

## Research on Share Repurchase of Chinese Listed Company

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**Abstract.** On basis of elaborating on methods types, motivation classification and main target of share repurchase, it sorts through development status of Chinese share repurchase and makes in-depth analysis of problems existing in share repurchase of Chinese listed company and the causes as well as proposes countermeasures to solve these problems faced by listed company in their share repurchase.

### Introduction

Share repurchase refers that listed company buys back the outstanding stock issued by itself, which aims at reducing the number of outstanding stocks, improving profit level of each share and optimizing capital structure and increasing stock value etc. It is important means of enhancing intrinsic value of stock of listed companies and it is of crucial value for listed company. In matured international capital market, it is a kind of financial means widely adopted by listed company.

### Development Status Analysis of Share Repurchase of Chinese Listed Company

**Development of Share Repurchase in Chinese Listed Companies.** Can be divided into three stages:

#### (1) Initial Stage (1992-2005.06)

Share repurchase in China starts late. With Implementation of *Regulation on Stock Company*, and *Company Law of People's Republic of China*, the first buyback event--- Great Yu Garden's share repurchase of Small Yu Garden, occurs. In October 1994, Lujiazui Company implemented the capital reduction plan. In 1997, *Constitution Guidance of Listed Company* put forward specific requirements on share repurchase, in which way of listed company's share repurchase is clearly specified. Afterwards, Tsingtao Beer, ShenNeng Stock, Changchun High-tech, Yuntianhua and other companies release stock repurchase announcement successively, reducing proportion of state-owned shares through share repurchase, which effectively solves the problem of excessive proportion of state-owned share.

#### (2) Growth Stage(2005.06-2008.09)

In June 2005, *Administrative Measures about Social Public Stock Buyback of Listed Company (Trial)* has made a series of specific provisions from such aspects as conditions, methods, price and information disclosure of listed company's share repurchase. Then, Handan Iron and Steel successfully completed buyback of social public stock. According to CSRC' requirement, the problem that dominant stockholder embezzles resource of listed company must be fundamentally solved before the end of 2006. Therefore, there were 24 listed companies coordinating Non-tradable Shares Reform by adopting share repurchase. The number has exceeded total number of share buyback events happened in initial stage. Share repurchase in the stage is special transitional repurchase, which aims at promoting in-depth Shareholding System Reform and avoiding behaviors damaging interest of enterprise investors and creditors. "Shares to offset debts" is the most distinctive feature of share repurchase at the moment. In addition, a majority of circulating stocks are repurchased at the stage, writing a new page for breaking through the historical limitation of repurchasing non-circulating shares. Besides, implementation of circulating

stock repurchase in Stock Exchange through centralized price bidding provides new idea for promoting rapid development of domestic financial market.

(3) Development Stage (October 2008 to present)

In October 2008, *Supplemental Provisions about Listed Companies Share Repurchase Based on Centralized Price Bidding* has cancelled the administrative examination and approval system about share repurchase, which makes share repurchase gradually meet requirement of markeization. In addition, *Supplemental Provision* has made detailed regulation on how to disclose relevant information to society. For listed company belonging to one of the following seven circumstances and not affecting its sustainable operational ability, it will be encouraged by Stock Exchange to conduct share repurchase. As affected by America subprime mortgage crisis in 2008, Chinese stock market has presented a state of sustained depression. A number of listed companies conduct share repurchase in order to enhance the share price. Stock repurchase in China enters a new period of rapid development.

There are 28 listed companies from 2007 to 2011, 40 in 2012, 60 in 2013, 78 in 2014, 165 in 2015, and 105 in the year 2016 as of the end of March releasing shares repurchase, from the time point of view, the number of shares repurchase of listed companies distributes as shown in Figure 1.

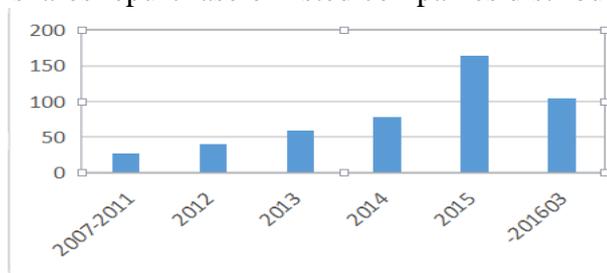


Figure1. the number of shares repurchase of listed companies distributes

**Characteristic of Share Repurchase of Chinese Listed Company.** (1) Laws and Regulations Related to share Repurchase of Chinese Listed Company

Special legislation includes *Administrative Measures about Listed Company's Repurchase of Social Public Stock (Trial)* and *Supplemental Provisions about Listed Companies Share Repurchase Based on Centralized Price Bidding*; other relevant regulations are listed in *Normative Opinions about Stock Company*, *Contract Law*, *Essential Clauses in Constitution of Overseas Listed Company* and other laws and regulations.

(2) Share Repurchase Way of Chinese Listed Company

Repurchase by agreement is the main way of share buyback in initial stage. *Constitution Guidance of Listed Company* has stipulated three ways of share repurchase: publicly traded repurchase, equal-proportion tender offer and other ways recognized by CSRC.

(3) Motivation of Share Buyback of Chinese Listed Company

Motivation of share buyback in China mainly includes the following several types:

① Optimizing the equity structure, realizing reduction proportion of state-owned shares.

In earlier stage, the equity structure problem the state-owned share or the State-owned corporate share is the “overwhelming shareholder” is solved by directional repurchasing. It not only improves equity structure of listed company but also benefits rising of share price. Typical representative of repurchase motivation is share buyback implemented by Lujiazui in September 1994.

② Non-performing asset stripping promotes smooth development of share-split reform

In April 2005, *Notice of Relevant Problems Existing in Share-Split Reform Pilot of Listed Company* was introduced, which intensifies contradictions between shareholders of circulating stock and non-circulating stock. Effective way of solving the contradiction is share repurchase.

③ Effectively solving dominant stockholders' capital occupying

*Opinions on Improving Quality of Listed Company* requires all substantial shareholders to liquidate the occupied capital before end of 2006. As a majority of shareholders are unable to pay back occupied capital, the listed company adopts share repurchase. That is to say the major

shareholder pays back the occupied capital through selling equity. After completion of buyback, capital quality of listed company will see obvious improvement.

④ Improving company value, stabilizing share price

During depression of share market, some stocks are underestimated by market so that the share price is lower than net value. In order to stabilize the share price, further improve the company value and stiffen the confidence of growth, listed companies often adopt share repurchase based on such purpose.

⑤ Implementing the equity incentive plan

According to *Guiding Idea about Share-split Reform of Listed Company (2005)* jointly issued by CSRC and other four ministries and commissions, Normative Opinion of Listed Company's Equity Incentive issued by CSRC (2006), listed company may implement equity incentive in management level through refinancing after completing the share-split reform

In above motivation analysis, the first three motivations are of Chinese characteristic.

## **Problems Existing in Share Repurchase of Chinese Listed Company and the Causes**

**Legal Issues Existing in Share Repurchase of Chinese Listed Company.** (1) Law Enforcement Basis for Share Repurchase:

Before 2005, listed company's share repurchase must pass examination and approval of relevant functional departments before implementation. From perspective of law, applicable scope of share repurchase shall be strictly restricted. Its applicable scope is extremely narrow, merely limited to reducing holding of state-owned shares, capital decrease, consolidation and other matters related to share buyback. Share repurchase beyond the foregoing cases must go through administrative examination and approval. There is absence of detailed regulation on specific operation and supervision of share buyback. After 2005, Chinese law gradually releases the control over share buyback, which not only gives more independence to listed companies for their share buyback but also enlarging the range of repurchase reasons. In addition, procedure, time, price of share repurchase and stock rights, punishment, information disclosure announcement, punishment of illegal acts etc. are made clear through administrative rules, self-discipline regulations etc. It enriches and improves relevant laws and regulations about share repurchase of Chinese listed company so that it will more operable and legitimate interest of small and medium shareholder and creditors can be better guaranteed. However, these laws and regulations still suffer some deficiencies.

(2) Unified Scope of Share Buyback Reasons

Chinese *Company Law* conducts strict supervision and management over share buyback of listed company. According to Chinese *Company Law*, reasons of listed company's share buyback include staff reward, consolidation, capital reduction, dissent shareholders' exercise of repurchase right etc. The listed company shall not repurchase its shares beyond the four circumstances. Afterwards, *Repurchase Guidance*, encourages listed company who is under the following seven circumstances: suffering long term underestimation of share price, possessing great deal of idle capital and there being great price difference between different kind of stock issued etc. and whose sustainable operating ability will not be affected to implement share buyback. That is to say, if listed companies meet the foregoing conditions, their share repurchase is allowable. Control over share buyback in law is released to a certain degree.

(3) Obscure Regulation about Share Buyback

Chinese laws are incomplete in stipulation of capital source, price and quantity of listed company's share buyback.

(4) Unclear Rights of Repurchased Share

① Rights of repurchased share

According to Chinese *Company Law*, repurchase share has no voting power, can't share profit. However, there isn't clear provision about whether it enjoys other rights. Therefore, whether the repurchased share enjoys other rights except voting power and profit distribution right, there will be

different results according to different legal documents.

#### ② Disposal of repurchased share

It is strictly prohibited by law that Chinese listed company possesses its own shares. Therefore, repurchased share must be written off or transferred within certain period. The processing method is relatively simple.

#### ③ Unclear Effectiveness and Ambiguous Punishment of Illegally Repurchase Share

Chinese law has no clear regulation about effectiveness of illegally repurchased shares. In regard to effectiveness of illegally repurchase share of listed company, there are four views: effectiveness theory, ineffectiveness theory, relative ineffectiveness theory and reversibility theory.

#### ④ No Definition of Share Buyback Evading Legal Regulations

Activities of listed company in its own name are stipulated in Chinese Law. Acts of listed company in name of others haven't been clearly defined. When the listed company purchases its own shares in name of the third party or its subsidiary company in pursuit of its own interest, superficially, the third party or subsidiary company holds the shares. In fact, it hinders management and operation of the company. On the other hand, expense of third party or subsidiary company for share purchase is usually borne by the listed company itself, which will affect capital of listed company and causes damage to interest of creditors.

**Information Disclosure.** One on hand, share repurchase hasn't been listed in "major event" of *Security Act, Administrative Measures for Listed Company's Information Disclosure* and *Provisional Regulations on Stock Issuance and Transaction Management*. Law avoidance is easy to occur.

On the other hand, in *Repurchase Guidance, Repurchase Approaches* and *Supplemental Regulation* information disclosure is merely stipulated in offer buyback and centralized bidding buyback; while it hasn't been stipulated in repurchase by agreement. Therefore, there is dead zone of legal provisions.

**Insider Trading and Market Manipulation.** On one and, share repurchase isn't clearly included in laws of insider information. Phenomena of law avoidance are easy to occur. On the other hand, supervision and management mechanism which realizes dynamic reflection of actual purpose of share repurchase hasn't been created. It is more covert to conduct interest transfer in insider trading and market manipulation.

## **Problems of Chinese Listed Company's Share Buyback and Countermeasures**

**Strengthening Top-level Design; Improving relevant Laws and Regulations.** From a global point of view, a majority of countries have gone through the legislation history from no express stipulation to exceptions and the legal regulations develop from legal precedent or simple, general provision into detailed stipulations. Share buyback is new things with development of our country. We should strengthen the legislation of share buyback and make constant improvement and development in practice.

#### (1) Enlarging applicable scope of share buyback

On one hand, relevant provisions about enlarging buyback reasons; on the other hand, legal documents at different levels are closely connected to form integrate regulations of buyback reasons, safeguarding its legal force and authority, giving full play to the guiding role of law in subject market.

#### (2) Clear and specific regulation on share buyback

Including: restricting quantity, capital source of share buyback and share; defining decision-making body of share buyback, protection of creditor and voting system and other procedures; defining rights and interest, punishment of share buyback; confirming effectiveness and liability of illegal buyback; preventing law avoidance phenomena. Listed company's acquisition of its own shares in name of third party or subsidiary company for seeking own interest shall be deemed as listed company's repurchase of its own shares. Shares acquired by repurchase shall be consolidated into shares of listed company itself. The quantity shall not exceed the limitation by law

and other requirements shall conform to relevant regulation of listed company's share buyback.

(3) Improving content of information disclosure

It is fully demonstrated by some cases of share buyback that there is serious information asymmetry in capital market. We should establish, improve and perfect the information disclosure system. The listed companies are required to disclose various information of share buyback more promptly and adequately so as to greatly prevent interest of small shareholders from being encroached by major shareholders.

(4) Enriching way of share buyback

Repurchase means, as important motivation for announcing and implementing share buyback and significant criterion of investor's value judgment, is playing a more and more decisive role in capital market. Different repurchase ways will have different impact on economic result of listed company. With rapid development of national economy and gradual improvement of capital market, our country makes constant efforts to enrich way of share buyback so as to meet increasing and diversified buyback demands of listed company.

**Reinforcing Supervision of Law Enforcement.** Relevant Security Regulatory Authorities shall strengthen follow-up and supervision of disclosed information of listed company and set up dynamic and real-time supervision mechanism, increase penalties for misconduct that violates relevant regulations and prevent insider trading and market manipulation.

**Enhancing Consciousness of Responsibility.** The intermediary organ shall give full play to its role of verification and supervision. Relevant independent financial adviser and other department of listed company shall make full use of their own professional advantages and closely cooperate with relevant department, with an attitude of being practical and realistic, fair and impartial so as to carry out whole-course effective supervision on share buyback of enterprise and promote sound and orderly development of share buyback.

**Enhancing Awareness and Preventing Risks.** The listed company shall dominate relevant theory and laws, regulations of security market and share buyback, have clear understanding about significance of share buyback so as to choose the appropriate way of share buyback according to practical situation of company and strength prevention and control over buyback risk.

**Exploring the Rule and Grasping the Characteristic.** Motivation of share buyback mainly includes financial leverage hypothesis, signal transmission hypothesis, tax avoidance hypothesis, free cash flow hypothesis etc. However, a majority of Chinese listed company's announcement and implementation of share buyback is based on such special motivations as improving equity structure of enterprise, and stripping non-performing asset of company. Chinese capital market shall make further and in-depth exploration of motivation and internal characteristic of share buyback of listed company from multiple perspectives, and fully exert the function and value of capital operation in share buyback.

**Firm Development of Self-discipline Consciousness, Safeguarding Rights and Interests of All Parties.** The listed company must take rights and interests of creditors and small and medium shareholders into full consideration, strictly comply with relevant provisions about share buyback, ensuring timeliness, authenticity, completeness and accuracy of buyback announcement, establish regular notification system of important information, establish and improve scientific equity balance system and decision-making mechanism.

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