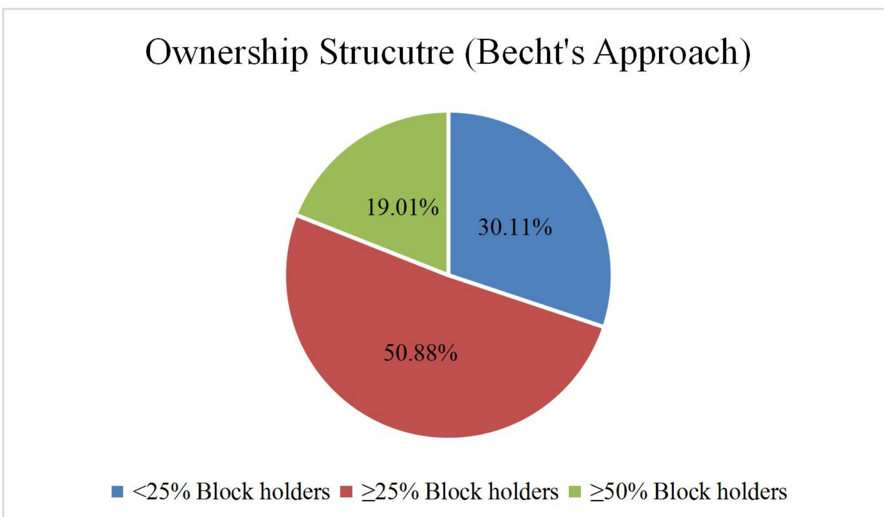
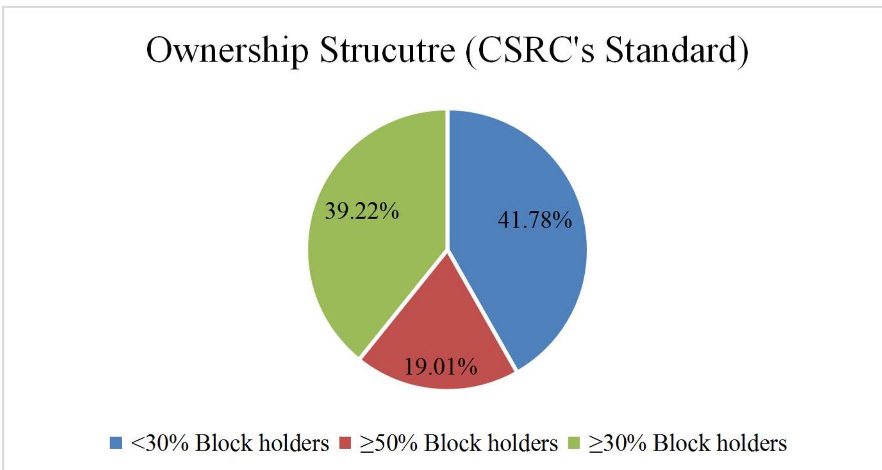


Chart 2

Ownership Structure (CSRC's Standard)				
Types	≥50% Block holders	≥30% Block holders	<30% Block holders	Total Firms
Firms	409	844	899	2152
Percentage	19.01%	39.22%	41.78%	100%

Graph 2



Graph 3

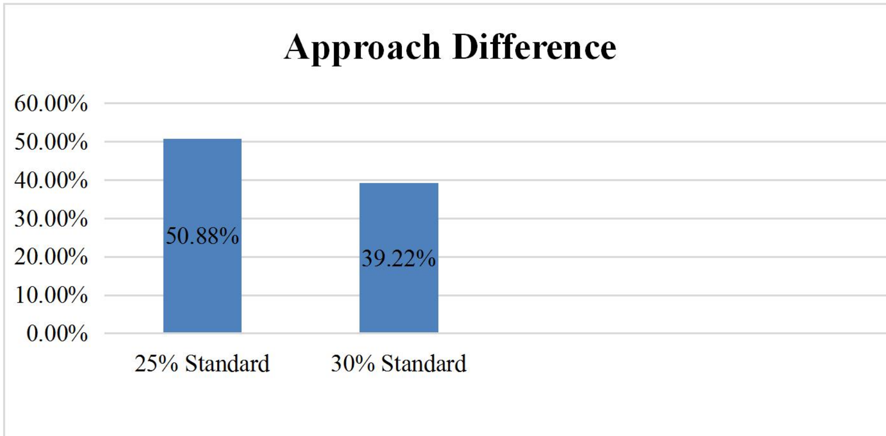


Chart 3

ACS, RCS and Actual Controller			
	With	Without	Total Listed Companies
Firm	2080	72	2152
Percentage	96.65%	3.35%	100%

Graph 4

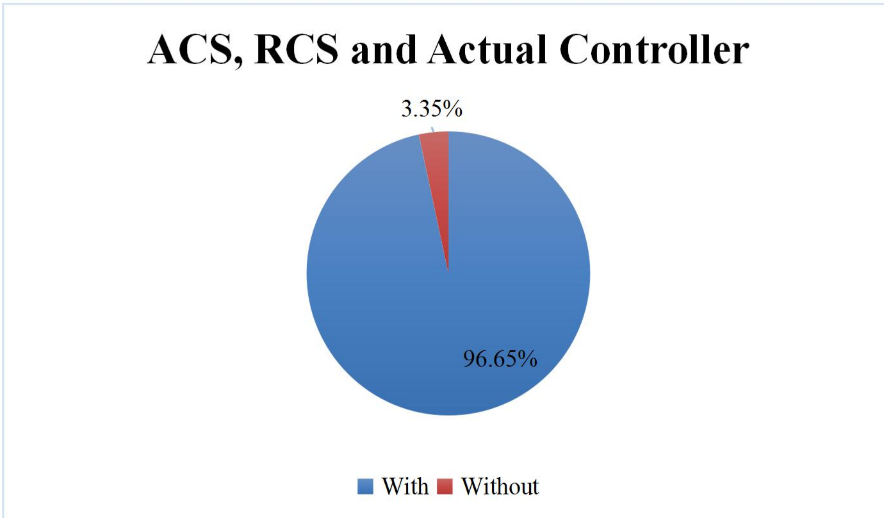
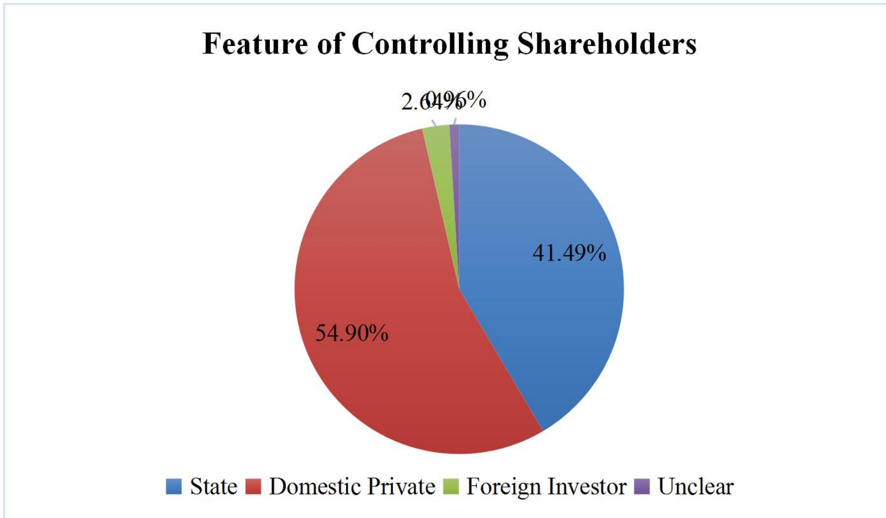


Chart 4

Feature of Controlling Shareholders					
Types	States	Domestic Private	Foreign Investor	Unclear	Total with CS
Firm	863	1142	55	20	2080
Percentage	41.49%	54.90%	2.54%	0.96%	100%

Graph 5


Feature of Controlling Shareholders
2.64%
0.96%
41.49%
54.90%
State
Domestic Private
Foreign Investor
Unclear