A shadowed legal transplantation: takeover defence regulations in China

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***J.B.L. 30** **Abstract**
Hong Kong served as a significant intermediary in the legal transplant of takeover defence regulations from the UK to mainland China. The article aims to investigate whether the transplanted takeover defence regulation in China is in line with its highly concentrated ownership structure and current model of corporate governance.

Introduction

In 2010, China overtook Japan as the world's second-biggest economy[1] making it the first country to surpass Japan in more than 40 years.[2] In October 2014, China's citizen's purchasing power parity outstripped that of the US citizens becoming the world's largest according to the IMF.[3] This extraordinary economic growth has been reflected in the Chinese securities' market over the last two decades.[4] Shanghai has now been considered as a world-class financial centre, increasingly being mentioned in the same terms as the traditional global financial centres.

In 2005, China launched a Non-tradable Share Reform aiming to gradually liberate all non-tradable shares that could not previously be traded openly to the market. Prior to that reform, two thirds of the shares in the Chinese securities ***J.B.L. 31** market were non-tradable.[5] This evolutionary liberalisation in the liquidity of shares, together with the continuous opening up of the market to the rest of the world and the launch of schemes attracting foreign investment such as Qualified Foreign Intuitional Investors and RMB Qualified Foreign Institutional Investors, have increased the likelihood of cross-border hostile takeovers and takeover defence activities. This is because there are now more shares available in the market and more capital (foreign and domestic) being pumped to trade in these shares. From 1993 to the end of 2002, the total value of merger and acquisition deals in China was US 7.3 billion,[6] whilst in 2018 alone, domestic merger and acquisition deals in China achieved a total value of US 371.5 billion, a 36.4 per cent increase from 2017.[7] This extraordinary upsurge of M&A activities alongside the potential increase in takeover defence from the target firms necessitates a review of the existing regulatory framework for takeover defence mechanisms in China.

Prior literature on takeover defences in China is mostly based on existing regulations and focuses on their restrictive nature.[8] Little has been written on fundamental issues such as whether current takeover defence regulation is in line with the existing ownership structure and models of corporate governance and if possible misalignment affects the achievement of such legislative goal, i.e. whether the most vulnerable constituent of shareholders in a takeover event is accurately identified and sufficiently protected.

To address these questions, this article analyses the development of the takeover and takeover defence regulations in the UK and China from a comparative perspective. The reason for adopting such an investigative approach is that takeover defence regulations in China were borrowed heavily from the UK via Hong Kong.[9] Currently similar to the UK and Hong Kong, the power to decide on takeover defence actions in China is granted to the general meeting of shareholders. This article argues that this is in line with China's ownership structure and corporate governance model. This model of takeover defence regulation, however, contributes towards majority shareholder dominance. The extremely concentrated ownership and weak control of the state in the securities market has resulted in majority shareholder dominance in China. As a consequence, the most vulnerable constituent of shareholders in a takeover event is the minority shareholders, but not shareholders as a whole. The power given to general meetings to make decisions regarding takeover defence can be abused by dominant majority shareholders to retain corporate control and pursue their own self-interest. The discipline function of takeovers is thus diminished. ***J.B.L. 32***

This article is structured as follows. The first part examines the phenomenon of global convergence and divergence of corporate governance and sheds light on the theory of path dependence, which provides a theoretical basis for the subsequent analysis. The second part documents the legal transplantation of shareholder-centric takeover defence regulations from the UK to China via Hong Kong. The third part of the article examines how the self-regulation model of takeovers and takeover defence regulation in the UK was established and how the current model of statutory regulation with strong self-regulatory characteristics has evolved from that. It also analyses the highly diverse shareholding structure in the UK in which the shareholder-centric takeover and takeover defence regulation is rooted. It then gives an overview of the establishment of the takeover and takeover defence regulation in the Chinese securities market and goes on to reveal how the corporatisation and privatisation of State-Owned Enterprises (SOEs) impact on the creation of China's securities market, resulting in the special feature of China's ownership structure; that is, an extremely concentrated shareholding structure by the state but with weak control. Consequently, unlike the typical agency problem faced by firms with sufficient dispersion of their shareholders' base the main problem faced by Chinese firms, in terms of corporate governance, is the conflict between majority and minority shareholders due to the presence of a highly-concentrated ownership structure. Finally, the article sheds more light on the aforementioned issue. It argues that the difference in ownership structure between China and the UK affects the key issues of corporate governance in these two countries. British diverse ownership structure correlates with shareholder-management conflict. Shareholder-centred takeover defence regulation serves the legislative purpose of restricting management from exploiting shareholders' interests. On the contrary, the extremely concentrated shareholding structure of Chinese firms results in majority-minority shareholder conflict.

Path dependence

The convergence of international corporate governance and laws has been a contested issue in the last two decades.[10] It is argued that the convergence is driven by companies under pressure to adopt the best structure to avoid risks and failures in global competition.[11] Gordon and Roe extensively studied economic globalisation and its impact on the convergence and divergence of the global corporate governance system.[12] The global economic integration urges companies to compete with foreign firms that are structured and governed differently. At a macro level, integration pushes countries to compete with each other to adopt the best corporate regulations in order to attract foreign investment and promote their businesses to generate national wealth.[13] The legal transplantation is particularly widespread in ***J.B.L. 33*** emerging markets. Developing countries often adopt corporate legislation and regulations into their local regimes from countries with mature corporate legal systems. The legal transplantation of takeover defence regulations from the UK to China is an example of this. The success of the legal transplantation is, however, largely subject to a country's political, historical, social and cultural background, since legal norms need to take into consideration social norms to achieve efficiency.[14]

In the realm of corporate governance, it is frequently adopted to explain the persistence and divergence of corporate governance[15] and other phenomena in the broad areas of commercial legislation, notably company law and securities law.[16] Bebchuk and Roe[17] argue about the importance of a country's pattern of corporate ownership as a source of path dependence. Countries with similar economies may still differ because of differences in their ownership structures at earlier points in time. They argue that prior ownership structures affect subsequent structures on the grounds of efficiency due to sunk adaptive costs, network externalities, complementarities and multiple optima, etc.[18] The initial ownership structure also influences the subsequent structure because of rent seeking; existing structures can persist due to the retention of rent seeking opportunities.[19] The "beneficiaries" or controllers will have "the incentive and power" to maintain the existing structure and avoid the loss of their private benefits (structure-driven path dependence).[20] This "rent protection" theory is also adopted by Coffee to prove that concentrated ownership will prevail over dispersed ownership when the private benefits of control are high.[21] In countries where legal rules favour controlling shareholders and encourage the presence of such controllers, the controlling shareholders' political power will be enhanced, and the country will be more likely to retain such rules (rule-driven dependence).[22]

The theory of path dependence provides a theoretical basis for the influence of the ownership structure on corporate governance, takeovers and takeover defence regulations. It therefore helps to explain the problems that can occur when countries with different ownership structures adopt the same model of corporate regulations. In the context of this article, the problems highlighted are those faced by China ***J.B.L. 34** due to the transplantation of British style shareholder-centric takeover defence regulations.

The legal transplantation

General Principle 3 of the City Code on Takeovers and Mergers (City Code) ensures the shareholders' "opportunity to decide on the merits of the bid",[23] whilst General Rule 21 forbids conduct that potentially frustrates takeover bids without shareholder approval. These rules, together with previous rulings of the Panel on Takeovers and Mergers,[24] the watchdog of takeover transactions in the UK, on takeover defences, have showed the Panel's intolerance toward takeover defences without shareholder approval and have effectively restricted managements' temptation to indulge in such practice.

Rule 4 of the Codes on Takeovers and Mergers and Share Repurchases in Hong Kong (Hong Kong Codes), which addresses takeover defence actions in Hong Kong, largely echoes the approach adopted by General Principle 3 and Rule 21. It emphasises the shareholder's right to decide on the merit of a takeover bid and forbids the board of an offeree company from taking actions that may frustrate a bona fide offer before shareholder approval. In addition, it prohibits the offeree company from purchasing or redeeming its own shares when a takeover bid is launched.[25]

According to the Measures for the Administration of the Takeover of Listed Companies 2006 in China (the Measure for Takeovers), takeover defence practice in China is also subject to the discretion of the general shareholder meeting. Article 33 of the Measure for Takeovers holds that, without the approval of the general shareholder meeting, the offeree company is prevented from affecting the company's assets, debts, interests or annual turnover by deploying company assets, making outwards investment, changing the company's business strategy, providing warranties for loans or obtaining new loans, and signing any contracts other than in the ordinary course of business, once the takeover bid has been announced. Article 8 of the Measure for Takeovers holds that the board of directors, the supervisory board and the managers of the offeree company owe fiduciary duty and duty of care to the company and must not abuse their power by setting "inappropriate obstacles" to frustrate bids. Article 8 also states that all bidders bidding for the offeree company should be treated equally and the offeree company is not permitted to finance its bidders in relation to the bid.[26]

In all three jurisdictions, the UK, Hong Kong and China, the offeree company is prevented from deploying takeover defences without shareholder approval.

Corporate and securities regulations in Hong Kong are largely inherited from the UK due to its pre-1997 British governance. The earliest Hong Kong Companies ***J.B.L. 35** Ordinance was modeled based on the British 1929 Companies Act.[27] The first Commissioner for Securities in Hong Kong's securities market was a former economist of the Bank of England. The Code on Takeovers and Mergers and Share Repurchases of Hong Kong was produced in 1975 based on the Takeover Code in the UK.[28] Consequently, takeovers and takeover defences in Hong Kong are regulated in a similar manner to the UK.

The British model of securities regulation started being transplanted to China via Hong Kong since the early 1990s. As China's "window to the world", Hong Kong plays a vital role in introducing western legal concepts and regulatory models to mainland China; hence, acting as an intermediary in introducing and transplanting British financial regulations, including that of takeover defences.[29] China gradually evolved into Hong Kong's natural resource supplier and manufacturing site after China's open door policy in 1979.[30] Investment from Hong Kong surged during the 1980s and 1990s.[31] This effectively contributed to the formation of the "front shop, back factory" economic model between Hong Kong and the mainland at the time.[32] During the same period, Hong Kong upgraded its economy by transforming itself into a business and financial service centre for the mainland and the rest of the world. Hence, with China seeking to establish a modern securities market, Hong Kong, as the "front shop", was a natural choice for China's authority to import sophisticated securities rules from a comparatively more mature jurisdiction.

Experts in the securities' supervisory body in Hong Kong were constantly consulted on legal and policy issues by their counterparts in China when the latter was establishing its securities market in the early 1990s. One of the aspects consulted was about choosing the most suitable supervisory model for the securities and futures markets. Guogang Yu, the founder and first deputy manager of the Shenzhen stock exchange said that he translated all securities regulations of Hong Kong into Chinese when he was preparing for the establishment of Shenzhen Stock Exchange in the 1990s in order to introduce a similar regulatory framework.[33] This open communication and co-operation amongst the various exchanges continued ever since, with Yongwu Fan, the director of the Department of Supervision on IPO in the China Securities Regulatory Commission's (CSRC) stating, in 2009, that they communicate frequently with the Securities and Futures Commission of Hong Kong on issues related to securities regulations.[34]

The co-operation of securities regulation authorities in China and Hong Kong in co-issuing China's H shares in Hong Kong Stock Exchange in 1993 further strengthened the legal collaboration and transplantation. It aligned the level of ***J.B.L. 36** shareholder protection, corporate governance, disclosure standard, and accounting standard of large SOE companies in mainland China with those in Hong Kong.

Further, the CSRC's important ministry level appointment of previous officials from the Securities & Futures Commission of Hong Kong (SFC) also contributes to the legal transplant. One of the appointed officials, Mrs Laura Cha, former vice-chairwoman of the SFC, was in charge of policy-making and regulatory compliance for merger and acquisition, and initial public offerings. During her term in office, she introduced a key regulation regarding the supervision of takeovers and takeover defence mechanisms, namely the Measure for Regulating Takeovers of Public Listed Companies 2002 of PRC (the Measure 2002). The key aspects of the Measure 2002 are very similar to the Hong Kong Codes.

At the market level, the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed in 2004 lowering the entry requirement for market access to each other's securities, financial and legal services. This agreement greatly enhances the interaction of securities practitioners and the integration of relevant regulations.[35]

Last but not least, the composition of the International Advisory Council (IAC) which is a crucial consultation body on the further opening up of China's security market of the CSRC also suggests the influence from Hong Kong and the UK is larger than that of any other countries or regions in the world. One third of the members of the IAC have British or Hong Kong background. This also indirectly signals the crucial intermediary role of Hong Kong in passing the British model of securities regulations to China.[36]

Takeover defence regulations in the UK and China

The theory of path dependence reveals a significant correlation between ownership structure and corporate regulations. As argued by Bebchuk and Roe, a country's legal rules are greatly impacted by its current and prior ownership patterns. This is emphasised in the case of transplanted legal rules, since the efficiency of those rules is subject to their alignment with the host country's ownership structure, as well as political, historical, social and cultural backgrounds. Therefore, analysing the social norms in which the regulated subject matter operates and the ownership structure under which it develops is vital when assessing the efficiency of the transplanted regulation. Consequently, takeover defence regulations should be analysed in the social context of the counties that they operate in.

The City Code

When the first wave of mergers hit the UK in the 1920s, British family-owned businesses started selling stakes on their businesses through promoters, swapping their ownership for portfolio diversification purposes. The surge of mergers ***J.B.L. 37** represented the start of the modern corporate economy in the UK.[37] Mergers were favoured and believed to be a better solution than a cartel or association in the face of economic depression and overcapacity.[38]

Merger deals in the 1920s were mostly consensual.[39] Only when the "real" takeovers started was the divorce of ownership and control greatly accelerated and the market for corporate control facilitated.[40] It was not until 1953 that the first publicly known hostile takeover, Charles Clore's bid for J Sears & Co, occurred. Clore, a businessman, successfully took over the undervalued J Sears, a company owned shoe shop chain,[41] despite "primitive" takeover defences adopted by the managers.[42] The Bank of

England (BoE)decided that takeovers should be described as "manoeuvres" against national interests.[43] Another notable incident relating to early takeovers was the attempted takeover of the Savoy Hotel in 1953.[44] The Chancellor was requested to write a takeover briefing note on it by the Prime Minister.[45] Takeovers were described as speculation and financial manipulation that were harmful to the public. A similar conclusion was drawn by the Board of Trade.[46] Takeover defences were also adopted in the Savoy takeover[47]; however, the board's self-defence provoked the City and was criticised as dangerous behaviour, splitting asset ownership and control. The defence did not take place and eventually the "crisis" was resolved by the Savoy directors repurchasing shares from the bidder.[48] Mr Milner Holland QC concluded that the proposal should be invalid, since the directors' intention was also to restrain the present and future use of the property, which breached their fiduciary duty.[49] The resolving of cases such as the Savoy demonstrated the legal uncertainty around takeover defence.[50]

The British Aluminium Co in 1958 overturned the City's hostile attitude toward takeovers and triggered a legislative response from the BoE) and the City.[51] British Aluminium represents the conflict between advocates of governmental intervention and those of self-regulation. It highlights the City's fear and dislike of governmental intervention in financial transactions. The BoE, which gradually realised the ***J.B.L. 38** "harmlessness" of takeovers, soon convened a conference on the self-regulation of the market for corporate control amongst City takeover practitioners in July 1959. The participants in the conference included the BoE) and representatives of institutional investors in the City.[52] The Notes on Amalgamations of British Businesses was promptly completed, expressing the principle of a free securities market, with no governmental interference.[53] In 1967, after concern over the government's threat to regulate takeovers by statute,[54] the Notes were amended and turned into a comprehensive handbook, the Takeovers Code. The Code strictly forbade the board of a target company from conduct that was potentially frustrating to a takeover, once it had become aware of a takeover bid.[55]

It is argued by Armour that the UK's self-regulatory model was driven by the "preponderance of institutional investors in the marketplace, and a regulatory framework that trusted them to govern themselves" because of the rapid expansion of collective investment vehicles caused by strict personal taxation and their status as a safe harbour for pensions since the 1930s.[56]

The Takeover Panel was established in 1968 and as much as 575 cases were handled successfully by the Panel in its first 12months of operation.[57] Since its establishment, although the Panel's role was altered from time to time following frequent amendments to the City Code, the alterations were not substantial until 2006, when the Panel was conferred statutory status upon the adoption of the EU Takeover Directive. Nevertheless, the Panel largely retained its self-regulatory feature.

The self-regulatory nature of the Panel altered upon the enactment of the 2004 EU Takeover Directive. After the Directive's incorporation into the Companies Act 2006 (CA 2006),[58] the Takeover Panel officially became a statutory body with statutory authority. It is now an unincorporated body that may sue and be sued in its own name.[59] This change raised concerns over potential damage to the consensual flexibility with which the Panel had operated up to that point, and led to more obstructive litigation.[60] Nevertheless, despite the Panel being granted the status of a statutory body, its self-regulatory feature remains strong. Recent ruling in *Re Expro International Group Plc* [61] suggests that British courts still follow the precedent in *Guinness* and *Datafin*,[62] remaining reluctant to become involved in ***J.B.L. 39** takeover cases, and were only willing to deal with these cases after the bid's completion.[63] The CA 2006 seeks to maintain most of the Panel's self-regulatory characteristics through channelling parties to resolve disputes through the Takeover Panel before bringing them to the courts,[64] exempting civil liabilities for the members of staff of the Takeover Panel,[65] excluding right of action for breach of statutory duty for breaching Panel rules,[66] and securing completed transactions from challenges for breaching Panel rules.[67]

The Takeover Directive 2004/25/EC was surrounded by speculation and doubt because of its controversial defensive tactic related articles.[68] Article 9, the Mandatory Board Neutrality Rules,[69] deals with post-bid defences[70] and art.11, Breakthrough Rule,[71] deals with pre-bid defences.[72] Due to controversy, the Directive gained the European Parliament's approval only under the condition that the two defensive tactic articles are promulgated as "opt out" articles. The UK government expressed its agreement with the implementation of art.9 since the principles of art.9 "have long been at the heart of the City Code (Rule21)".[73] It decided to opt out of art.11 based on freedom of contract for companies to structure as they wish.[74] Consequently, the position on takeover defences is not substantially altered after the EU Directive.

Upon the UK's withdrawal from the EU, arrangements had been made following the Panel's public consultation in November 2018.[75] An Instrument 2019/3 was published in April 2019 by the Panel to clarify the amendments.[76] All rules in the Takeover Code referring to the Takeover Directive or the sharing of jurisdiction with EU Member States have been excluded. Nevertheless, the Panel will remain a statutory body as set out in and under Ch.1 of Pt 28 of the CA 2006 after Brexit.[77]

The takeover of Cadbury by Kraft in 2010 raised concerns over hostile takeovers becoming too easy and on the problem of short-termism[78] in takeover transactions.[79] Following public consultation, the Panel adopted several proposed amendments ***J.B.L. 40** to the Code.[80] These amendments enhance protection for offeree companies in relation to virtual bid periods, inducement fee agreements and deal protection measures; strengthen the position of the offeree shareholders by pushing for greater disclosure of offer-related fees; raise stakeholder protection by clarifying the offeror's intentions regarding the offeree company and its employees and encourage employee representative participation.[81] The Panel's attempt to tackle short-termism was complemented by the then Business Secretary, Vince Cable, via a review of corporate governance regulations.[82] Professor John Kay was commissioned with the task and the Kay Review of UK Equity Markets and Long-Term Decision Making was finalised in July 2012.[83] Professor Kay's 10 principles for stock markets were endorsed by the Department for Business, Innovation and Skills in November 2012.[84] The review expresses the duty of company directors to stakeholders requires decisions be made for the long-term, implying that if directors believe a transaction is detrimental to the value of the offeree company over the longer term, they may recommend rejecting a bid despite good financial return.[85] In May 2017, the Investment Association initiated a Long Term Reporting Guidance to set guideline for good practices in long term reporting.[86] In July 2018, following the collapse of Carillion, the Financial Reporting Council published a series of proposed changes to the Corporate Governance Code. One of the tasks of the revised Code is to strengthen the role and responsibilities of shareholders in stewarding the companies in which they have investments.[87]

Dispersed ownership

Similar to the US, the UK has an "outsider, arm's length" model of ownership, where large firms are listed in stock exchanges and ownership is highly dispersed.[88] Florence found in his research in 1951, that no single controlling shareholder owned more than 20 per cent of the voting equity.[89] Evidence has shown that by the late 1950s, ownership patterns in a number of publicly listed companies had become so dispersed that a single controlling shareholder would not have been able to veto a shift in control resulting from a hostile takeover offer. ***J.B.L. 41** [90]

Table 1 below breaks down the UK's ownership structure between 1963 and 2016 in detail.

	1963	1969	1975	1981	1990	1992	1994	1998	2000	2002	2004	2006	2008	2010	2012	2014	2016
Rest of the World	7.0	6.6	5.6	3.6	11.8	13.1	16.3	30.7	35.7	35.9	36.3	40.0	41.5	41.2	53.2	53.8	53.9
Insurance Companies	10.0	12.2	15.9	20.5	20.4	19.5	21.9	21.6	21.0	19.9	17.2	14.7	13.4	8.6	6.2	5.9	4.9
Pension Funds	6.4	9.0	16.8	26.7	31.7	32.4	27.8	21.7	17.7	15.6	15.7	12.7	12.8	5.1	4.7	3.0	3.0
Individuals	54.0	47.4	37.5	28.2	20.3	20.4	20.3	16.7	16.0	14.3	14.1	12.8	10.2	11.5	10.7	11.9	12.3
Unit Trusts	1.3	2.9	4.1	3.6	6.1	6.2	6.8	2.0	1.1	1.2	1.4	1.6	1.8	6.7	9.6	9.0	9.5
Investment Trusts	11.3	10.1	10.5	6.8	1.6	2.1	2.0	1.3	1.3	1.3	2.5	2.4	1.9	2.1	1.8	1.8	2.1
Other Financial Institutions	0.0	0.0	0.0	0.0	0.7	0.4	1.3	2.7	2.8	7.7	8.2	9.6	10.0	16.0	6.6	7.1	8.1
Charities	2.1	2.1	2.3	2.2	1.9	1.8	1.3	1.4	1.4	1.1	1.1	0.9	0.8	0.9	0.6	1.2	1.0
Private non-financial companies	5.1	5.4	3.0	3.0	2.8	1.8	1.1	1.4	1.5	0.8	0.6	1.8	3.0	2.3	2.3	2.0	2.2
Public Sector	1.5	2.6	3.6	3.6	2.0	1.8	0.8	0.1	0.0	0.1	0.1	0.1	1.1	3.1	2.5	2.9	1.1
Banks	1.3	1.7	0.7	0.7	0.7	0.5	0.4	0.6	1.4	2.1	2.7	3.4	3.5	2.5	1.9	1.4	1.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 1. Beneficial Ownership of UK Shares 1963-2016 [91]

According to figures in Table 1, overseas shareholders had become the biggest stockholders at the end of 2016, comprising 53.9 per cent of market shares. The ownership of those shares is dispersed since they are held by foreign investors from different continents. The shares held by overseas shareholders can be further broken down, as Table 2 depicts. The region with the largest stake of shares in this category is North America, holding 48.1 per cent of all overseas shareholding in the UK. Therefore, no single category holds more than 25.9 per cent of the total shares in the stock market in the UK. The market can therefore be concluded to be comparatively dispersed.

	1999	2000	2001	2002	2003	2004	2006	2008	2010	2012	2014	2016
Europe	28	37	38	37	36	34	30	34	28	25.8	26.1	25.7
Offshore UK	1	1	1	1	1	1	1	1	1	0.1	0.2	0.6
North America	41	32	32	30	31	32	33	30	56	48.3	45.7	48.1
Asia	19	21	19	21	22	22	21	17	11	10.1	16.0	15.5
Africa	11	9	10	11	10	11	13	15	0	7.2	5.3	4.1
Australasia and Oceania	1	0	0	0	0	1	1	2	2	1.7	1.5	1.5
Middle East	0	0	0	0	0	0	0	0	2	4.1	4.1	2.9
South & Central America	0	0	0	0	0	0	0	0	0	2.5	1.1	1.6

Table 1. Beneficial Ownership of UK Shares 1963-2016 [91]

Table 2. Geographical Analysis of Overseas Shareholders by Beneficial Owner 1999–2016 ***J.B.L. 42** [92]

Shareholder primacy tradition[93]

Corporate governance is particularly significant in the UK because of its historically large scale of industrialisation.[94] Berle and Means document the phenomenon of the separation of ownership and control in public corporations in 1932.[95] Because of the widely dispersed ownership of shares, collective action problems and rational apathy make it difficult for the shareholders to coordinate their activities.[96] The management thus has an incentive to increase the number of shareholders,[97] as every step that weakens the monitoring power of shareholders potentially enhances the authority of the board.

Separation of ownership and control theory became the foundation of the principal-agent model of the firm in the early 1980s.[98] The dispersed ownership structure and highly separated ownership and control features of the UK security market makes agency problem a major concern for the regulation of UK corporations. It provides justification for the shareholder primacy in the UK's corporate governance regime over the past decade.

Since the introduction of the Cadbury Committee, triggered by the corporate failures in early 1990s, various committees focussing on addressing corporate governance issues have been established to tackle the problem of potential exploitation by management.[99] The Combined Code was produced following the Hampel Report in 1998. It had a comprehensive influence on investor relationships and shareholder activism.[100] The latest regulations on corporate governance are the UK Corporate Governance Code 2018 and UK Stewardship Code 2019 by FRC. The Corporate Governance Code 2018 imposes higher standards on directors' "Comply or Explain" duty and auditing reports. The Stewardship Code 2019 aims to enhance the engagement between institutional investors and companies and intermediary service providers to facilitate the generation of long-term return for shareholders taking into account the environmental, social and governance (ESG) factors.[101]

Takeover defence regulations in China

The establishment and development of China's securities supervisory regime is closely linked with China's transition from a planned economy to a market economy ***J.B.L. 43** at the end of the 1970s through corporatising the state owned enterprises (SOEs).[102] Following the establishment and development of the securities market in the late 1980s and early 1990s, SOEs gradually converted into listed companies.[103] Most of the current public listed companies in China are large SOEs established under the planned economy. In the early stages of transforming from a planned to a market economy, China was cautious in its development of the securities market. The securities market was strictly controlled and run according to government plans by a number of government agencies.

The multi-ruled securities market eventually became completely chaotic.[104] The regulatory power allocation was distorted because more and more supervisory power was grasped by local governments and governmental bodies and this started distorting the regulatory power allocation. Meanwhile, the Southeast Asian financial crisis which broke out in1997 captured the attention of the Chinese government and raised awareness on the significance of stability in the financial and securities markets.[105] To enhance regulatory efficiency, the government reformed the regulatory regime through reclaiming regulatory power from local governments and putting it under the supervision of the CSRC alone. The CSRC was upgraded to a vice ministry ranked unit under the State Council in March 1995. In August 1997, the State Council decided to put both the Shanghai Stock Exchange and the Shenzhen Stock Exchange under the CSRC's supervision. Empowered by the Securities Law of the Republic of China (the 1998 Securities Law) 1998, the CSRC became the sole institution supervising the securities market under the State Council.[106]

The legal framework of China's securities market developed step by step alongside its regulatory regime. The first Company Law of the PRC was enacted in 1993 (the 1993 Company Law) and the first Securities Law of PRC took effect in 1998 (the 1998 Securities Law). Following several substantial amendments, the "fine-tuned" Company Law 2018 and Securities Law 2014, together with the Securities Investment Fund Law 2015 formed the basis of the legal framework of China's securities market. The three pillars were supplemented by 13 regulations and administrative rules and over 300 departmental rules, guidelines and codes. In terms of takeovers and takeover defence regulations, the Measure for Regulating Takeovers of Public Listed Companies 2014 (the Measure for Takeovers 2014) was promulgated by the CSRC in 2006 and amended in 2014. ***J.B.L. 44***

The Non-tradable Share Reform and the ownership structure after the Reform

Prior to the launch of the Non-tradable Share Reform in 2005 only around 36 per cent of all shares in listed companies in China's securities market were tradable.[107] Since the 2005 reform, the tradability of China's securities market has increased dramatically. According to Table 3, from 2005–2018, the number of tradable shares has achieved a more than tenfold increase from 291.5 billion to 4.904 trillion. The percentage of listed shares floated freely in the market and free flow capital have increased from 38.- 85.2 per cent and from 38.2–81.3 per cent respectively. Those statistics accurately depict the changing nature of the Chinese equities market.

Table 3. Tradability of China's Securities Market 1998–2018[108]

Year	Tradable Shares (Billion)	Total Shares (Billion)	Free Flow Shares (%)	Free Flow Market Capital (Billion RMB)	Total Market Capital (Billion RMB)	Free Flow Capital (%)
1998	86.2	252.7	34.1	574.6	1950.6	29.5
1999	108.0	308.9	35.0	821.3	2647.1	31.0
2000	135.4	379.2	35.7	1608.8	4809.1	33.5
2001	181.3	521.8	34.7	1446.3	4352.2	33.2
2002	203.7	587.5	34.7	1248.5	3832.9	32.6
2003	227.0	642.8	35.3	1317.9	4245.8	31.

2004	257.7	714.9	36.0	1168.9	3705.6	31.5
2005	291.5	763.0	38.2	1063.1	3243.0	38.2
2006	344.5	1492.6	23.	2500.4	8940.4	32.8
2007	1033.2	2241.7	46.0	9306.4	32714.1	28.4
2008	1257.9	2452.3	51.3	4521.3	12136.6	37.3
2009	1976.0	2441.3	75.5	15125.9	24393.9	62.0
2010	2564.2	3318.4	77.3	19311.0	26542.2	72.8
2011	2885.0	3609.6	79.9	16492.1	21475.8	76.8
2012	3134.0	3839.5	81.6	18165.8	23035.8	78.9
2013	3674.4	4056.9	90.6	19958.0	23907.7	83.0
2014	3910.4	4361.0	89.6	31562.4	37254.7	85.0
2015	3703.4	4302.4	86.1	41788.1	53146.2	78.6
2016	4113.6	4875.0	84.4	39340.2	50768.6	77.5
2017	4504.5	5374.7	83.8	44929.8	56706.8	79.2 ***J.B.L. 45**
2018	4904.8	5758.1	85.2	35379.4	43492.4	81.3

Strong ownership and weak control of the state

The state continues to retain large blocks of shares and exert influence on the board of directors, the members of the supervisory board and senior management in the companies as a controlling shareholder. By March 2014, 39.7 per cent of public listed companies were controlled by the state, amounting to 51.9 per cent of the total value of A-class shares.[109] By the end of 2018, the number of companies controlled by the state reached 242,000, a 10.9 per cent increase from 2013 according to an economic census of National Bureau of Statistics of PRC.[110]

As the main majority shareholder and controller in China's securities market, the state dominates corporate control in listed companies and affects corporate decision-making. Nevertheless, the system of control over these shareholdings by the state has been far from effective.[111] Because of the huge size of the securitised SOEs, the controlling right of the state is sometimes entrusted to internal, or increasingly external, asset management companies or groups, who in practice have no incentive to maximise company value.[112] In particular, in the case of the restructuring or insolvency of listed companies, because the representatives of the government agencies are not able to engage with the restructuring or insolvency thoroughly due to the large size of some SOEs, a large amount of power and responsibility has to be delegated to the entrusted management or other interested parties. This sometimes causes”unsuitable” enterprises to merge together and lead to dis-economy of scale and wastage of public resource.[113] Minority shareholders are frequently the biggest losers in these sorts of transactions.[114] The amount of power and responsibility delegated is largely decided by the government agencies or domestic institutions in charge of the SOEs and this leaves a grey area for potential rent seeking.

Over complicated cross-shareholding in SOEs is another cause for the weak control of the state. The state holds shares in various forms, such as non-tradable state shares, legal person shares, employee shares and tradable public shares. These shares are held by different government agencies and domestic institutions. The complex shareholding structure, as well as numerous cross shareholdings amongst them, have further weakened the state’s control over the shares it owns.

The strong ownership and weak control of the state enables the majority shareholder of the company to collude with internal management. It also brings ***J.B.L. 46** the possibility of exploiting the financial resources of the listed company and expropriating the interests of the minority shareholders.[115]

Calling for minority shareholder primacy

It is widely argued that the extremely concentrated ownership has resulted in controlling shareholder dominance in China’s securities market.[116] Domination by the largest shareholder, the state, is one of the most significant reasons why other shareholders, whether they possess substantial or minor shareholdings, are not incentivised to participate in those general meetings of shareholders.[117] Since 2000, the increasing number of cases of controlling shareholders abusing corporate control and diminishing the rights of minority shareholders[118] have raised strong public concern.

Moreover, the controlling shareholders of listed companies could also indirectly manipulate the supervisory boards[119] as all members of the supervisory boards are selected by the board of directors that might have been appointed by the controlling shareholders, in the first place. Therefore, indirectly, the right to decide on members of the supervisory board falls into the hands of the controlling shareholders.[120] The supervisory board therefore cannot properly supervise the conduct of the board of directors.

According to Bebchuk and Roe’s explanation of the persistence of the ownership model, when private benefits are large in terms of public listed companies, controlling shareholders will be reluctant to “relinquish their lock on control when raising extra capital” since “they will not be compensated by existing shareholders for forgoing the larger benefits that come with a lock on control”.[121] The model of “insider/control-oriented” ownership in China, whereby controlling shareholders are well positioned to influence corporate decision-making, provides great incentives for rent seeking behaviour.[122] In order to continue profiting from the old ownership structure, the rent seekers will fight to maintain the status quo.

Last but not least, institutional investors’ potential “collusion” with controlling investors may also result in the dominance of majority shareholders. By the second quarter of 2019, institutional investors held 18.6 per cent of shares in China’s securities market.[123] Generally speaking, the expansion of the role of institutional investors is beneficial in relation to supervising and restricting controlling ***J.B.L. 47** shareholders’ misconduct. However, it can also be a double-edged sword as the institutional investors, together with the majority shareholders, can infringe minority shareholder interests. For instance, during the Non-tradable Share Reform, many institutional shareholders used their votes to help controlling shareholders pass resolutions against minority shareholders’ interests.[124]

Concentrated ownership requires that minority shareholder protection be emphasised in corporate governance[125] since such groups of shareholders are in a particularly vulnerable position under the strong ownership and weak control of the state in China. The general meeting of shareholders is often used as a tool by majority shareholders to manipulate corporate control and infringe minority shareholder interests. Since 2000, the increasing number of cases of controlling shareholders abusing corporate control and diminishing the rights of minority shareholders[126] has raised strong public concern[127] and solving the problem has become a significant mission of the CSRC.

Unachieved legislative goal

Past literature suggests takeovers can discipline offeree companies’ management,[128] achieve synergies between offerors and offerees,[129] and consequently benefit the securities market and the investors. Many prior studies on the economic effects of takeovers, although not conclusive, show that takeovers are value enhancing.[130]

It is more important for countries with concentrated share structures such as China to encourage the disciplinary function of takeovers in the securities market because those countries are more likely to have to solve the "double agency problem" existing between shareholders and managers and between the majority shareholders and minority shareholders. The latter very often involves collusion between managers and majority shareholders against minority shareholders.[131]

As an emerging economy with complex market conditions, China has a great need to achieve synergies between offerors and offerees and make the best use of the disciplinary function of takeovers to discipline managers in all potential offeree companies and reduce the managers' exploitative conduct. This is one of the main reasons why the Chinese government encourages the market for corporate control and discourages takeover defences. Takeover defences, being tactics used to ***J.B.L. 48** increase the obstacles to takeovers, add to the difficulties for takeovers to perform their market disciplining function. The bargaining power hypothesis, the main theory which supports takeover defences, only applies to negotiations in which there is a bilateral monopoly between buyer and seller where there are no incremental costs to making a hostile bid, symmetric information, and loyal sell-side agents.[132] Takeover defences, therefore, do not provide much bargaining power for the shareholders in the offeree companies under normal market conditions, where there are costs to making hostile bids, where asymmetric information is everywhere and where loyal sell-side agents are hard to find. These issues commonly exist in China. Hence, it is extremely difficult for takeover defences to provide sufficient bargaining power for offeree shareholders in China. The offeree shareholders cannot therefore benefit from takeover defences. The legislative goal of takeover regulation in China, therefore, should be encouraging takeovers and discouraging takeover defences because they frustrate takeovers and restrict the disciplinary function of takeovers which is desired in China.

This legislative goal, nevertheless, has not been achieved. The current model of takeover defence regulation in China could not effectively promote the disciplinary function of takeovers. Delegating the right to decide on takeover defence activities to general shareholder meetings controlled by majority shareholders would not reduce, but only increase unfairness since the shareholder meetings are very often manipulated by majority shareholders, the resolutions made regarding takeover defences may eventually be controlled by the majority shareholders. Majority shareholders may use their right to pass takeover defence resolutions and fend off all potential takeovers to retain corporate control.

Conclusion

Takeovers in the UK are governed by a statutory regulatory regime with strong self-regulatory characteristics. The City Code has mainly been written by financial practitioners and institutional shareholders in 1968. This provides the root for the shareholder-centric features of the code. This is demonstrated in takeover defence regulations by the granting of the power to make decisions on takeover defences to the general meeting of shareholders. It is designed to avoid a situation in which management could abuse takeover defences to defend bona fide bids because of the fear of a potential change of management in the event of a successful takeover. This design is in line with the corporate governance model in the UK, which also focuses on shareholders' protection. The dispersed ownership structure in the UK ensures that shareholders are rather well represented in the general meeting of shareholders and the decision on the adoption of takeover defences reflect the real intentions of the different categories of shareholders.

Takeover defence regulation in China borrows heavily from the UK via the historical link of the UK with Hong Kong.[133] The power to make decisions on takeover defences in China is also delegated to a general meeting of shareholders. ***J.B.L. 49** [134] However, the enactment of takeover regulations follows a different path from that of the UK. The regulations are laid down by the government watchdog, CSRC, whilst those in the UK are modelled by the City institutional shareholders. Thus, takeover defence regulation in China is hardly a natural progression resulting from calls from practitioners. China is a country of concentrated ownership due to historical reasons. Shares are often controlled directly or indirectly by the state. This situation has not fundamentally changed, even after the recent non-tradable share reforms. Nevertheless, control by the state is rather weak because of a lack of supervision of the state-owned shares. A complex combination of methods used to delegate power to various governmental agencies and the cross holding of state-owned shares add to the difficulty faced by the state in strengthening its control as the ultimate shareholder. This blend of extremely strong ownership and weak control of the state over the securities market has resulted in substantial majority shareholder (government agencies of the state) dominance in public-listed companies. Consequently, the most significant issue in corporate governance in China is that of how to effectively protect the minority shareholders as opposed to shareholder protection in general.

Delegating decision-making power on takeover defences to general meetings, in firms with highly concentrated ownership in

China, increases the dominance of majority shareholders. This is unfortunately enabled by the current model of takeover defence regulation that allows them to abuse their premium position in terms of voting power in order to adopt takeover defences to frustrate bona fide bids and maintain permanent corporate control. As such, this study concludes that it is inappropriate for China to adopt the same approach as the UK and that it should consider appropriate legislative amendments to this matter.

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