

Empirical Study on Exploitation by the Controlling Shareholder and Transaction on Limited Deviation

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Abstract: The concept of exploitation over corporate resources has become one of the main focuses in corporate finance and financial engineering. Exploitation by the controlling shareholder in listed enterprise or EPBC (excessive private benefits of control) is the question about which many scholars have been so much discussion. Some related cases have taken place in the stock markets of Shenzhen and Shanghai concerning the transaction of control in the stage of 1999-2010. The substantial results indicates that the exploitation of excessive private benefits of control is positively related to the SHS under the level of 5%, negatively related to the VAL under the level of 5%, and so forth. The policy meaning of this research is summarized consequently. Labor is privy to inside information on customers and suppliers and can hold up the controlling shareholder. The high employer must treat the subordinate worker with the excellent service particularly for Chinese labor; the subordinate worker can treat the customer well for a second time.

Keywords: exploitation; excessive private benefits of control; the controlling shareholder

1 Introduction

The concept of exploitation over corporate resources has become one of the main focuses in corporate finance and financial engineering. The negative effect on the security development of the controlling shareholder stems from his or her role in the company. Exploitation by the controlling shareholder in listed enterprise or EPBC (excessive private benefits of control) is the question about which many scholars have been so much discussion.

An outstanding indication of the framework for analysis is found in Grossman S. and Hart D. They broke new ground via private benefits of control and checked one share one vote and corporate control in financial theory with a modeling device in 1988^[1].

He Weifeng, Zhang Zhaoguo, Zhu Shasha (in 1988) used “a sample of Chinese firms, cases were examined where there had been a transaction involving non-tradable stock. The cases where there had been stock transactions which both did and did not involve the transfer of control within a single year were selected”^[2]. The difference between the two categories of transaction was used to estimate the exploitation of the controlling shareholder in Chinese firms.

Some scholar discussed empirical study on ownership structure, and corporate governance which deemed to foster exploitation. Their “findings provide empirical support to the argument that minority shareholders value private information on firms with high expropriation likelihood..... Additional findings show that it is, in part, explained by these firms’ reliance on private communication channels rather than

public disclosure, producing poor informational environment”^[3]. They discussed the private benefits or exploitation of the controlling shareholder of French listed firms.

About Chinese exploitation, excessive private benefits over corporate resources by the shareholder, some discussed from rights issues including Pan Hongbo, Xia Xinping, and Yu Minggui. With 444 rights-issuing firms meeting the standard, the evidence indicated “that the change in wealth of tradable shareholders is negatively correlated with the change in wealth of nontradable shareholders, and consistent with an expropriation effect. Additional evidence indicates that the expropriation effect in rights issues is exacerbated when the firm is not ultimately controlled by the government. The nontradable shareholders do not subscribe the shares of rights issues, or the firm has a large second-largest shareholder”^[4].

XU Wenbin gave an empirical study on the contemporary dark side of industrial economics in Chinese listed companies. Firstly he “showed the temporary private benefits of control in China’s stock market. Thirdly the paper built a model to quantify the private benefits of control in China to capture the special institutional circumstances.showed the causality factors that had significant influence on them”^[5]. Thus, he summarized the guiding principle and recommendation consequently in this field.

The definition and concept of exploitation of control on the small ones by the controlling shareholder^[6-13] distorted the nature of the controlling shareholder’s exploitation. Liu “makes amendments to the theory of private benefits of control and large shareholders’

expropriation, points out and proves that the private benefits of control actually are the compensation for the cost of control and are the risk premium of control. The benefits are realized as the value increments by controlling the company and influencing the corporate governance of the company and finally improving the performance of the whole company^[14]. It has nothing to do with the exploitation. In fact, the exploitation is a kind of excessive private benefits of control by the controlling shareholder in the enterprise. It is the result of “hegemony” behavior from the controlling shareholder, showing the maximization of exploitation by the controlling shareholder.

2 Empirical Constructions

YOU Daming, SHEN Yidong utilized 91 transaction of property, finding that “excessive benefits of control is positively relative with the degree of competition for control and the debt-to-asset ratio and passively relative with the ratio of independent directors and the scale of the board of directors^[15]. They found that excessive benefits exceed the normal income of the controlling shareholder. They thought that the excessive private benefits of control should be shared originally by the small shareholder equally.

With the sample in the stock markets of Shenzhen and Shanghai, we can measure the exploitation directly with some cases taken place on the transaction of control share in the stage of 1999-2010.

2.1 Constructions

In a limited deviation model we give the empirical exploitation by the controlling shareholder.

Description of the standard limited deviation approach from MATLAB is:

The ordinary least squares estimate provides the response that has a normal distribution with no outliers. After using both ordinary least squares and this regression to estimate a straight-line fit, we find: a scatter plot of the data together with the fits shows that this fit is less influenced^[16] by the outlier than the ordinary iteratively function regression.

The limited deviation approach is used to regress the transaction of the controlling shareholder in the stage of 1999-2010 to measure EPBC and relationship between exploitation by the controlling shareholder and transaction.

2.2 Data

Our data used in the text are drawn from the databases of RESSET and CSMRA of Chinese accounting research in stock markets. Beijing Gildata Rerset DataTech Co.Ltd (RESSET) is the primary rank economic service and information supplier in China.

RESSET / DB 3.0 is a brand new upgraded version of RESSET / DB 1.0 developed and copyrighted by Gildata Rerset Co.Ltd, adding many up to the minute utility and improving and revising some defect. The database of CSMRA is from GuoTaiAn Information Technology Company in Shenzhen.

The following criteria that the sample transactions is defined:

First, the block is identified in the transaction from the largest to the largest shareholder.

Second, there had to be data in CSMRA and RESSET to identify the opening price one day after announcement.

Third, if suspend = yes the sample is deleted.

Finally, in the transaction if some data unknown the sample is deleted, and so on.

2.3 Equation to quantify

Now we want to quantify the exploitation by the controlling shareholder, E10, E11 are:

$$\frac{(TP-(NA+TM)/2)*Percent-TPSE*NA}{NA}$$

$$\frac{(TP-NA)*Percent-TPSE*NA}{NA}$$

Here, the transfer price is TP, the net assets is NA, the stock price is TM; the ratio of transaction is Percent, the average of first three years company performance TPS is TPSE.

The ratio before transaction (SHS) stands for the competition of control, BOA for number of the board of director, IND for the percent of independent directors, DEB for the debt of the enterprise, VAL for the total value of the enterprise, and so on. SHS, BOA, IND, DEB, VAL are X1-5.

3 Results

We now present descriptive statistics.

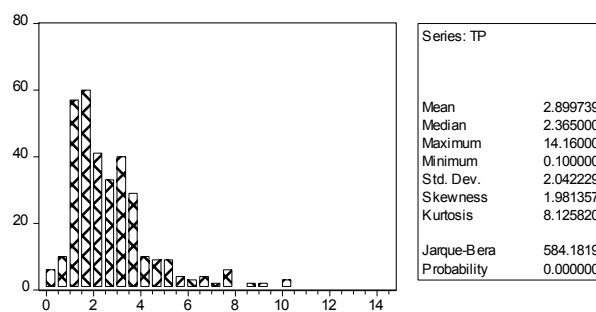


Figure 1. Curve of TP

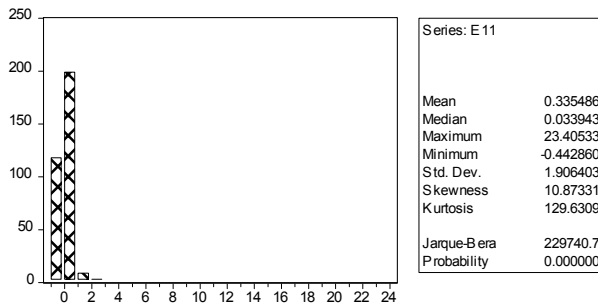


Figure 2. Curve of E11

As we show presently, we regress the exploitation on our variable. We find no significant correlation between the exploitation and SHS, VAL..... in an ordinary least squares model. But in a limited deviation model we get good results.

Table 1. Result of OLS about E11

	Coef.	Std. Err.	P
SHS	-.1485724	.6946697	0.831
BOA	-.0081529	.0190875	0.670
IND	.0086668	.0083883	0.302
DEB	1.170784	.3958883	0.003
VAL	-.0550807	.1427613	0.700
cons	.8719545	3.126126	0.780
F	2.06	Prob > F	0.0706

Table 2. Result of a limited deviation model about E11

	Coef.	Std. Err.	P
SHS	.1169074	.0557486	0.037
BOA	.0041314	.0015318	0.007
IND	-.0002662	.0006732	0.693
DEB	.1815789	.0317708	0.000
VAL	-.0435384	.0114569	0.000
cons	.8010618	.2508775	0.002
F	12.09	Prob > F	0.000

The indexes of the empirical results such as F-statistic are shown on the low level. The coefficients of the empirical results such as SHS, BOA, IND, DEB, VAL, are shown on the higher level of the Table 1 or Table 2.

The results indicate that the exploitation of control is positively related to the SHS under the level of 5%, negatively related to the VAL under the level of 5%, and so forth.

Just like the finding of YOU Daming, SHEN Yidong that “excessive benefits of control is positively relative with the degree of competition for control and the debt-to-asset ratio and passively relative with the

ratio of independent directors and the scale of the board of directors”. Now this part gives the evidence of excessive benefits in China based on limited deviation. According to the characteristics we further offer the research implications.

4 Research implications

Governance of the listed factory may be characterized as the system. Now the study enlightens the policy meaning -research implications- to lay the good foundation, such as to perfect the structure of corporate governance for stopping the controlling shareholder to exploit effectively with many ways:

The growth of the newly national economy needs encouraging the development in company system reformation for the small scaled business enterprise. We must construct a good environment to perfect the corporate governance. Company is needed to be a “social person”. In particular, it would be useful to encourage the disclosing of information. We must insist the principle of disclosing of information with “transparent, clear”. It is necessary to implement the adjustment of the cost and to promote the soft cultural strength.

We should train the employee with the basic and common sense to promote the business competitiveness. “Labor is privy to inside information on customers and suppliers and can hold up the controlling shareholder by threatening to withhold services.....” (Dyck). The high employer must treat the subordinate worker with the excellent service particularly for Chinese labor; the subordinate worker can treat the customer well for a second time. So the worker, employee, small shareholder will align against the exploitation by the controlling shareholder.

5 Summary

As far as the accurate road is concerned, the listed enterprise is important. The concept of exploitation over corporate resources has become one of the main focuses in corporate finance and financial engineering. The exploitation is a kind of excessive private benefits of control by the controlling shareholder. This excessive benefit exceeds the income of the controlling shareholder normally. It is the result of “hegemony” behavior, showing the maximization of the controlling benefits. Some related cases have taken place in two stock markets of Shenzhen and Shanghai concerning the transaction of control in the stage of 1999-2010. The substantial results indicates that institutions are most important in curbing the exploitation.

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