Protection the Interests of Small and Medium Shareholders in the Acquisition of Listed Companies

Lin Quan[1, 2, a *]

[1]Xi'an Medical University, Xi'an, China

[2]School of Economics, Wuhan University of Technology, Wuhan, China

[a] 13991317007@139.com

* Corresponding author

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Abstract. Although the acquisition of a listed company is manifested as a stock transaction between the acquirer and the management of the target company, it lurks a variety of potential damages to the interests of small and medium shareholders of target companies. Therefore, in order to effectively protect the rights and interests of small and medium shareholders, it is necessary to improve the existing legal requirements. Based on the author's learning and practical experience, this work first analyzed the necessity for listed companies to acquire the rights and interests of small and medium shareholders, then analyzed the problems existing in current cumulative voting system of China, and finally put forward measures to protect the interests of small and medium shareholders in the acquisition of listed companies.

1. Introduction

The acquisition of listed companies is an inevitable phenomenon in the development of the securities market, which has a history of more than 100 years in western countries. The acquisition of listed companies is an important form of corporate mergers and acquisitions. It plays an important role in the reorganization of listed companies based on the shareholding system, and it is a reflection of the market mechanism in the optimization of resource allocation [1]. On the surface, the acquisition of a listed company is a stock transaction among the acquirer, the management and shareholders of the target company, but it hides the possibility of infringement on the interests of small and medium shareholders in the target company [2]. In this process, the small and medium shareholders of the target company are extremely unstable and vulnerable due to their weak economic strength, poor ability to obtain information, and slow response to changes in the stock market, so it is necessary to strengthen the protection of the rights of small and medium shareholders.

2. Necessity of Protecting the Rights and Interests of Small and Medium Shareholders by Listed Companies

There is a close interest relationship between the acquisition of a listed company and the entities such as the acquirer, the target company's shareholders, and the management of the target company. In this type of interest system, the small and medium shareholders of the target company are often in a weak position, and their interests are also the most vulnerable. The specific performance is that the small and medium shareholders of the target company are in a weak position compared to the acquirer. Although the ultimate goal of the two is to control the equity of the target company, compared with the powerful acquirer, the small and medium shareholders have the following disadvantages: first, its human, financial, energy, and professional investigation and analysis capabilities are much weaker in the acquisition process; second, it is often difficult for small and medium shareholders to cope with surprise purchases with their own strong advantages; third, the small and medium shareholders of the target company are in a weak position compared with the large shareholders of the target company. Whether it is a public malicious acquisition or a private

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agreement, the large shareholders of the target company have strong bargain ability, but the small and medium shareholders do not have this strength. In the acquisition activities of listed companies, the major shareholders of the target company often use their advantages of voting rights brought by the advantages of holding stocks to influence the company's will, which often makes it difficult for the interests of small and medium shareholders to be fully considered; fourth, the small and medium shareholders of the target company are in a weaker position compared with the operators of the target company [3]. In the acquisition activities, the managers of target companies often take anti-acquisition measures that damage the interests of small and medium shareholders on the basis of protecting their existing positions and interests. In summary, in the acquisition of listed companies, the small and medium shareholders of the target company are in an extremely weak position and in an extremely weak part of the interest system. Therefore, the protection of the interests of small and medium shareholders in the target company should be strengthened, so as to truly achieve the balance of interests of all parties in the acquisition process of the listed company.

3. Problems Existing in the Current Cumulative Voting System of China

3.1. Problems in the cumulative voting system

First, the cumulative voting system is only effective for companies with a small difference in shareholders' shareholding ratio. Suppose that at the shareholders' meeting for the election of directors of company a, the shareholding ratio of three shareholders is 75:15:10. Obviously, even if the latter two shareholders apply the cumulative voting system, the purpose of electing a director cannot be achieved. The election of directors is completely controlled by the major shareholders, and the cumulative voting system cannot play a role. It can be seen that if the number of shares held by major shareholders and other shareholders is too large, even if implementing the cumulative voting system, it cannot achieve the purpose of power balance. At present, the phenomenon of "one-dominated stock" in listed companies in China is very serious, so the purpose of electing directors and supervisors through a cumulative voting system in China is difficult to achieve.

Second, the cumulative voting system is only effective if small and medium shareholders have sufficient voting rights. Article 103 of *Company Law* regulates: "shareholders who individually or collectively hold more than 3% of the shares can submit an interim proposal ten days before the stockholders' meeting to the board of directors". According to the provisions of Article 12 of the *Regulatory Opinions of the Listed Companies Shareholders' Meeting*, only shareholders who individually or collectively hold more than 5% shares can have the right to propose shareholders' meetings [4]. Obviously, under the existing equity structure of a listed company, ordinarily small and medium shareholders are unlikely to hold more than 5% of the shares. In this way, small and medium shareholders do not even have the opportunity to include the people they want to nominate on the list of director candidates, let alone to use cumulative votes to compete for seats on the board with major shareholders, and the result will inevitably cause the current embarrassing situation of "old wine in a new bottle".

3.2. Deficiencies in the mandatory tender offer system triggered by agreement acquisitions

Article 96 of China's *Securities Law* states: "in the case of an agreement acquisition, if the acquirer acquires or jointly acquires a listed company's issued shares through agreement or other arrangements with another person when the acquisition continues to reach 30%, it shall issue an offer to all shareholders of the listed company to acquire all or part of the shares of the listed company, while the securities regulatory body under the state council is exempted from making the offer". That is to say, in the case of an agreement, once the acquirer holds 30% of the target company's shares, in principle, a tender offer should be made through a stock exchange. The significance of a mandatory tender offer is that when the company's control power is transferred, small and medium shareholders have the opportunity to share the premium brought by the transfer of control power and have the opportunity to exit the company. However, it should be noted that when the acquirer holds 30% of the issued shares of a listed company, it does not necessarily create an obligation to issue a tender offer. If the investor does not continue the acquisition, it means that he can be exempted from the obligation to issue an offer; if the investor continues to acquire, he can

also be exempted from its obligation to make an offer with the approval of the securities regulatory authority of the State Council. To some extent, this has diluted the legal enforcement inherent in mandatory takeover offers, which is unfavorable to protect the interests of small and medium shareholders of the target company [5].

3.3. Difficulties in implementing information disclosure

The information disclosure in the agreement acquisition directly affects the interests of small and medium shareholders; however, since the agreement acquisition itself has the characteristics of low degree of information disclosure, listed companies lack transparency in the information disclosure during the agreement acquisition process, and the authenticity of information disclosure needs to be improved. In addition, it is difficult to implement an information disclosure system.

3.4. Independent directors are unworthy of their titles

According to Article 6 of the *Guiding Opinions on Establishing an Independent Director System in Listed Companies*, independent directors should express independent opinions on major matters of the company and matters that may harm the interests of small and medium shareholders. Since the establishment of the securities market, a variety of behaviors that infringe on the interests of small and medium shareholders emerge one after another. For example, major shareholders embezzle listed company assets through connected transactions, use listed companies as cash dispensers, and engage in various types of false mergers and reorganizations to hype the company's stocks, making small and medium shareholders who do not know the truth are repeatedly caught, and their interests are seriously damaged. However, most independent directors do not play their due role in corporate governance or represent the interests of small and medium shareholders, which have a great deviation from the positioning of independent directors.

4. Countermeasures to Protect the Interests of Small and Medium Shareholders in the Acquisition of Listed Companies

4.1. Improving the controlling shareholder system of the target company and strengthening the integrity obligations of the controlling shareholder and management

First, it is necessary to clarify whether the resolutions of the shareholders' meeting are valid. The effectiveness of the resolutions made by the shareholders' meeting of the joint stock company is very important, which affects the interests of the company and shareholders. If the controlling shareholder intentionally fails to perform his duty of good faith, the resulting resolution of the shareholders' meeting is bound to be defective, and the law shall determine that the resolution of the shareholders' meeting made thereby is invalid or revoked.

Second, it is necessary to expand the content of the obligation of good faith in legislation. From the above point, it can be seen that the importance of controlling shareholder's good faith obligation and its frequency of absence. Therefore, it is necessary to use explicit obligation of good faith in the legislation to restrict the rights of controlling shareholders, thereby reducing the imbalance between them and small and medium shareholders. In addition, since the management of the company controls the company on behalf of the interests of the company, the management also needs to abide by the obligation of good faith. The author believes that the following content should be added to the integrity of the controlling shareholder and management in the acquisition of listed companies: (a) Legislative provisions should be made in the company's acquisition of decisions related to the interests of small and medium shareholders, which should be decided through shareholders' meetings, so as to protect the rights of decision-making and information of small and medium shareholders. (b) Management shall promptly and effectively communicate to shareholders all non-confidential information regarding the acquisition of the listed company.

4.2. Improving the information disclosure system

First, it is necessary to expand the subject of information disclosure. So far, relevant laws and regulations in China have not stipulated the disclosure obligation of the board of directors in terms of the main body of disclosure in the acquisition process of listed companies. As the management of the target company, the board of directors plays a very important role in making relevant decisions, and there are conflicts between its own interests and small and medium shareholders. Therefore, it

is necessary to stipulate the information disclosure obligation of the board of directors, and correspondingly improve the content, degree and effectiveness of its disclosure..

Second, it is necessary to clarify the content of information disclosure. Although the Constitution in China has stipulated in detail what should be disclosed in the acquisition process of listed companies, there are still many problems in practice that need to be further improved. Based on the data search and in line with the principle of protecting the rights and interests of small and medium shareholders, the author suggests that the disclosure should also include the situation of shareholders' shareholding, the company's financial status and acquisition intention.

Third, information disclosure should be timely. In the process of a listed company's acquisition, the disclosure of acquisition information is particularly important for small and medium shareholders to understand and judge whether to accept the offer [6]. However, the timely disclosure of information is even more critical, that is because even important information will become worthless if it is not disclosed in time. In practice, the obligor for information disclosure usually damages the interests of small and medium shareholders by deliberately delaying and failing to disclose information in a timely manner. Therefore, it is necessary for internal supervision departments and external supervision institutions to strengthen the supervision over the timeliness of information disclosure.

4.3. Determining criteria for anti-takeover measures of listed companies

For different goals, if the acquisition is beneficial to both target company and shareholders, and can flow into a better and more professional management team, this acquisition is undoubtedly widely accepted. However, the success of the acquisition of a listed company means the transfer of corporate control and the dismissal and replacement of the original management. In this case, the management often only considers its own interests and uses illegal methods to obstruct the acquisition, which will definitely harm the interests of the small and medium shareholders. In addition, in order to pursue the maximization of their own interests, acquirers often do not hesitate to take any measures to counter anti-takeover, which is bound to cause a double blow to the interests of small and medium shareholders. Therefore, the standards for anti-acquisition measures are urgently required to be regulated and clarified by law, so that both acquisitions and counter-acquisitions can proceed under the framework of regulations. To this end, the author has a few summary to the legal standard of anti-takeover measure: (a) the subject of the anti-takeover decision needs to be clarified; (b) whether the process of making the measure meets the requirements of relevant procedures; (c) whether the anti-takeover measures are aimed at hostile takeovers and will affect the interests of small and medium shareholders. In summary, the management of the target company is likely to abuse their power to take anti-takeover measures for their own interests, which is urgent to clarify that the right to decide anti-takeover measures should not be given to managers, but to shareholders' meetings, because the general meeting of shareholders consists of all the shareholders of the company, and the decisions it makes are fair and democratic. At the general meeting of shareholders, shareholders can decide whether to transfer their own equity according to their own wishes. As for the management, as a company operator, after all, it has professional knowledge and rich experience, so it should still be given appropriate right of recommendation. However, the large shareholders who have absolute control over the company may still use their controlling advantages to infringe the interests of small and medium shareholders in the company's decision-making mechanism under the principle of capital majority decision. Therefore, in law, while supporting the shareholders' meeting to have the right to decide; it is necessary to restrict their rights to fully protect the rights of small and medium shareholders.

4.4. Improving the shareholder representative litigation system

First, it is necessary to rationalize the shareholder representative's litigation costs. In civil lawsuits in China, the people's courts mainly divide cases into two categories: property cases and non-property cases. According to the different nature of the cases, the courts separately charge litigation costs. From the perspective of China's judicial practice, the court has identified shareholder representative actions as property cases. In the foregoing paragraph, the author has already described that small and medium shareholders generally sue as plaintiffs. When small and

medium shareholders sue to the court, the court charges according to the property case and the litigation costs for the small and medium shareholders are undoubtedly a great burden. Therefore, the author believes that adjustments should be made in the collection of litigation costs, and courts should charge litigation costs according to non-property cases. This will help small and medium shareholders to apply legal means to safeguard their legitimate rights and interests.

Second, it is necessary to lower the threshold for plaintiff qualifications. According to the relevant provisions of the *Corporate Law*, if small and medium shareholders of a listed company want to file a shareholder representative lawsuit, the small and medium shareholders must hold the listed company's shares individually or collectively for up to 1% for 180 consecutive days. As the author mentioned before, the shareholding structure of China's current listed companies is relatively concentrated. Among them, the shareholding ratio of small and medium shareholders is very low, and they are scattered and non-aggregative without connection between small and medium shareholders [7]. In this way, it is not easy for small and medium shareholders to hold more than 1% of the shares individually or in total. Therefore, it is recommended that the threshold for shareholders' qualifications as plaintiffs should be lowered and some restrictions should be appropriately reduced so that small and medium shareholder can better protect their legitimate rights and interests.

Third, it is necessary to establish an incentive mechanism for shareholder rights protection. Although small and medium shareholders have spent a lot of money and energy to carry out shareholder representative litigation, the benefits after the protection of the rights are directly attributed to the listed company, and the small and medium shareholders who file lawsuits for rights protection only benefit indirectly, which greatly reduces the enthusiasm of small and medium shareholders for rights protection [8]. Therefore, the author believes that some rights protection incentive mechanisms can be established. Whether the shareholders carry out the lawsuit on behalf of the shareholder for their own interests or for the interests of the company as a whole, when they win the lawsuit, laws and regulations can reward the small and medium shareholders as the plaintiff in proportion to the size of the benefits, which is more conducive to encouraging small and medium shareholders to safeguard their own rights and interests of the company.

5. Summary

For the acquisition of listed companies, for one thing, due to the incompleteness of relevant laws and regulations in China, and for another, due to conflicts of interest in various aspects, the rights and interests of small and medium shareholders cannot be properly and timely protected. With the increasing dispersion of the company's equity, the number of small and medium shareholders of the joint stock company increases day by day and these small and medium shareholders with a small shareholding share constitute an indispensable part of the capital of the joint stock company. If the rights of small and medium shareholders are not protected, it will certainly affect the company's healthy development and investors, and the enthusiasm for investment is also not conducive to the steady development of the securities capital market.

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