Imperfection of Protection System of the Rights and Interests of Minority Shareholders

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ABSTRACT

with the development of the market economy, the rights and interests of minority shareholders have been increasingly attached, but the problem is still not optimistic. There are usually conditions that the controlling shareholder infringes the minority shareholders. Damage to the rights and interests of minority shareholders will harm the entire society. Firstly, it will affect the operating conditions of listed companies. Secondly, it will restrict the effectiveness of the capital market and hinder the development of the national economy. The purpose of this article is to improve the enthusiasm of minority investors, so that companies can develop healthily, and the stability and prosperity of the capital market can be promoted. This article will first define some concepts and determine the research scope. After that, this article mainly compares the status quo of the protection of minority shareholders in China with that of foreign systems, so as to summarize the methods for the protection of minority shareholders in China.

Keywords: minority shareholders, protection of rights and interests, corporate law

1. DEFINE THE RIGHTS AND INTERESTS OF MINORITY SHAREHOLDERS

Minority shareholders refer to shareholders other than the directors, supervisors, senior managers, and shareholders who individually or collectively hold more than 5% of the company shares.

1.1 Rights and interests of shareholders

The concept of rights and interests of shareholders has been expounded in many disciplines, such as: accounting, finance, economics and law. These disciplines are highly related, so some disciplines have similar interpretations of rights and interests of shareholders. This article focuses on the concept of rights and interests of shareholders in law.

1.1.1 Viewpoint of explanations on rights and interests of shareholders in law

In law, the concept of the rights and interests of shareholders is also known as the “shareholder equity”, which has generalized and narrowed meanings. In a broad sense, shareholder equity refers to the various rights that shareholders can exercise against the company. According to this definition, if a shareholder is a creditor of a purchase contract, the creditor's rights to the company are also included in the broad sense. In a narrow sense, shareholder equity refers to the shareholders’ right to obtain economic benefits from the company based on their qualifications and to participate in the management of the company.[1] The shareholder equity in a narrow sense illustrates the essence of the shareholders’ rights and interests, thus being widely used in the practical application.

The academic circle of law has many classifications on the shareholder equity. The same as Japan, China divides the shareholder equity into self-benefit right and share-benefit right according to the exercising purpose. The American scholar Branting divides shareholder equity into property rights, control and management rights, relief and subsidiary rights according to the purpose of exercising shareholder equity; divides them into inherent rights and non-inherent rights according to their importance; divides them into general shareholder rights and special shareholder rights; divides them into legal shareholder rights and shareholder rights stipulated in the articles of association according to the origin of generating the shareholder equity.[2]

In this article, the self-benefit right and share-benefit right which are recognized in the law circle in China is used as the classification of shareholder equity.

1.1.2 Connotations of self-benefit right and share-benefit right

The existence of the self-benefit right is based on the individual interest of the shareholder and relies on the shareholder qualification. The self-benefit right in shareholder equity includes: the right to receive dividends in proportion to the capital
2. ANALYSIS ON DAMAGING THE RIGHTS AND INTERESTS OF MINORITY SHAREHOLDERS

2.1 Circumstance of infringing the rights and interests of minority shareholders

2.1.1 Insider trading

2.1.1.1 Concept of insider trading

Insider trading refers to the behavior that insiders who know the inside information of securities trading and those who illegally obtain inside information use inside information to buy and sell securities on their own, advise others to buy or sell securities or disclose inside information, or instigate others to use the information to buy and sell securities, thereby profiting or avoiding losses. Insider trading violates the “open, fair and justified” principle of the security market and seriously affects the function of the security market. In the meanwhile, insider trading losses the timeliness and objectivity of the security price and index formation process. It makes the security price and index become the result of minorities using the insider information to speculate, instead of investing the result of the public’s comprehensive evaluation on the company performance, so that the security market losses the effect of optimizing resource configuration and becoming the weatherglass of the national economy. The insider trading behavior will inevitably disorder the security market.

2.1.2 Unfair related transaction

2.1.2.1 Hazard of unfair related transaction

Formal and fair related transaction actually has a certain positive meanings. Related transaction can enable related parties to understand each other. In case of a problem, related parties can solve effectively, and can also save transaction costs, reduce transaction costs, improve capital utilization efficiency, and reduce information asymmetry, thus helping to expand the scale of the company, and making it develop towards the direction of group and multinational corporations.

Unfair related transaction goes against the principle of fair market competition. Unfair related transaction is also known as fraud in related transaction. It means that the managers with rights make full use of the related transaction to cover up losses, make up profits, and fail to make proper and adequate disclosures in the statements and notes as required. The resulting information will have a serious misunderstanding on the statement user. There are many types of of related transaction frauds, such as fraud in related purchase and sales, fraud in entrusted operation, fraud in fund transaction, and fraud in cost sharing, etc.

The unfair related transaction has many negative influences, first of all, it has influence on the listed company. Because the related transaction will make the listed company have a strong reliance on the related party, result in the declined market competition. In case of a problem of the related party, the listed company will probably standstill or even drop into the valley. Furthermore, if the related party has any improper capital registration to the listed company, whitewash the accounting statement, the covering of the listed company will probably be protected in the short period, but the problems will finally be exposed in the competition. Secondly, it will damage the interests of the creditors and minority shareholders. In order to increase the profits of listed companies and to protect the “covering” of listed companies, controlling shareholders will sacrifice their own interests, or create conditions for the issuance of bonds and stocks, but ultimately they will infringe the interests of creditors and minority shareholders. Since shareholders themselves may also lose money, too much capital injection is not a profit in the form of full cash, but only book profits. In the end, the listed company has made profits or raised funds to earn more funds through transfer of funds and profits. In the long run, this move harms the interests of minority investors and creditors.

2.1.3 Information manipulation

Information manipulation of listed companies will infringe the rights and interests of minority shareholders. The kinds of information manipulation are probably as follows: untrue and incomplete information disclosure;
non-disclosure of information; lag in information disclosure. The first two types are related to the quality of information disclosure, and the latter is related to the timeliness of information disclosure.

Untrue and incomplete information disclosure means that although the listed company has made information disclosure, for the purpose of raising funds or other purposes, the listed company conceals some unfavorable information to the company or discloses untrue information, which will eventually mislead the investment behavior of investors.

Information non-disclosure means that the listed company does not disclose the information that must be disclosed to investors. For example, when many listed companies disclose related party transaction information, they often avoid discussing their transactions and transaction content, or play down them, deliberately making investors unable to distinguish whether such related party transactions are legal or fraudulent. If some investors invest in listed companies with major problems, their rights and interests will be harmed.

The lag in information disclosure is a common method to infringe the rights and interests of minority shareholders. This kind of information manipulation is very unfavorable for minority shareholders to grasp and digest company information, which will affect their choices.

2.2 Reasons of damaging the rights and interests of minority shareholders

2.2.1 Imperfect inner control system of the company

In a modern enterprise, the general meeting of shareholders holds the equity, that is, ownership; the board of directors holds the right to operate the company; and a board of supervisors is set up within the company to supervise the company. It seems that a situation of separation of powers has formed, but in reality the shareholders’ meeting holds the real power of the company. The board of directors is elected by the general meeting of shareholders or the meeting of shareholders based on the principle of capital majority decision, so the controlling shareholder has the final decision on the members of the board of directors. Since the board of directors is formed in this way, the board of directors should be responsible for the interests of the controlling shareholder. In terms of the decision-making and governance of the company, priority should be given to the opinions of major shareholders. If the will of minority shareholders is inconsistent with that of major shareholders, such a governance structure will inevitably harm the interests of small shareholders. In addition, although the board of supervisors includes employees elected by employees, two-thirds of the supervisors in the board of supervisors are elected by shareholders. Such an employee structure will also result in the board of supervisors being controlled by major shareholders. In this case, the board of supervisors oversees the shareholders meeting and the board of supervisors only in form. This kind of internal control system of the company will of course harm the rights and interests of minority shareholders and is extremely detrimental to the long-term development of the company.

2.2.2 Concentrated rights of few shareholders

The problem of high concentration of equity exists in our country. Neither listed companies nor non-listed state-owned enterprises and private enterprises have escaped its influence. Moreover, the high concentration of equity has become the most significant and profoundly important feature of the entire governance structure in Chinese corporate governance. [4] Excessive concentration of equity is very likely to lead to the phenomenon of monopoly. In this case, a few shareholders actually control most of the company's power. In order to maximize their own interests, they are very likely to take actions that harm minority shareholders.

2.2.3 Weak right consciousness of minority shareholders

In China, most of the minority shareholders only regard investment as a financial management method, and they lack attention to the governance and operation of the company. At the same time, because they hold a very small proportion of equity, they have no right to speak. In addition, weak legal awareness has also become one of the reasons why their rights and interests have been violated. The current Company Law in China actually grants minority shareholders the right to file a lawsuit collectively, but in reality, many minority shareholders are not aware of using legal weapons to protect their interests.

3. STATUS QUO OF PROTECTING MINORITY SHAREHOLDERS IN CHINA

The Company Law of the People's Republic of China which is newly revised has the positive significance to protecting the rights of minority shareholders and restricting major shareholders from using the rights abusely.

3.1 Improvement of the new Company Law

3.1.1 Lay emphasis on protecting the minority shareholders’ right to be informed

Article 33 of the Company Law clearly stipulates that shareholders have the right to check and copy the
company's articles of association, shareholder meeting minutes, resolutions of the board meeting, resolutions of the supervisory board and financial accounting reports. This regulation expands the scope of shareholders' right to know, thus the scope of minority shareholders' right to know expands accordingly. In this way, to a certain extent, it can avoid the abuse of power by major shareholders to damage the right to know of minority shareholders.

3.1.2 Improve the vote system

According to article 105 of the Company Law, it can be known that the accumulated vote system has been adopted. This system gives minority shareholders the opportunity to select candidates who represent their own interests as the members of the board of directors or board of supervisors, so that these candidates will be able to participate in the business decisions of the company or provide necessary supervision to the managers of the company. This system reflects the will of minority shareholders, realizes the internal supervision of the board of directors or the board of supervisors in a certain degree, reduces the investment risks of minority shareholders, and avoids the monopoly of all members of the boards selected by controlling shareholders.

3.1.3 Improve the shareholder exit mechanism

Before the issuance of the latest company law, there was no provision regarding the withdrawal of share capital by shareholders in the old company law. Coupled with the voting system of capital majority voting, at this time, if the investment preference of minority shareholders is not in line with that of major shareholders, these minority shareholders can only passively accept the voting results of major shareholders. In the end, their own equity cannot be withdrawn, which damages their rights. However, the new company law has added provisions on the shareholder withdrawal mechanism. Under some special conditions and circumstances, shareholders can choose to withdraw their share capital and exit investment. With this provision, minority shareholders can protect their rights and interests in the above-mentioned situations.

3.2 Insufficiency of the new company law

Although some clauses in the newly revised Company Law have positive significance for protecting the rights and interests of minority shareholders, it also has some shortcomings.

3.2.1 Insufficient protection of the right to know

Although the scope of the right to know of minority shareholders has been further expanded in the company law, there is no detailed regulation on the conditions and background of the access to which the right to know applies. Moreover, when it comes to using the right to know to check accounts, the company law does not specify the scope of accounts in detail. In addition, in the specific operation and management process, because the major shareholder has the right to veto the relevant regulations of the enterprise and the company, it does not have much practical significance for the expansion of the right to know. [5]

3.2.2 Existence of the cumulative voting system

Although the new Company Law clearly stipulates the cumulative voting system, most of the cumulative voting in the operation and management activities of most joint stock companies is controlled by major shareholders, while the proportion of cumulative voting occupied by minority shareholders is very low. This provision also plays a small role. In practice, companies often ignore this system.

3.2.3 Difficulties in equity repurchase

The new Company Law clearly stipulates that when a company merges or separates, or when the company continues to be profitable for more than five years, minority shareholders can apply for share repurchase. [6] However, in practice, if minority shareholders want to repurchase their shares, they will suffer from a plenty of obstacles from major shareholders. The share repurchase system is one of the most important ways for minority shareholders to protect their rights and interests. However, because minority shareholders generally have a relatively low status and have no right to speak, it is easy for major shareholders to use their power to prevent from minority shareholders to repurchase shares. The system has a very good starting point, but if it can be improved, the rights and interests of minority shareholders will be well protected.

4. MECHANISM FOR FOREIGN COUNTRIES PROTECTING THE MINORITY SHAREHOLDERS

4.1 Protection mechanism in the United States

4.1.1 Voting trust system

This system started in the United States. It is a combination of trust system and voting right system. We all know that voting right is a very important right for shareholders. In the voting right system, the principle of capital majority decision will damage the rights and
interests of minority shareholders to a certain extent. The voting right trust system pioneered by the United States is to grant a trustee the right to vote on behalf of shareholders through a formal voting contract. This system plays a very important role in protecting the rights and interests of minority shareholders.

4.1.2 Distribution system for the surplus profits of shareholders

This system gives minority shareholders the right to file a lawsuit. When the company has behaviors such as maliciously distributes profits or distributes less profits, in order to protect their legitimate rights and interests, minority shareholders can file a lawsuit to the court to compel the company to distribute profits. However, if the company can prove that the reason for non-distribution or less-distribution is for the benefit of the company and all shareholders, the court can exempt the company from liability. The plaintiff needs to bear the responsibility of presenting evidence to the court, for example, the company does not need so much cash for circulation, the excessively high salaries of directors and supervisors, and the malicious decisions of the management layer of the company. All these can prove that the major shareholders have abused the advantage of controlling power to make the general meeting of shareholders to refuse to distribute the remaining profits. [7]

4.2 Protection mechanism in German

4.2.1 Shareholder voting right avoidance system

The shareholder voting right avoidance system means that when a matter that needs to exercise voting rights in a general meeting of shareholders has a certain interest in some shareholders, especially major shareholders, these shareholders cannot exercise their voting rights on this matter. For minority shareholders, this plays an extremely important role in protecting their rights. This system effectively avoids damage to the rights and interests of minority shareholders because of the power abusing of major shareholders.

4.2.2 Cross-shareholding restriction system

Cross-shareholding fundamentally damages the principle of equal rule of shareholders. Cross-shareholding refers to the fact that two or more companies hold shares mutually issued by each other for certain specific purposes, thereby forming cross-shareholding between corporate legal persons. [8] In this case, it is more convenient for the managers of the company to control the shareholder meeting of the other company. For example, it is possible to achieve this goal by falsely increasing the rights of some shareholders. Therefore, in order to limit the phenomenon of cross-shareholding, achieve fairness and justice, and maintain the internal order of the company, the German Corporate Law restricts cross-shareholding voting rights in a relatively complete manner. According to the relevant provisions of the German Stock Company Law, if a joint stock company and another company carry out cross-shareholding, then once one of the companies is aware of the existence of cross-shareholding phenomenon, the company owns a quarter of the equity in another company belonging to it, but new stock rights arising from the use of company funds to increase capital and the situation of listed companies’ general meetings is not included. In addition, cross-shareholding companies shall exchange information in a timely manner in written form, including but not limited to changes in the amount of shares. [9]

5. CONCLUSION

5.1 Improve the right to know of shareholders

The newly revised company law adds shareholders’ right to know, but its content is still incomplete. For example, the original vouchers are not stipulated as the documents can be consulted by the shareholders. However, if the original vouchers are unable to be consulted, it is impossible to truly master the real operating conditions of the company. Although minority shareholders can file a lawsuit in court when their rights and interests are damaged, the cost of litigation fees and litigation time is too high. There is no point in doing so. This runs counter to the original intention of legislators to protect minority shareholders. Therefore, in order to improve the right to know, the scope of shareholders’ access to the account books of the company should be expanded as much as possible. All accounting books that reflect the financial status and operating conditions of the company should be clearly stipulated within the scope that shareholders can consult.

5.2 Improve the cumulative voting system

The cumulative voting system is a very effective voting method. However, the newly revised Company Law has very few provisions on it, resulting in a very limited implementation scope of the system. The prerequisite for the effective play of the cumulative voting system is the convergence of the interests of minority shareholders. The current cumulative voting system is effective for joint stock limited companies, but it is required to prevent from the blocking effect to the company development because of the insufficient openness and publicity. The improvement of the cumulative voting system can stimulate minority shareholders to participate in company activities and enhance the influence of minority
shareholders. Therefore, China should insist on mandatory implementation of the cumulative voting system.[10] In some cases, minority shareholders cannot participate in the shareholders' meeting to vote. If the law can grant them the right to appoint an agent to attend the meeting, the minority shareholders can express their opinions and protect their rights.

5.3 Imperfect the share repurchase system

The share repurchase system is a beneficial system, and it can play an effective role for minority shareholders to stop losses timely. In order to better protect the legitimate rights and interests of minority shareholders, it is necessary to ensure that they are not obstructed by major shareholders when applying for share repurchase. Therefore, it is suggested that a third-party organization independent of the interests of major shareholders can be set up to specifically manage the approval of equity repurchase matters. In this way, the rights and interests of minority shareholders can be effectively protected, and the company can also be supervised, which is more conducive to the development of the company.

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