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Research on the Relationship between the Proportion of the Actual Controller and the Growth of the Chinese Listed Companies

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ABSTRACT

After a sustained decline of IPO activities in 2018 and 2019, global IPOs recovered to be active in 2020, with 1,591 IPO companies raising US$331 billion globally, increased by 42% year-on-year. This includes 502 IPOs in Mainland China, another strong driver of IPO growth besides the U.S. (Baker & McKenzie, IPO Report 2020 and Key Trends 2021). Since 2013, the number of IPOs and fundraising in China have showed an upward trend, with more than 4,100 companies currently listed in Shanghai and Shenzhen Stock Exchangs. The buoyancy of IPO activity in China has benefited from a series of capital market reforms since the 18th National Congress of the Communist Party of China. The introduction of a number of promoting policies and mechanisms have encouraged high-quality development of market players. The implementation of registration-based Sci-Tech innovation board and the Growth Enterprise Market (GEM), in particular, accelerated IPO activities.

Since the inception of Shanghai Stock Exchange and Shenzhen Stock Exchange in 1990s, the companies that are listed on Chinese stock exchanges have been playing a prominent role in Chinese economy. In recent years a number of listed Chinese companies with strong global competitiveness were listed as the world's top 500 enterprises. The total profit of the listed companies is equivalent to that of the half of the national enterprises above designated size, becoming the foundation of the national economy and the leader of industrial upgrading. However, while seeing the huge contribution of the stock exchanges, it is also necessary to see the extreme imbalance in the development of listed enterprises. When outstanding listed companies keep expanding themselves, loss-making enterprises were widening the profit gap. In the “2019 Overall Annual Analysis Report" published by the Shanghai Stock Exchange, the total annual operating revenue reached to 37.21 trillion yuan, increased by 9% year-on-year. In the “2020 Overall Annual Analysis Report” published by Shenzhen Stock Exchange, the total annual operating revenue achieved 14.8 trillion yuan, increased by 8.1% year-on-year. In Shanghai Stock Exchange, more than 60% industries realized growth in net profit in 2019 but nearly 40% of the industries declined. Moreover, 16.9% of enterprises listed on Shenzhen Stock Exchange suffered from lost in 2020, increased by 3.9% compared with 2019, with

unbalanced performance.

Solving the problem of unbalanced development among listed companies, consolidating the foundation of economic growth and promoting high-quality development of listed companies have always been the focus of government authorities and academics. As an important index to measure the operation condition and development prospect of a company, the study on the growth of listed enterprises has always been the focus of research by academics and practitioners. For listed companies, apart from external factors such as policy, industry environment and scale of the company, internal factors such as products, financial condition and governance structure will also affect the growth of the companies. As an important element of the corporate governance structure, ownership structure is the key to connect the internal and external governance environment, which directly reflects the structure of the shareholders' meeting and greatly influences the design of the shareholders' meeting and the corporate governance structure.

In terms of the growth of companies listed in different exchange market, enterprises listed on the Growth Enterprise Market (GEM) that of new technologies, new industries, new business models and new modes show a strong growth trend and distinguished growth features. Among GEM listed companies, more than 90% are high-tech enterprises, over 80% have independent core R&D capabilities, more than 70% are in strategic emerging sector, the average annual compound growth rate of total business revenue in the past 5 years was 22.9% and over 30% of the companies have their year-on-year net profit growth rate surpass 20% (Source: Hexun.com). Therefore, the author decided to take the shareholding of the actual controller as the entry point, to study the influence mechanism between the shareholding ratio of the actual controller and the growth of GEM-listed enterprises from the perspective of optimizing internal governance structure through improving shareholding structure.

This dissertation reviews domestic and foreign literature concerning corporate growth and the impact of ownership structure on corporate growth based on the principal-agent theory and corporate growth theory, taking the actual controller’s share proportion as the starting point. After comparing the differences of corporate growth under the charge of three typical actual controllers with different share proportions in Company A, B and C, further study was

conducted with GEM listed companies over the period of 2009-2020. The finding reveals an inverted U-shaped correlation between the shareholding ratio of the actual controllers and corporate growth among GEM listed companies. When the shareholding ratio of the actual controller exceeded 46.67%, the entrenchment effect may emerge between the actual controller and the company. R&D intensity positively moderates the relationship between the actual controller and corporate growth, i.e., the higher the R&D investment, the steeper the inverted U-shaped curve. This finding was also verified in companies where the actual controller is a natural person and the actual controller adopts indirect shareholding, with the shareholding ratio being 50% and 33.33% respectively. For listed companies where the actual controller is controller is the state-owned in nature, such relationship was negative, which indicates that greater flexibility should be given to such innovative companies. Moreover, when the actual controller adopts direct shareholding or mixed ownership, the actual controller and the listed company are more closely related with a positive relationship between the shareholding ratio of the actual controller and the growth of the enterprise. In addition, it was found that when the actual controller is a natural person, both indirect shareholding and R&D intensity may positively regulate the relationship between the actual controller and corporate growth.

Based on such findings, the author proposes following suggestions to improve the growth of GEM listed companies: firstly, it is necessary to provide training on the equity tools of the capital market for the actual controllers to improve the growth of companies. Secondly, it is necessary to bind the interests of the actual controllers with the listed companies closely to make an interest convergence effect between the two. Thirdly, to provide guidance on equity structure design for various types of listed companies.

Keywords: Share proportion of actual controller, Corporate growth, Ownership structure, Corporate governance

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