

On Protection of Rights and Interests of Minority Shareholders in Listed Company

Yong Cheng

School of Business Administration, Shenyang University
No.54, Lianhe Road, Dadong District, Shenyang 110041, China
Tel: +86-13555704468 E-mail: 19781978cy@163.com

Received: January 14, 2012

Accepted: February 10, 2012

Published: March 15, 2012

doi:10.5430/ijba.v3n2p54

URL: <http://dx.doi.org/10.5430/ijba.v3n2p54>

Abstract

With the rapid development of China economy, more and more listed companies appear and the size of securities market is growing. Their influences on economic development tend to be more prominent. Inevitably, there are some flaws in securities market. One of serious problems is the issue of controlling shareholders taking advantages over minority shareholders' equities. In this paper, the author tries to analyze the actual situations of minority shareholders' losses, starting from the theories and incentives, and proposes relevant countermeasures for this problem.

Keywords: Listed Companies, Minority Shareholders, Protection of Rights and Interests, Countermeasures

Minority shareholders are different from the controlling shareholders. They are not involved in company's daily production and business and have no real control over the company. The purpose of minority shareholders is to get their bonus. The number of minority shareholders is big and their status is low, being incapable of controlling the company. Because of less holding, minority shareholders can not influence the decision of the company. The imbalance of powers causes the insecurity of minority their interests. Minority shareholders are usually the "disadvantaged group" in listed companies.

Rights and interests of minority shareholders mean that minority shareholders, as the investors of listed company, have the right of participating in company's production and management and getting interests. Minority shareholders should not only have the right of getting interests from the company. More importantly, the nature of rights and interests of minority shareholders is a "membership of community", which means they are entitled all rights conferred by the Company Law as a part of the listed company. No matter who are controlling shareholders or minority shareholders, there is no difference in nature. However, in actual operations of listed companies, minority shareholders cannot participate in the decision-making because of their small amounts of investments. The right of minority shareholders in production and management has been weakened gradually, what finally affect the acquirements of interests.

1. The Need for Protection of Rights and Interests of Minority Shareholders in Listed Company

1.1 The Internal Factors

For the listed company, the cornerstone for listed company's long-term existence and development is to strengthen the protection for minority shareholders' rights and interests, which includes three aspects in detail: strengthening the material basis, optimizing the equity structure, and stabilizing the stock price. The material basis for the foundation of listed company is supplied by both controlling shareholders and minority shareholders. Because minority shareholders are from different social stages, in a broader distribution, they are the most fundamental element for the existence of listed company. Poor protection of rights and interests of minority shareholders will directly hurt their enthusiasm for investment, which will weaken the material basis of listed company and harm the long-term operation and development of listed company. To strengthen the protection of rights and interests of minority shareholders can favor the optimization of corporate structure, especially the optimization of ownership structure, improving the fairness, rationality, and science of decision-making in listed company. Meanwhile, the optimization of structure can help to achieve more scientific management and accelerate the building of modern enterprise system. In listed company, the stock price is closely related to minority shareholders' confidence in investments. To improve minority shareholders' confidence and enthusiasm can help to stabilize and increase the stock price. Conversely, if fail to protect the rights and interests of minority shareholders, they will feel frustrated and suppress the desire for investments. Accordingly, the stock price of listed company is not safe.

1.2 The External Factors

(1) To strengthen the protection of rights and interests of minority shareholders can help to ensure the stability and prosperity of China's stock market

In perspective of external factors of listed company, to strengthen the protection of rights and interests of minority shareholders can help to ensure the healthy operation of China's financial market. On one hand, minority shareholders provide long-term stable capital sources for securities market. The number of minority shareholders is large, being the main financing channel for capital market. To maintain the stable investments from amounts of minority shareholders has certain connection with the financing situation of listed company. On the other hand, the stable operation of securities market depends on the sustainable investments from minority shareholders. If the economy is running well, minority shareholders are enthusiastic about investments and the capital market is prosperous. If the economy develops slowly and the rights and interests of minority shareholders cannot be protected effectively, the external investments will be blocked and the stock price will fall, causing a crisis in capital market.

(2) To strengthen the protection of rights and interests of minority shareholders can help to achieve the stable development of China's economy and society

Minority shareholders are mostly normal labor class, with weak economic basis. They cannot fight back a financial crisis with powers. Particularly, some speculative investors take investments in stock market as the main means of survival. Once there are losses, the strike will be fatal. As a result, it will increase the unstable factor of the society, influencing the stability and unity of the whole society. Therefore, to protect the rights and interests of minority shareholders is not only the responsibility of capital market and listed companies, but also the obligation of the society. On the other hand, the legislation of capital market is always an important aspect of China's market economic reform. To strengthen the protection of rights and interests of minority shareholders can promote the legislation and standardization of China's capital market operation, providing a fair, safe, and standard external environment for the operation of capital market.

2. The Manifestation of Invasion of Rights and Interests of Minority Shareholders in Listed Company

2.1 Insider Trading

The so-called insider trading means people who are close to non-public information, in violation of relevant laws and regulations, trade non-public information in order to obtain economic returns. In securities market, the banker or controlling shareholders of listed companies have easy accesses to non-public information of companies due to their special status. They can obtain enormous economic returns by trading non-public information or trading securities based on non-public information. For example, they can obtain price spread by arbitrary price manipulation. In contrast, minority shareholders who are far away from non-public information sources suffer losses due to information asymmetry. Insider trading severely damages the order of fair trading in securities market.

2.2 Illegal Guarantee

Illegal guarantee is always the focus of governance of listed companies. The activity is divided into two specific forms: vertical guarantee and horizontal guarantee. The so-called vertical guarantee means the listed company gives guarantees for debts of shareholders, shareholders' subsidiaries, affiliates, and individuals by its assets. The so-called horizontal guarantee means the mutual guarantee between listed companies. In either form of illegal guarantees, the overall interests of the listed company are taken as the objects in avoiding risks. Once a risk arises, the listed company suffers losses and innocent minority shareholders bear joint liabilities. Under this circumstance, the interests of minority shareholders are invaded and occupied.

2.3 Illegal Related Transaction

The so-called illegal related transaction among listed companies means the listed company builds connections with other interest-related companies or individuals, and directly transfers relevant resources, information, and services in transactions. Related transaction has its advantages and disadvantages. The two parties can save transaction costs due to the connections. On the other hand, because related transactions usually happen under the condition of no full transparency, the two parties may use administrative powers to control prices and volumes, what will finally hurt relevant interests of shareholders. In the listed company, controlling shareholders make best use of their special status and conduct related transactions with other companies or organizations, gaining more interests. They even develop policies to control relevant resources of the listed company, making the company and minority shareholders useless, and damaging the interests of minority shareholders.

2.4 Embezzlement

In listed company, the controlling shareholders control the use of capitals. Minority shareholders only care about the

dividends. They do not attach importance to capital flows. Then, the controlling shareholders can divert corporate funds for their own business. As a result, it will hurt the rate and size of cash flow, causing low profitability and returns, and harming the interests of shareholders, especially that of minority shareholders. At present, there are always some listed companies in bad operations or even in bankruptcy because of the embezzlement of controlling shareholders. Although the government and the supervision agency try to interfere with the illegal possession of funds, the phenomena of controlling shareholders embezzling capitals in listed companies are still serious, because there are no settled laws and systems to monitor the behaviors of controlling shareholders.

3. Reasons for the Invasion of Rights and Interests of Minority Shareholders in Listed Company

3.1 Internal Reasons

3.1.1 Defects in the Internal Structure of Listed Company

The institutional defects in the internal structure of listed company mainly focus on the general meeting of shareholders and the board of directors. The general meeting of shareholders is supposed to be the top authority of the listed company, making decisions for all important business, reflecting the wills of all shareholders, and protecting the interests of all shareholders. However, because controlling shareholders control a large amount of equities and possess more votes in the general meeting of shareholders, they can easily manipulate the general meeting and pass favorable decisions. Meanwhile, in the general meeting of shareholders, the controlling shareholders have the veto power, which gives them the right of declining any decisions that might hurt their interests. As a result, it may hurt the interests of minority shareholders indirectly. The general meeting of shareholders turns into the means and tools for controlling shareholders robbing minority shareholders and acquiring interests. The board of directors, as the top administrative agency, is supposed to serve all shareholders. However, because the board of directors is under the control of controlling shareholders and lack of independence, it cannot ensure the fairness of decisions. At the initial establishment of the board of directors, the appointment of the chairman and the choices of members of the board are manipulated by controlling shareholders. In the name of the board of directors, controlling shareholders can make up decisions and plans that benefit them in the future. Although independent directors have the right of supervision and coordination, due to the constraints of controlling shareholders, the proportion of independent directors is low in most listed companies. Controlling shareholders can even manipulate the appointment and removal of independent directors. As a result, the independent director system is nothing but a piece of paper.

3.1.2 The Weakening Role of the Board of Supervisors

The board of supervisors is a necessary supervising agency in listed company. It supervises the board of directors and the daily operation of general managers and directly reports to the general meeting of shareholders. The board of supervisors exists between the general meeting of shareholders and the board of directors in listed company, being committed to supervising the decisions of the board of directors in order to ensure the fairness of all decisions, for the sake of most shareholders. However, latest researches show that the board of supervisors has worse efficiency and its function of supervision is weakening. For the board of supervisors, the establishment and the form of institutions are subject to the controlling shareholders. Nominally, the board of supervisors is a supervising institution, being parallel to the board of directors in listed company. In fact, it is only a “subsidiary agency” of the board of directors. Its function of supervision cannot be displayed thoroughly. Besides, the board of supervisors is financially supported by the board of directors. Without the economic independence, the board of supervisors cannot get rid of control from the board of directors and cannot play its role of supervision well.

3.1.3 The Disadvantages of Minority Shareholders

As for the reasons of invasion of rights and interests of minority shareholders, except for the lack of corporate institutions, the disadvantages of minority shareholders may give some explanations. Objectively speaking, the stock trading is a highly technical industry. Without special technical training, stock investors cannot understand the nature of stock trading. Most minority shareholders are common people. They have poor competence and specialty techniques. Therefore, minority shareholders are easily deceived by controlling shareholders, suffering losses of interests. Subjectively, minority shareholders take the dividends of stocks as the only goal. They do not care about the business operation of listed company. Their investments are usually speculative, with conformity and blindness. The “careless” attitude of minority shareholders objectively facilitates the invasion activities of controlling shareholders.

3.2 External Reasons

3.2.1 The Legislation is Lagging Behind

So far, the legislation of laws of protecting the interests and rights of minority shareholders is lagging behind. Illegal

possession of interests of minority shareholders is serious. The phenomenon is caused by three factors: the high prices for civil action, the imperfect laws and regulations of securities, and the weak punishment. Lawsuits are the most stable protection for the rights and interests of minority shareholders, but various preconditions for lawsuits increase the prices for civil action in securities field, hindering the way of minority shareholders protecting their rights and interests. Minority shareholders have no confidence in protecting their rights and interests by lawsuits. Amounts of illegal invasion activities are free of punishment. Relevant securities laws and regulations that protect the rights and interests of minority shareholders cover a small field. The update of laws is slow and the legal environment is not good. Some laws even stray away from realities and fail to match up with the current operation of securities market. As a result, some evil behaviors that invading the rights and interests of minority shareholders, such as the related transaction and the invasion of company assets by controlling shareholders, escape from legal punishment. Even there are relevant securities laws and regulations, relevant punishment items are not serious enough to warn illegal activities. Compared with the enormous interests generated by illegal invasion, the costs and risks of punishments are almost nothing. As a result, some listed companies take the risk and invade the rights and interests of minority shareholders. In a sense, the weak punishments in securities laws benefit the growth of illegal invasions.

3.2.2 The Lack of Credit Mechanism

The market credit relationship is a soft constraint to market behaviors. However, at present, the problem of market discredit is more serious. The securities market and the listed company are facing the credit crisis. Because the lack of relevant supervising mechanism and the discredit behaviors, such as arbitrarily making up false accounting information, and shamelessly stealing capitals from the listed company, the credit in securities market is damaged. On the other hand, because controlling shareholders and minority shareholders access to different information, there are some problems for information disclosure in securities market, such as spreading rumors and false information, delaying the disclosure of information, concealing insider information, and even gaining interests by information disclosure. As a result, the information disclosure in securities market is in a lack of reliability, affecting the stability and the efficiency of market operation.

4. Countermeasures for the Protection of Rights and Interests of Minority Shareholders in Listed Company

4.1 Strengthen the Protection of Minority Shareholders Awareness

In order to protect the rights and interests of minority shareholders in listed company, on one hand, we should strengthen the protection of minority shareholders awareness. The listed company should hold the “shareholders-oriented” idea that the company is owned by all shareholders and all corporate activities should serve the shareholders. The general meeting of shareholders, the board of directors, the controlling shareholders, the board of supervisors, or even the minority shareholders should take the interests of all shareholders as the starting point and ultimate goal. On the other hand, strengthen the cultivation of minority shareholders and employ special institutions to train minority shareholders with relevant securities knowledge, improving the comprehensive quality of minority shareholders quickly, and sharpening their abilities of dealing with changes in market and fighting risks. Meanwhile, minority shareholders should establish an awareness of protecting legal rights. They should join in the general meeting of shareholders and try to participate in the operation and management of listed company. Once the rights and interests are invaded, they should use laws to protect their legal rights and interests by lawsuits.

4.2 Improve the Internal Governance Structure of Listed Company

4.2.1 The General Meeting of Shareholders

The general meeting of shareholders, the board of directors, and the board of supervisors are the three means for the governance of listed company. Here, the general meeting of shareholders is the top authority, which plays an “ultimate decisive” role in big decision-making. Therefore, in order to improve the internal governance structure of listed company, the first is to improve the institution of general meeting of shareholders. Specific measures include restricting the power of controlling shareholders and strengthening the right of minority shareholders. In order to prevent controlling shareholders manipulating the general meeting of shareholders and ensure that the meeting reflects the will of most shareholders, the listed company should restrict the power of controlling shareholders. For example, set up certain proportion for controlling shareholders’ voting right in the general meeting of shareholders. The excessive votes will be excluded from the valid. On the other hand, strengthen the right of minority shareholders and give them more powers in the general meeting of shareholders. For example, use the cumulative voting system, or the voting system for different kinds of shareholders, or the proxy voting system, or the voting-right collection system, or online voting system to enhance the voting right of minority shareholders. In a word, adopt the principle of fair voting and make a balance of powers between minority shareholders and controlling shareholders.

4.2.2 The Board of Directors

For the improvement of internal governance structure of listed company, the construction of the board of directors is the core. The key is to enhance the independence of the board of directors. Therefore, considering the composition of the board of directors, we should change the monopoly of controlling shareholders, give more chances for minority shareholders entering the board, and control the proportions of different kinds of shareholders in a reasonable range, ensuring the fairness of the board decisions. In the selection of independent directors, we should choose professional qualified people as candidates. Meanwhile, we can increase the number of independent directors, strengthen their functions, and give them more actual powers, in order to make them play the coordinative role in listed company. To improve the structure of the board of directors is vital for balancing the rights and interests of controlling shareholders and minority shareholders.

4.2.3 The Board of Supervisors

Modify the structure of the board of supervisors and make it fulfill its supervising function. For example, in the composition of the board of supervisors, choose people who are professional and respectable as supervisors and ensure the authority of the board of supervisors. For the expenses of the board of supervisors, the listed company can set up a special account getting rid of interests with the board of directors, ensuring the economic independence of the board of supervisors. As for the daily operation of the board of supervisors, the listed company should constitute relevant regulations and rules to establish the responsibilities of the board of supervisors, guaranteeing the legal execution of its supervising functions.

4.3 Promote the Legislation Process

Promote the legislation process and use standard valid laws and regulations to safeguard the stability of China's securities market. Specific operations include regulating civil actions of securities and enforcing the execution of securities law. The legislative branch should modify relevant securities laws and also build a standard civil securities litigation system, using laws against controlling shareholders' invading rights and interests of minority shareholders, and strengthening the protection of minority shareholders. At the same time, enhance the enforcement of securities laws and achieve the timely and effective enforcement. Punish the activities of violating the rights and interests of minority shareholders severely and track down relevant remediation for minority shareholders, reducing losses to the minimum. Use effective enforcement to guarantee the authority of laws and give more confidence to minority shareholders.

4.4 Establish an Organization to Protect the Rights and Interests of Minority Shareholders

Minority shareholders hold a small amount of shares, being loose and low professional. They cannot prevent risks effectively. Once suffering from the violation of rights and interests, it is difficult for minority shareholders unifying to fight back, because of own defects. Therefore, it is necessary to form a special organization to protect the rights and interests of minority shareholders. The staff in the organization should be professional and familiar with the operation of securities market and the laws of securities. They cannot only represent minority shareholders to participate in the general meeting of shareholders, exercising the normal rights of common shareholders, but also keep communications between minority shareholders and securities supervising branches, and file civil lawsuits on behalf of minority shareholders to protect their rights and interests when violation of rights and interests happens. In a sense, the establishment of rights-and-interests protection organization builds a bridge for minority shareholders and securities supervising branches, providing powerful supports and protection for legal rights and interests of minority shareholders.

Reference

- Shen, Ran. (2010). Minority shareholders' rights and interests protection after full circulation. *World Economic Outlook*. No.9: 52.
- Sun, Shuwei. (2006). *Research on the Rights and Interests Protection System for Individual Investors in Stock Market*. Beijing: China Finance Publishing House. p87-88.
- Zhang, Bin. (2011). Defects of the rights and interests protection mechanism for minority shareholders in Company Law and the improvements. *China Economic & Trade Herald*. No.16: 76-77.