Panacea or Wisdom Tooth? Assessing the Misconstrued Mandatory Bid Rule

Author: Weng, Xiaochuan

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Panacea or Decorating Vase? Assessing the Misconstrued Mandatory Bid Rule in China

Charlie Xiao-chuan WENG

University of New South Wales
Business School

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Abstract
The Mandatory Bid Rule (MBR) requires a bidder who acquires control over a firm to make a general offer to all remaining shareholders to purchase their residual shares. It is the most powerful institution that requires controlling shareholders to share the control premium with other shareholders in a control transaction. The MBR is considered to be a key method of protection for minority shareholders, but nevertheless faces strong criticism over high implementation costs and an ongoing debate over its effectiveness in practice.

From a utilitarianism perspective, the paper shows the relevance between the MBR and the effectiveness of minority shareholder protection mechanisms in a jurisdiction of legal transplantation. Using Mainland China as the test sample where the MBR was adopted, removed then re-introduced, the paper employes the empirical research methodology to highlight market reactions when the rule is removed. The paper analyses the efficiency of the MBR and outlines the types of environments and jurisdictional specifications where the MBR can operate at an optimal level, and alternatively, where the MBR will not be value-maximizing. It offers ideal legislation suggestions for similar jurisdictions considering transplanting MBR.

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INTRODUCTION

The Mandatory Bid Rule (MBR) requires any bidder that acquires control over a firm to make a general offer to all remaining shareholders to purchase their residual shares. It is so far the most powerful institution that compels controlling shareholders to share the control premium with other shareholders in a takeover bid, otherwise known as a control transaction. The control premium refers to the additional value above the market price of each share when the controlling shareholder is selling their share block to an acquirer. For many jurisdictions, the MBR is a primary method to protect minority shareholders (Shuster 2013). The UK Takeover Panel first introduced the MBR in the City Code in 1972. Decades later, the European Union (EU) adopted it in the process of takeover regulation promulgation in 2004 in the Takeover Directives (TOD) (Skog 2002). Under the influence of European civil law, many countries in the world have implemented a variation of this rule (Shuster 2013). It is arguable that some East Asian countries, such as Korea, introduced this rule for the critical purpose of catering to international financial institutions in order to secure financial assistance.

Empirical studies have shown that takeovers can be a beneficial business strategy to create synergy gains and reduce agency costs (Romano 1992). Synergy gains refer to the increased value as a result of the combination of two firms, which is higher than the mathematic aggregation of the two entities on a stand-alone basis (Romano 1992). Management changes often follow takeovers in an attempt to improve managerial efficiency, whereby the margin increases, post-change is considered to be the most significant reduction in agency costs (Furtado 1990; Walsh 1988). The effect of a
reduction in agency costs in a jurisdiction with a predominantly concentrated ownership structure is immaterial. This is mainly because concentrated ownership structures tend to have sufficient shareholder supervision, which automatically minimizes agency costs incurred by inefficient management (Gilson 2013). Generally, most takeovers may be value-increasing deals that often lead to a share price increase, while some scholars believe some of the takeovers might be long-term value-decreasing (Jarrell, Brickley & Netter 1988; Jensen & Ruback 1983).

In a firm with a controlling shareholder, the price per share of control blocks will always have a higher value compared to those of non-controlling shareholders (Enriques, Gilson & Pacces 2014). That is primarily because corporate control is associated with the private benefit of control (PBC), which may be in the form of either pecuniary or non-pecuniary benefits (Gilson 2005). In a control transaction, the controlling shareholders receive higher consideration for their shares compared to selling their shares to the market at market price (Enriques, Gilson & Pacces 2014). The MBR enables the distribution of PBC amongst all shareholders in a target by setting a benchmark for the offer price, which is often the recent highest price before the bidder acquiring control over the target firm (Shuster 2013). However, the MBR may have a chilling effect on the takeover market, as the MBR not only causes financing problems that result in investments being less diversified but also increases the cost of the deals by inflating the cost of acquisition.

There has been an ongoing dispute over the effectiveness of the MBR. Similar to other mandatory rules under corporate law, ownership structure, and market dynamics significantly impact the effectiveness of the MBR (Gilson 2005; Enriques, Gilson &
Some scholars believe that the rule is suboptimal as it fails to take into account firms whose structures do not accommodate the implementation of the rule. As such, the rule may not necessarily maximize the value of certain types of firms in the market (Enriques, Gilson & Pacces 2014). In an attempt to address this issue, some scholars tried to circumvent the debate by proposing the shift from a mandatory to an optional rule, with the hope to optimize the utility of the rule (Enriques, Gilson & Pacces 2014).

Interestingly, regardless of the MBR, there are examples of different jurisdictions successfully implementing mechanisms for minority shareholder protection. For instance, Delaware does not have MBR, while the UK has. Both are recognized as successful minority shareholder protection jurisdictions (Armour & Skeel Jr. 2007).

In this globalized era, it would be difficult to find a jurisdiction that has not yet incorporated some variation of the MBR. However, the ratio of adoption does not represent the effectiveness of the MBR. Aside from external pressure from international financial institutions, another underlying reason to adopt the MBR may be that the adopting jurisdiction is affiliated with specific associations or has inherited a particular legal culture. For example, some members of the EU, despite having incorporated TOD, did not opt to implement the MBR before 2004 (Hopt 2014). It suggests that the adoption of the MBR for many countries could be suboptimal as it fails to consider jurisdictional specifications. The adoption or omission, in some cases, is merely a coincidence, or serendipity of legal transplantation.

Mainland China hereon referred to only as 'China', incorporated the MBR in its first
version of securities law in 1998 (Weng 2012). It was abolished in the new Chinese securities law in 2005 but partly reinstated by the market regulator, the Chinese Securities Regulatory Commission (CSRC), in the Measures for the Administration of the Takeover of Listed Companies (Measures) in 2006. China's adoption, abolishment and re-adoption of the MBR make it an appropriate sample to test the impact of the market on the rule, and vice versa. After all, the MBR is designed for the market to promote minority shareholder protection. It would be difficult to argue that a crash in share price will result in minority shareholders being better off.

The paper examines the application of the MBR in a typical legal translation jurisdiction: China. Part I will analyze traditional rationales that support a functional MBR and assess their effectiveness in China from a normative perspective. Exploring beyond the traditional justifications for the MBR, the paper also examines the impact of the rule from a market reaction perspective through testing market price changes under MBR rule changes. Part II discusses the adoption, development and practice of the rule in China, and Part III examines the efficiency of the rule in the market. The empirical method is used for all tests in Part IV, which analyzes the market reaction when the rule was abolished in 2005. The conclusion presents an evaluation of the MBR based on previous normative and empirical analysis.
I. **Adoption of Mandatory Bid Rule in Mainland China**

a. Adoptions of Mandatory Bid Rule: a paradox proposition

1) We have the panacea

With the globalization of commerce, legal transplantation has become an increasingly common method for regulating innovative business models and emerging industries that mirror those from other jurisdictions (Xi 2009). Although the reliance on direct legal transplantation, where there is no modification and adaptation, has been questioned (Hou 2018; Weng 2013), a significant number of regulations in China over the past two decades is directly 'borrowed' from other jurisdictions (He 2011). MBR is a crucial example of legal transplantation. China incorporated the rule into its securities law in 1998 but was abolished seven years later by the legislature. Ironically, the market regulator, the CSRC, partly reinstated the rule in 2006.

The legislature and the market regulator's attitudes towards the MBR are conflicted. It is unclear and confusing to understand whether China has implemented the MBR or not.

Article 81 of the first securities law in 1998 stipulates that:

'Where through securities trading on a stock exchange, the shareholding of an investor, or the deemed joint shareholding of an investor and others in virtue of agreements or other arrangements, has reached 30% of the issued shares of a listed company, if a further acquisition is to be pursued, unless being exempted by the securities regulatory authority under the State Council, a tender offer of acquisition shall be launched pursuant to law to all of the shareholders of the listed company.'

In practice, the CSRC interpreted this provision to be the MBR, despite having no
mention of whether the offer can be partial or not. There are several possible reasons behind the introduction of the rule. First, introducing the MBR is a symbol for increased minority shareholder protection, which is conducive for China's accession to international trade organizations such as the World Trade Organization (WTO). Moreover, taking this first step would encourage financial assistance from other international organizations, such as the World Bank and the IMF. After all, minority shareholder protection was considered insignificant compared to receiving international financial support and accession to the international market. The Chinese government was in full support of the economic trend of security acquisitions in the 1990s. It was because the State controls over 90% of listed firms, and any transaction related to a change in control between two firms with the same majority shareholder is often a condition of the MBR exemption. It significantly weakens the function of the MBR.

China's legislature abolished the MBR in the 2005 securities law. Interestingly, the current securities law acknowledges the abolishment of the MBR. The legislature nevertheless made a very nuance but effective change seemingly to disable the MBR in 2005: the allowance of a partial offer made to all non-controlling shareholders after reaching the 30% benchmark. China's developments in securities law have divided takeover operations into two types. First, share acquisition through regular exchange trade and second, trade through personal agreements with large blockholders. In accommodating both types, a distinct reference to article 81 of the 1998 securities law exists in both articles 88 and 96 in 2005 version. Article 88 states that:

'Where through securities trading on a stock exchange (article 96, Where the negotiated
acquisition is pursued), when the shareholding of an investor, or the deemed joint shareholding of an investor and others in virtue of agreements or other arrangements, has reached 30% of the issued shares of a listed company, if a further acquisition is to be pursued, a tender offer of acquisition shall be launched pursuant to law to all of the shareholders of the listed company for acquiring \textbf{ALL or PART} of the shares of the listed company…’

As previously mentioned, the MBR protects minority shareholders in two ways: 1) sharing the benefit of control premium amongst minority and controlling shareholders, and 2) providing an opportunity for all shareholders to sell their shares if they no longer wish to be associated with the acquirer (Enriques 2004). However, the allowance of a partial offer alters the function of the provisions in its entirety. The acquirer will be able to determine the extent that they share the control premium or restrict the benefit entirely. The acquirer may offer a price for the shares that excludes any control premium because the law does not stipulate a referential period to lock up the offer price. The referential period could vary, depending on the jurisdiction, from 30 to 90 days prior to the transaction between the existing controller and the bidder.

Nevertheless, articles 88 and 96 fulfil its purpose of protecting minority shareholders. Although core MBR related functions were minimized as a result of the change, articles 88 and 96 functions to restrict forceful and unlawful offers in control transactions. The second part of the article stipulates that:

‘…In the tender offer for acquiring part of the shares of a listed company shall be stated that in case the number of the shares committed to selling by the shareholders of the
company to be acquired exceeds the number of the shares proposed to acquire, the acquirer shall proceed on a prorating basis.'

It means that minority shareholders should not be concerned about losing the acquirer's offer because all shareholders ultimately have an equal chance to sell their shares. The acquirer will not be able to pressure minority shareholders by launching a two-tier offer.

The reintroduction of the MBR occurred mere months after its abolishment. In July 2006, the CSRC promulgated a ministerial rule, the Measures for the Administration of the Takeover of Listed Companies (2006) (the 2006 Measures), thereby fulfilling its legal explanatory power provided under the securities law (Cai 2011). The 2006 Measures, however, is not merely an explanation of the law. Instead, it reinstated elements of the MBR, which effectively resurrected the notion of the MBR in Corporate China. The 2006 Measures inherited similar expressions to what was used in the law for takeovers by regular exchange trade, however, modified the law for takeovers by agreement. Article 47 of the 2006 Measures states that:

‘If a purchaser plans to purchase more than 30% of the shares of a listed company BY AGREEMENT, the part of shares that exceed the said 30% shall be purchased by means of the tender offer; however if it is under any circumstance as prescribed in Chapter VI of these Measures, the purchaser can apply to the CSRC for exempting from making a tender offer. The purchaser shall, after obtaining the exemption of the CSRC, fulfil the takeover agreement; if the purchaser fails to obtain the exemption of the CSRC and plans to continue fulfilling the takeover agreement, or fails to apply for exemption, the purchaser shall make a GENERAL tender offer before the takeover agreement is
fulfilled.’

This article is undeniably in conflict with the securities law, which allows for partial offers even for takeovers by agreement. Given the fact that the ownership structure of Chinese listed companies is predominantly concentrated, reintroducing the MBR in a sale of shares by agreement essentially re-establishes the MBR for the majority of control transactions (Weng 2017).¹

Chinese legislation specifically mandates that if in the case of a contradiction between ministerial rule and law, the law will prevail and related administrative regulation provisions will be invalid. Despite this contradiction, the ministerial rule has nevertheless survived, and the most updated version, the 2014 Measures, maintains the same expressions as was used in article 47 of the 2006 Measures.

Intuitively, controlling shareholders are more likely to oppose the MBR as it regulates the sharing of control premium and inflates their takeover costs in a control transaction. So, this raises the questions: why does it remain unchallenged by private parties through administrative litigation? We will try to answer this question in the next part of the paper.

¹ It is worth noting that since 2015 there are some takeover plans launched through open market operation, which is hardly happened in the past. The reasons for this are quit circumstance specific. First, after the 2014 market meltdown, acquisition cost becomes lower. Second, there are a handful of well-performed firms without controlling shareholders. Third, bidders excessively and ruthlessly leverage for takeover, which supports the most expensive way to acquire. Traditionally, Chinese firms have controlling shareholders or actual controllers. For more information regarding Chinese ownership and control landscape.
b. Business and legal environments

To assess the effectiveness of a rule in a specific jurisdiction, the underlying factors that affect the operation of the rule should be thoroughly examined. There is no single legislation that is universally effective and foolproof. The effectiveness of MBR is determined by both internal and external environments of the jurisdiction in which it operates. It is, therefore, imperative to analyze the fundamental elements necessary for the successful operation of the MBR. Undoubtedly, there is numerous literature disputing the effectiveness of the MBR. In reality, the success of rules directly borrowed from other jurisdictions is determined by the characteristics of the target jurisdiction.

In this part, we will park the discussion on efficiency in order to examine the jurisdiction-specific elements that can substantially affect the application of the MBR in China. Subsequently, further empirical implications for the adaptation of the MRB in China are discussed in Part IV.

1) Ownership structure and control

The ownership structure is one of the most important determinants to the efficacy of the MBR. If corporate institutions do not match the agency problem incurred by the specific types of ownership structures, the rule would be dysfunctional and ineffective (Kraakman 2017). The ownership structure is a good indication of the concentration of the shares held. If the existence of a blockholder is present in most firms, and they have absolute control over the decision-making of the firm, then it is likely that the jurisdiction has a concentrated ownership structure as opposed to a dispersed ownership structure. However, in reality, categorizing ownership structure into two classes is too simplistic (Gilson 2005).
There must be some degree of necessity for the introduction of the transplanted, or borrowed rule; otherwise, the rule will be ineffective and redundant. The MBR aims to protect minority shareholders (Shuster 2013). Therefore, the rule would be ineffective if the ownership structure is predominantly dispersed. However, implementing regulations only based on ownership structure is suboptimal because an individual company's ownership structure is likely to vary in practice. Even if 99% of the firms in the market have a concentrated ownership structure, a rule made solely based on this fact fails to consider and maximize value for the remaining 1% of the market.

A logical disconnection exists between the absence of a controlling shareholder and a dispersed ownership structure. In order to maintain control over a firm, it is not necessary to possess a controlling share block (Gilson 2005).

Majority presumption is likely to be that China’s ownership structure is highly concentrated (Claessens, Djankov & Lang 2000). In reality, it is less concentrated than most belief. Only one-fifth of listed firms in China have an absolute controlling shareholder (ACS), whose share block is no less than 50% of remaining shareholders (Weng 2017). Considering that China currently holds a conservative view towards dividing the voting rights and dividend rights, acquiring 50% or more of total shares essentially guarantees absolute decision-making power (Feng 2016).

According to the CSRC, shareholders whose share block is no less than 30% are also defined as a controlling shareholder. Considering the volume of Chinese listed firms, the CSRC sets the benchmark to reasonably categorize the concentrated ownership structure (Weng 2017). In practice, holding 30% of the total shares is sufficient to hold decision-
making power in a firm. Nevertheless, less than two-fifths of listed firms have controlling shareholders. With only one-fifth of listed firms with an ACS, there are more than two-fifths of listed firms without one single decision-maker. These statistics suggest that China's ownership structure is not as concentrated as several decades ago. With China's aggressive economic development, ownership structure in China is likely to continue changing.

Many shareholders, and even non-shareholders, maintain control over listed firms by joining as a collective or through a pyramid structure of firms. It enables the same benefits to be enjoyed as a majority shareholder, with the bonus of being hidden from the radar of market supervisors (Fu 2017). These groups are also known as the Actual Controllers (AC) (Zhang & Luo 2017; Zhu 2011). Due to the ACs rise, the CSRC now requires listed firms to disclose the existence of any ACs in their annual reports. Taking into account the fact that ACs exist in 97% of listed firms, the landscape of China becomes significantly more concentrated. Therefore, from a control transaction perspective, it is imperative to protect minority shareholders from the ACs acting in their self-interest by permitting decisions that externalize costs onto minority shareholders. However, the issue of ownership structure alone does not directly result in the introduction of the MBR. After all, the ACs can take advantage of complicated corporate structures to avoid triggering a breach of the MBR (Fu 2017). The following sections of this paper analyze other relevant factors to assess this issue. The existing control landscape primarily supports the protection of minority shareholders by way of the MBR.

2) Private Benefit of Control (PBC)
The term Private Benefit of Control (PBC) has many definitions (Schuster 2013; Gilson 2005; Gilson & Schwartz 2013). It is essential for research because the MBR aims to spread PBC amongst all shareholders during a control transaction (Davies 2002). Generally speaking, PBC is a bonus value in addition to the cash-flow rights attached to the block of shares that can guarantee control (Shuster 2013). Leveraged control complicates the discussion of PBC (Claessens, Djankov & Fan 2002; Gompers & Metrick 2010), but fortunately, China has illegalized such operation for listed firms.

There is much literature that explores the taxonomy of PBC (Gilson & Schwartz 2013). For instance, Professor Ron Gilson divides the definition of PBC into pecuniary and non-pecuniary (Gilson 2005). Typically under a well-established jurisdiction, PBC would be perceived as non-pecuniary, because a pecuniary interpretation usually allows for the controller to receive additional cash flow at the expense of the firm and other shareholders, which in most cases, is illegal under a well-established legal system (Gilson & Schwartz 2013). The boundary between a pecuniary and non-pecuniary interpretation of PBC is unclear. In some cases, a non-pecuniary PBC interpretation can easily be converted into a pecuniary interpretation. The dichotomy may be helpful for categorization but fails to explain the reasons behind the very few negative attitudes towards sharing PBC in well-established jurisdictions (Gilson & Schwartz 2013).

Professors Alan Schwartz and Ron Gilson believe that ‘PBC have virtues as well as vices (Gilson & Schwartz 2013).’ After the flourish of the agency theory, a galaxy of mechanisms has been introduced to alleviate the costs incurred by the agency problem (Kraakman 2017). Any legal strategy under corporate law that targets the agency problem
is attached to suboptimal costs (Gilson & Schwartz 2013). The supervision of controlling shareholders is the most efficient method to reduce managerial agency costs (Gilson 2005). Nevertheless, controlling shareholders must bear two high costs in carrying such responsibility for the more significant benefit of shareholders as a whole: 1) restriction on investment diversification, and 2) time and resources behind monitoring activity needs (Gilson & Schwartz 2013). These costs are also the reason behind controlling shareholders enjoying, to an extent, a proportion of legalized control premium.

The controller, who pays for the reduction of the managerial agency cost, may wish to gain control premium in the form of a pecuniary PBC. Based on the theoretical notions underpinning the ‘law matters’ thesis, PBC can further be categorized into legal and illegal (Porta, Lopez-de-Silanes & Shleifer 1998). Illegal PBCs should neither be encouraged nor shared, as it would be unjust because the exploited shareholders may not be the ones that receive a share in the illegal PBC from the control transaction. Moreover, the law should not encourage illegal conduct.

From an efficiency perspective, if a significant portion of PBC is created by illegal means, the MBR should discourage sharing in a control transaction. If the law encourages sharing PBC through illegal means, controlling shareholders will then openly exploit minority shareholders to recoup the increased costs as a result of the MBR. Therefore, promoting the sharing of control premium may incentivize controlling shareholders to exploit minority shareholders illegally.

3) Minority shareholder protection mechanisms and the application of the

MBR
China has undergone several decades of reform to build a comprehensive commercial law system (Zhao 2018). The strength of the commercial law system nevertheless depends on the answers to two questions: 1) whether the law is functional; and 2) if so, has it been appropriately enforced? Unfortunately, in the case of China, both answers are far from adequate. As a consequence, minority shareholder protection mechanisms are not as effective in China as its counterparts in legally developed jurisdictions.

The system relied upon to protect minority shareholders in China lacks practicality. Research has highlighted that the emphasis of Chinese corporate and securities law is on alleviating the managerial agency problem, not the protection of minority shareholders (Weng 2013). Based on studies on former ownership structure, in combination with the fact that only a limited number of shareholders control the majority of Chinese corporations, it can be established that the fundamental problem that exists is the controlling shareholder agency problem (Weng 2013). The mismatched shareholder protection regime dampens the practicality of the law (Weng 2013). There are two explanations, both from a historical and a political science perspective, to assist in understanding the paradox. Firstly, the primary influence for the Chinese corporate law framework has shifted from west European countries to the United States (US). It is a result of the rise of the capital market and the success of the US market development (Yuan 2004; Weng 2013). However, the US is a jurisdiction with a predominantly dispersed ownership structure. Therefore, the focus of the law is on monitoring management to ensure that they do not enrich themselves at the expense of shareholders as a whole (Weng 2017). Secondly, Chinese corporate law is biased towards protecting
controlling shareholders, mainly because the controlling shareholder, in most cases, is the State. When the first Chinese corporate law framework was promulgated, 99% of firms in China were owned by the State. It significantly impacts the legislature's attitude towards regulation against controlling shareholders. In recent decades, exploitation of minority shareholders has become an increasingly common practice, thereby shaking investor confidence (Zhang & Luo 2017). Regulations that disadvantage or limit the power of the controlling shareholder, such as the MBR, is a definitive act against the best interest of the State.

The enforcement of the MBR is another significant drawback. The judiciary’s independence and degree of power eclipse China’s ambitious legislative campaign on MBR (Zhu, Chen & Yu 2006). As previously discussed, when the State's interest is in jeopardy, the judiciary, who is selected and financially supported by the State, is likely to experience considerable influence from the State (Zhu, Chen & Yu 2006). Although recent reforms to increase the independence of the local judiciary creates hope for a fair and efficient judiciary system, only time will be able to determine its success (Chen 2018). In the interim, minority shareholders can rely on mechanisms that are widely available for shareholders as a whole, such as derivative litigation and shareholder suit for dividends, in order to protect themselves from exploitation and fraud (Huang & Howson 2017). Although mechanisms exist, its lack of enforceability has proven that many protection methods are merely decorations in the law (Huang & Howson 2017). Before 2005, the Chinese judiciary refused to hear certain types of derivative litigation, thereby significantly weakening the enforceability and effectiveness of the derivative litigation
regulations.

The final element that determines the effectiveness of the MBR is the application of the rule. The exemption of the MBR is an essential legal instrument for the market supervisory body to intervene and prevent its application because it is recognized that the MBR is not always appropriate and exemption should be granted where the MBR is a more significant burden than value-adding. The conditions for exemption have been a changing variant and amorphous since the MBR was introduced in Chinese securities law. The list of exemptions has gradually grown over time. Statistics have shown that from 2009 to 2014, 477 cases triggered application of the MBR and 454 exemptions were granted; however, it is not sure whether every case applied for an exemption. These figures reveal a 95.18% exemption rate (Sun 2014), indicating an ongoing problem with enforcement. It highlights the small chance that minority shareholders have to obtain a control premium in a takeover bid.
II. Efficiency Analysis of the MBR

In Part II, we discussed three factors that affect the application of MBR in China. The agency problem determines whether the market needs more substantial protection for minority shareholders through the MBR. PBC is the critical determinant for sharing the benefit of a control premium, whereby illegally derived PBC is discouraged despite the MBR. From a public enforcement perspective, legislation for the protection of minority shareholders and the application of the MBR are attempting to determine whether public enforcement is the appropriate method to achieve equality and protection in control transactions. In this part, we further analyze the MBR by combining the three dimensions, with a focus on efficiency.

Research has indicated that the type of agency problem that dampens the operational efficiency of Chinese corporations is the majority-minority agency problem, not the managerial type (Weng 2012). This type of agency problem undoubtedly calls for a more substantial degree of minority shareholder protection compared to jurisdictions that experience the managerial agency problem (Kraakman 2017). Nevertheless, the demand for more excellent protection does not equate to labelling the MBR as an essential concept that must be enforced by public agencies.

The underlying method in which the MBR favours minority shareholders is by compelling the controller to share PBC (Shuster 2013). However, it is necessary first to clarify what is considered PBC in China. If PBC is sourced from illegal operations, as previously discussed, sharing it can encourage illegality and a breach of the legal framework, which may also raise the issue of impartiality. It is difficult to argue in favour
of China's current capital market laws, not only from a conceptual perspective but also from a practical aspect. Consequently, PBC is likely sourced from illegal methods. There is much evidence both in practice and in finance literature showing that tunnelling is rampant in China and exploiting minorities is a familiar concept. A mandatory rule should be enforced to protect the weak that have minimal bargaining power (Ayres 2012). When a firm's PBC is mainly derived from illegal practice, can it still be considered preferable to share this illegal PBC under the guise of promoting equality for minorities? When sharing PBC without understanding its source is not desirable, is it efficient to introduce a mandatory rule to share PBC regardless, in order to fulfil the purpose of protecting minorities in control transactions? The appropriate answer to both questions is no. Any hesitation about the source of PBC should be sufficient to cast doubts on the effectiveness of utilizing the MBR.

The threshold for enforcing the MBR is further evidence against sharing PBC through mandatory law enforced by an administrative agency. Since China's introduction of the MBR in the 1990s, the majority of mergers and acquisition deals are closed at just under the 30% threshold (Sun 2014). It is by no coincidence that this occurred and likely used as a popular technique to avoid triggering the MBR and thus sharing PBCs with minority shareholders. Due to the large volume of capitalization of listed firms in the modern economy, it is no longer an iron rule to have more than 30% of the outstanding shares in order to gain control. In exceptional cases, less than 10% of voting rights can guarantee control over a transnational conglomerate, considering controllers can ultimately have familiar faces sit on the board of directors without contest from minority shareholders.
suffering from the collective action problem. The MBR is ineffective in the case of law evasion and a one-size-fits-all model, therefore, the existing public-enforced PBC sharing rule is not as functional in practice.

The final dimension to consider is enforcement. As CSRC holds the power of exemption once MBR is triggered, the agency plays a fundamental role in the enforcement of MBR. Chinese securities law relies on the CSRC to consider efficiency in control transactions during enforcement of the MBR. If enforcement is not economically efficient and unable to protect minority shareholders, the CSRC will exempt the unanimous tender offer obligation. An inevitable question follows: if the exemption ratio is so high, is the MBR still meaningful? From an economics perspective, the institutional purpose cannot be articulated because the high exemption ratio and uncertain exemption outcomes can alter the decision-making process of controlling shareholders. They may first attempt to apply for an exemption, and if this fails, they may withdraw the entire takeover deal to avoid the cost of a tender offer and risk the danger of being delisted. It causes undesirable share price fluctuations and creates countless opportunities for insider trading. With alarmingly high exemption rates, minority shareholders can neither have the chance to sell their shares to the bidder nor the opportunity to obtain a share of the control premium. It is unrealistic to expect the CSRC to promote market growth while protecting the interests of minority shareholders when considering the grant of an MBR exemption. The two values appear to be contradictory and mutually exclusive, but it is an unspoken understanding that the CSRC currently prioritizes market growth.

The above discussion confirms that the enforcement of the MBR by a public agency,
under the justification of sharing PBC, lacks stability. Particularly within the Chinese context, the elusiveness and legality of PBC raises a further question: do we understand the holistic impact of the rule before introducing it as a mandatory regime? Moreover, the public agency may have different purposes that reduce the effectiveness of minority shareholder protection under the MBR. The reality in the capital market is that a need exists for minority shareholder protection in a takeover deal. It is no longer justifiable to ignore the entitlement of minority shareholders and ignore their exploitation. Admittedly, it is logical to allow the market to decide the application of the MBR, as it is a case-specific regime. Taking into account the fact that the control landscape is highly concentrated, the MBR should be an opt-out concept, rather than an opt-in model. The individual firm can decide the threshold and trigger conditions before embedding it into its articles of association. Unquestionably, controlling shareholders should not be included in the voting process. It is recognized that some degree of information asymmetry may also exist in the opt-out process. For example, controlling shareholders may divide their shares into two portions, thereby controlling under the guise of different shareholders (Fu 2017). This issue of conflicting purposes may be reduced through a shift in the CSRC’s role from ad hoc to ex-post.
III. EMPirical Study

Through the normative analysis above, we concluded that drawbacks and benefits for minority shareholders might exist under the current MBR. However, it may be necessary to consider the benefits of MBR through the lens of quantitative research. This research designed tests to determine market reactions when the rule was removed from Chinese securities law in 2005 using an event study approach (Mackinlay 1997; Wang & Xie 2007). If the market preferred to retain the MBR, then the performance of shares in the market should be negative, given that the market did not fully anticipate the event before the event window. Consequently, negative abnormal returns are expected in this scenario.

In the modification of the 2005 securities law, the removal of the MBR was the only change within the framework under Chinese takeover law. It enables us to design a separate test to estimate the extent of the impact that the removal of the MBR had on the securities market. A crucial question to ask is whether there were any other laws relevant to takeover bids that were modified at or around the same time. It is a fact that the Chinese legislature tends to group adjustments on laws from different departments in a single period. As such, it is no surprise that Chinese company law also was modified around the same timeframe. A detailed comparison by the author was made between the new and old versions and concluded that there are no further changes related to takeover bids.

It is admittedly challenging to test the impact of the return of the MBR in 2006 because the change was an administrative rule-making process, and information leaks were inevitable. Therefore, the market was likely to have anticipated this reversal and react well in advance from the event window. Moreover, information leakage could
contaminate the results of any test, and if the event window is excessively long, then the
test may be interrupted by noise. The law-making process is very rigid from a
confidentiality perspective. We will, therefore, only focus on the 2005 modification.

As previously mentioned, Chinese securities law was revised and published on 27\textsuperscript{th}
October 2005. The modification abolished the MBR in its entirety. Article 88 of the
revised law stipulates that any bidder whose acquired proportion reaches 30\% may choose
a tender offer for all or part of the remaining shares. This change, while seemingly
insignificant, ultimately disabled the MBR. Bidders no longer have an obligation to
acquire all shares from minority shareholders and would no longer have to share the
control premium. Instead, bidders can launch a tender offer at any per cent based on their
needs. We can confidently conclude that the 2005 securities law abolished all functions
of the MBR. Based on this conclusion, we can set two hypotheses to test:

Hypothesis one: the mandatory bid rule is negatively associated with stock price
consistent with the low-efficiency view (Enriques 2004).

Hypothesis two: the mandatory bid rule is positively associated with stock price
consistent with the value-enhancing view (Shuster 2013).
a. Sample selection, measures of stock cumulative abnormal return, and descriptive statistics

1) Sample selection

We acquired firm-year observations available from the Wind Info database for all listed entities from the Shanghai Stock Exchange in 2005. There are two major stock exchanges in China, the Shanghai Stock Exchange and the Shenzhen Stock Exchange. At the beginning of 2005, the latter is far less developed compared to the former (Yuan 2004). For a long time after establishment, the Shenzhen Stock Exchange only enlisted small and medium-sized firms (Yuan 2004). In terms of comprehensiveness and diversification, the Shanghai Stock Exchange (SSE) was undoubtedly more suitable for empirical study. Aside from price information, we also collected the following information, which is believed to be relevant to the probability of being subject to a tender offer to trigger the MBR: capitalization, control block, number of years after IPO, State ownership, earnings before interest and tax (EBIT), size of non-tradable shares, leverage ratio, free cash flow and number of shareholders. An industry categorization code also is included for further study.
2) Measures of stock cumulative abnormal return, price impact and coding for the MBR possibility score

Following previous literature on short-term performance studies (Brown & Warner 1980, 1985), we construct a firm-specific cumulative abnormal return measure by taking the difference between actual cumulative return and expected cumulative return in an event window. Taking into account the fact that the market may not be at absolute efficiency, it is practical to use cumulative abnormal return (CAR) instead of abnormal return (AR) to calculate the impact of the removal of the MBR.

\[
AR_{i,t} = R_{i,t} - E[R_{i,t} | X_t]
\]

\[
CAR_{i(t_o,t_o+k)} = \sum_{t=t_0}^{t_0+k} AR_{i,t}
\]

The abnormal return of each share i in a specific time t (denominated as ARi,t) equals to its actual return, less the expected return given that change occurs. Cumulative abnormal return sums up ARs in a specific window period (+k).

We define the event happening day T_0, which is on 27th October 2005. For the interval estimation period T_0-T_1, we use a 120-day estimation period. The interval T_1-T_2 is the event window. The interval T_2-T_3 is the post-event window. We leave a 30-day gap between the estimation period and the event window to isolate the impact.
We use the market model to run OLS regressions to estimate variables for getting expected return. \( R_{i,t} = E[R_{i,t}|X_t] + \epsilon_{i,t} \), where \( E[R_{i,t}|X_t] + \alpha_i + \beta_i \times R_{m,t} \). In this model, \( R_{m,t} \) is the return of the Shanghai Stock Exchange composite market index, and the model’s linear specification follows from an assumed joint normality of returns. We use the period from 30 to 150 days before the event as the estimation for \( \alpha \) and \( \beta \). After having derived the expected return, the difference between actual and expected return is the abnormal return. Subsequently, we sum up the abnormal returns in the event window in order to record the cumulative abnormal return (Linn & McConnell 1983).

Finally, we utilize cumulative abnormal returns as a dependent variable to regress on the independent variables, which we believe to be relevant to a higher probability of receiving a tender offer, which will thus have an impact on market reaction. The regression helps us to answer the question of whether the cumulative abnormal return is correlated with firms with a strong potential of being a target firm in a takeover. Moreover, we can prove whether either of the hypotheses above is correct.

\[
CAR_t = \alpha_t + \beta_{1i} \times X_{1i} + \beta_{2i} \times X_{2i} + \cdots \beta_{ji} \times X_{ji} + \epsilon_{i,t}
\]

Capitalization is an essential indicator of a takeover deal. The larger the firm is, the lower takeover risk it faces. It is because a more significant project demands higher capital,
which limits the number of cases from a demand and supply perspective. The listed firms are categorized into three groups: big, medium and small firms. The top 30% in capitalization is considered a big firm, while the bottom 30% is defined as a small firm. The remaining firms in the middle band are categorized as medium-sized.

If a shareholder controls 30% or more of a listed company, we can safely conclude that there is a controlling shareholder. It means that it is highly probable that someone interested in gaining control would need to acquire the shares from the existing controller. Transferring the controlling share block usually will trigger the application of the MBR.

If there is no shareholder with more than 30% of a listed company shares, the probability of triggering the MBR is at its lowest.

The length of time on the market can be evidence demonstrating the odds of being eaten by sharks in the market. We categorize firms into three classes of survival: less than five years, longer than five years but no more than ten years, and longer than ten years. If a firm is on the market for 10 years and is not taken over, the possibility of triggering the MBR is low.

EBIT is a useful measure to analyze the performance of a firm. If a firm's EBIT is below its industry average, it is underperforming. Many potential bidders are likely to be interested in the firm for the margin of value maximization (Romano 1992). If EBIT is around the average mark, it should be facing relatively fewer potential bidders. If it is above the average, this indicates that the performance of the firm is strong. There are not many non-synergy gains for potential bidders, therefore, we believe the probability of triggering the MBR is low.
The size of non-tradable shares is a unique aspect of the Chinese market. In order to comply with regulations and rules limiting the liquidity of certain types of shares, the Chinese capital market regulator introduced non-tradable shares. It is a misnomer because non-tradable shares can be traded. There are two conditions for non-tradable shares to be transferred: trade by way of agreement and approval obtained from the CSRC. Therefore, the larger the size of non-tradable shares, the higher probability that there will be a wholesale agreement. It is because the transaction costs ensure that wholesale is a more appropriate choice compared to retail sales. Intuitively, if the percentage of non-tradable shares is higher than 30%, it is likely that the MBR will be triggered in the share transfer process.

The leverage ratio and the size of free cash flow are useful factors to consider for management performance. If the leverage ratio is excessively higher than the industry average, this suggests the existence of management problems (Romano 1992). Excessive free cash flow is a characteristic of being a takeover target (Romano 1992). We, therefore, use the same rationale as EBIT to leverage ratio and size of free cash flow to determine the odds of being taken over. Of course, the comparison is still on an industry level instead of a market level, because different industries may have different ideal leverage ratios and size of free cash flow (Romano 1992). If they are higher than their industry average, it might attract the attention of potential bidders.

(Insert Table 1 about here)
Besides regressing on the factors mentioned above (Table 1), we also code these factors to produce a comprehensive MBR Possibility Score (MBRPS).\textsuperscript{2} The score reflects the likelihood of being a target in the takeover market and thus trigger the MBR. The higher the score is, the more likely a firm will become a target and launch an unconditional offer to all shareholders. The highest score is 18, while the lowest score is 0. Each individual coding is divided into three bands that range from 0 score to 2 score. 0 score means the low possibility that the MBR will trigger.

On the contrary, a 2 score means firm with the feature is probably targeted and trigger MBR. In the coding of the State-owned feature, we only set two bands because the feature is a dummy: either State-owned or not. If the firm is State-owned, although it will not significantly reduce the likelihood of being acquired, the frequency of triggering the MBR is low. The dominant number of State-owned firms and the exemption rule for State-owned firms has led to this inclusion. As the MBR is triggered at the 30% threshold, the controlling shareholder and the size of non-tradable shares are dummy factors that use 30% as the cut-off line.

\textsuperscript{2} To be sure, the rationale of PBS is based on western takeover literature. A fair question can be if the western standards on difficulty level in takeover are entirely applicable to the Chinese market. It is indeed an interesting issue that the author would like to find out. The best way to test it could be using Probit Analysis method to test if the score has the same explanatory power for Chinese firms as for western counterparts. The author looked into quite a lot of Chinese and English databases in order to find out a comprehensive one that can reflect the frequency of facing tender offer for Chinese firms. Unfortunately, none is reliable enough for the author to declare the to-be-done Probit test is a convincing one. Of course, it is not new that Chinese related researches directly apply the research outputs from western literature. The author only would like to leave a caveat here to illustrate the degree of the explanatory power of this research.
3) Descriptive statistics

(Insert Table 2 about here)

Table 2 highlights descriptive statistics on all of the nine variables used for MBRPS. We compared the data of the listed firms in SSE in 2005 from Bloomberg, WRDS and Wind. We discovered that Wind is the most comprehensive database for that particular year, with 838 companies in the sample. Even if we used the most comprehensive database, some items would nevertheless be missing for various reasons. In most cases, incomplete data is usually missing no more than one parameter.

The share concentration in the Chinese capital market is high. The mean is 42%, and the standard deviation is 16%, which means that in China, it is easy to trigger the MBR if existing controlling shareholders want to transfer their share blocks completely. The non-transferable shares percentage was high across Chinese listed companies in 2005. The mean is 59%, and the standard deviation is 12%. For any shareholders holding the individual shares and wishes to transfer, the only method of transaction is by agreement, and the proportion is very likely more than 30%. The mean of government control is 35% with a standard deviation of 26%, which suggests that the Chinese government does not control a large proportion of listed companies. Since Shanghai established its stock exchange in 1991, it had been fourteen years in 2005. The firms with the longest listing history have been on the stock exchanges for almost fourteen years, although the mean of the years after IPO is six years. Market capitalization distribution is very similar to the
shareholder number variable, which implies that the firms are very diversified in the two features. Debt ratio, EBIT and Free Cash Flow are observed on a market level. Undoubtedly, the firms' features relevant to the rule are highly diversified. It is challenging to select one or two categories to describe them all.
b. Main Empirical Results

1) CAR

We firstly would like to know the market performance when congress promulgated the new law. Cumulative Abnormal Return (CAR: actual return less expected return in an event window) is a suitable indicator to demonstrate the degree of market performance. This research tests multiple event windows in order to find out CAR to the changes because the information dissemination degree may vary in different markets. Moreover, Chinese markets may not have absolute efficiency. Therefore, we need to use multiple event windows to test CAR instead of merely taking the event day price change as evidence of impact.

The day when 2005 Chinese securities law is promulgated is the event day. A fair question could be if the market expects that MBR was going to be removed before the official promulgation day? If so, the draft releasing day should be the event day. The first draft of the law was publicized six months before the event day, where the modification on MBR was not the focus of the draft. However, two months before the event day, the second draft of the law was published for comments, where people can easily find the proposed change on MBR. The linchpin for investors to establish an expectation of MBR abolishment is the certainty of the draft.

Nonetheless, Chinese legislation drafts usually will be modified multiple times before the promulgation. Years of collecting comments and several versions of drafts are not news. It would not be a surprise that draft provisions vanish or new provisions are created on the promulgation version. Therefore, although previous government publications have
some impact on investors' expectation, it is reasonable to use the promulgation day as the event day to test the significant impact of the abolishment of MBR on the market.

We recorded various event windows: the day before and after the event, the event day and a day before the event, the event day and a day after the event, three days before and after the event, five days before and after the event, and five days before the event and the event day. Panel A highlights that there is significant cumulative abnormal return five days before and after the event. On event day and a day before the event period, there is CAR, but not as significant as the ten-day period as well as the five days before the event and the event day period. It appears the market reacts positively when the MBR is removed through generating a significant abnormal return in a reasonable period. The CAR amounts to 22.73%.

(Insert Panel A about here)

From the comparison of the abnormal returns across the different event windows, it is intriguing to see that the market reaction is particularly evident around five days before and after the event date, and is relatively strong one day before the event day. The abnormal return continues to accumulate within five days after the event date. We have also tested ten days before and after the event day, however, there are no significant abnormal returns.

Additionally, we are interested in understanding how the firms with a higher possibility of triggering the MBR performed in the respective periods. We selected ownership
concentration and the size of non-tradable shares as dimensions to test. Panel C almost coincides CAR in the ten-day period (five days before and after the event). The firms with controlling shareholders greater than 50% of the outstanding shares produced 22.62% abnormal return in the period with 5% significance, while the firms without absolute control failed to offer abnormal returns.

Most of the holders of the non-tradable stock are the State controlling shareholders and high-level executives that are under performance incentive schemes. If the non-tradable shares exceed half of the outstanding shares of the firm, it is highly likely that when a control transaction occurs, the MBR will apply. The test in Panel C suggests that there is a CAR for firms with more than 50% of non-tradable shares. It amounts to 22.73% with significance, while the rest does not report CAR.

(Insert Panel B about here)

(Insert Panel C about here)

As we used the proportion of control and the proportion of non-tradable shares to categorize sample groups, there may be more information in the classifications. We would like to understand if the classifications are biased as it may lead to inaccurate outcomes. We conducted the T-test to see if the sample means in all controlled variables are significantly different. Judging from Tables 3 and 4, we can find that the comparison groups are very different in terms of the variables’ sample means reporting significance.
The significant differences in the firm characteristics might be the factors driving event-day abnormal returns, instead of firms being more or less likely to be subject to the MBR. To address this concern, we further include additional control variables, as well as implementing a more sophisticated measure related to takeover likelihood in the multivariate regression study to test how event-date abnormal return is affected by the likelihood of triggering the MBR.

(Insert Table 3 about here)

(Insert Table 4 about here)

2) Multivariate Regressions

We take three steps in Table 5 to increase the control number in order to determine the consistency of the significance of the coefficients in the regression. In the first step, we put in the number of shareholders as well as the percentage of director control to find significance. Subsequently, we add the percentage of non-tradable shares and the firm size with the two previous variables to find the coefficients. Percentage of non-tradeable shares is the only parameter without significance. There are several possible explanations for the non-significance. Firstly, the statistics for the percentage of non-tradable shares is very noisy. Some of the firms have non-tradable shares due to incentive plans for executives. The size of non-tradable shares consists of many small share blocks held by directors and officers. The change in takeover law does not impact the transaction costs.
Secondly, most of the firms with non-tradable shares are also State-owned. Control is usually transferred between other State-owned entities (SOEs) or subjects. According to the exemption rule for the transfer between firms under the same controller, the MBR will not be triggered.

To be sure, the state owner can behave differently in certain situations when compared to private controlling shareholders. The utility of the state owner could be maximizing the value of the firm in most cases. However, when the financial interest conflicts with the political agenda, the state, of course, prioritizes the agenda (Weng 2017). In the takeover market, there are usually less political considerations as long as the industry involved is not national security. Therefore, we assume the SOE should act as profit-driven as private controlled firms in facing takeover deals, which means SOE should receive the same chance of being under tender offer as non-state actors in the market. The only difference is the one mentioned above: when the deal is between two SOEs, MBR becomes less relevant.

Findings in the first two regressions are consistent with the results in the sample study in section 3(1). We observed that companies with a higher shareholder score (with a lower number of shareholders) and companies with a higher percentage of direct control tend to have greater positive returns. These two features of a company, namely ownership concentration and greater direct control, are closely related to the possibility of triggering the MBR.

The third step is the comprehensive multivariate regression, which considers all factors that we previously recognized as having the effect of triggering the MBR. The number of
shareholders, percentage of direct control and the firm size report positive correlation with the CAR, while IPO years and government control show a significant negative correlation. The results are predominantly consistent with our model construction. With a higher percentage of a controlling share block, it should be easier to trigger the rule. It was unexpected that the size of the firm is positively correlated with the CAR. From financial literature, big firms usually report more robust takeover abnormal returns. There are two effects of removing the MBR, namely, growth in the firm size but also an increased cost of takeover. Although the CAR experienced a downward trend, the positive effects offset the adverse effects and ultimately shows a positive result.

As we predicted, years on the market after IPO and government-controlled share percentage show a negative correlation with the abolishment of the MBR. It means the abolishment of the rule has minimal impact on the State as a controlling shareholder. The State often transfers its control amongst other State-owned enterprises, which would not trigger the application of the MBR.

Interestingly, the percentage of direct control only reports statistical significance due to the abolishment of the MBR, instead of both statistical and economic significance. It should be a significant parameter to report the correlation between the rule change and CAR.

It may be owing to two reasons. Firstly, the impact is partially absorbed by the number of shares as these two variables are closely related, and secondly, the marginal impact may not be economically significant. A reasonable explanation should be that the benchmark-setting in triggering the application of the MBR is currently unclear because there are
methods to circumvent the application of the MBR in practice. For instance, using orchestrated parties to acquire control or flying just under the radar by sitting under the 30% requirement, are both commonly used methods to circumvent the application of the rule. This finding is in line with previous criticism of the MBR (Fu 2017).

Finally, we regress CAR on MBRPS. The first score (column 4) consists of all nine variables and reports a positive correlation with the change. The second score (column 5) consists of variables we found with significance in previous multivariate regressions only. The correlation is still reported to be significant, but the significance and confidence levels are higher. It suggests that the abolishment of the MBR has had a positive effect on the share price in the Chinese capital market, with impact on companies with a higher possibility of trigging the MBR to be more significant. The market welcomes the change.

(Insert Table 5 about here)
IV. CONCLUSION

There continue to be disputes over the effectiveness of the Mandatory Bid Rule (MBR). It is necessary to examine this in the context of a specific jurisdiction, however. Jurisdictions often ‘borrow’ legal frameworks from other jurisdictions, however, this is not always effective as the suitability of the framework has not been considered. As such, the legislation and operation of the MBR in China have been criticized for its ineffectiveness.

Three significant features determine the optimal application of MBR in China. Firstly, the ownership structure has proven to be less concentrated over time, and most of the firms are controlled without a control share block. It means that the MBR is not a one-size-fits-all solution, and usually, the rule can be evaded through fraction after fraction trading. Secondly, there is no evidence proving that the Private Benefit of Control (PBC) comes from legal operations from the perspective of developing minority shareholder protection. In light of the ambiguous feature of PBC, sharing PBC in every case raises an issue of equality. Lastly, a successful MBR largely depends on a competent enforcement agency. If the agency places a greater emphasis on market growth compared to the protection of minority shareholders, then the MBR will not be able to satisfy its purpose as it lacks enforcement support. The empirical results suggest that the Chinese market has responded undesirably to the MBR, evident through share price fluctuations. It has been determined that the higher the likelihood that a firm triggers the MBR, the higher the share price will fluctuate when the rule is removed. This paper concludes that the existing MBR can be replaced by an opt-out mandatory bid system to allow individual firms to maximize their
utilities so that minority shareholders are protected while also enjoying the benefits.
APPENDIX

Table 1
MBR Possibility Score (MBRPS) Chart

This Table provides the factors, which are believed to be relevant to the probability of being subject to a tender offer to trigger the MBR. In Table 5, all the factors of this table will be used in producing a takeover score variable (MBRPS) to calculate the coefficient between it and Cumulative Abnormal Returns (CAR). We categorize each of the factors into three bands receiving 2, 1 and 0 point respectively. The higher takeover possibility with the increase/decrease of the factor, the higher score band it will receive. Eventually, in Table 5 we are going to use all the factors to derive a MBRPS based on the features of an individual firm. The follow is the explanation on the definition of each variable we believe will affect the probability of being under a tender offer.

Panel A Variable Definition

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalization</td>
<td>An important indicator for a takeover deal. The listed firms are categorized into three groups: big (top 30% in capitalization), medium and small firms (the bottom 30%).</td>
</tr>
<tr>
<td>Controlling shareholders</td>
<td>A shareholder controls 30% or more of a listed company</td>
</tr>
<tr>
<td>Years after IPO</td>
<td>Firms are categorized into three classes of survival: less than five years, longer than five years but no more than ten years, and longer than ten years.</td>
</tr>
<tr>
<td>EBIT</td>
<td>Earnings before interest and taxes (EBIT) is a company's net income before income tax expense and interest expense have been deducted.</td>
</tr>
<tr>
<td>Size of Non-tradable shares</td>
<td>In order to comply with regulations and rules limiting the liquidity of certain types of shares, the Chinese capital market regulator introduced non-tradable shares.</td>
</tr>
<tr>
<td>Leverage Ratio</td>
<td>A useful factor to consider for management performance. If the leverage ratio is excessively higher than industry average, this suggests the existence of management problems.</td>
</tr>
<tr>
<td>Shareholders</td>
<td>A factor shows how big the shareholder group is.</td>
</tr>
<tr>
<td>State-owned</td>
<td>A variable indicates if the firm is state-owned</td>
</tr>
<tr>
<td>Free Cash flow</td>
<td>It measures the free cash flow level of an individual firm across its individual industry</td>
</tr>
</tbody>
</table>
## Panel B: Score Construction

<table>
<thead>
<tr>
<th>No.</th>
<th>Variables</th>
<th>2 scores</th>
<th>1 score</th>
<th>0 score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Capitalization (tradable)</td>
<td>Percentile</td>
<td>Percentile</td>
<td>Percentile</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(.7, 1)</td>
<td>(.3, .7)</td>
<td>(.01, .3)</td>
</tr>
<tr>
<td>2</td>
<td>Shareholders</td>
<td>Percentile</td>
<td>Percentile</td>
<td>Percentile</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(.01, .3)</td>
<td>(.3, .7)</td>
<td>(.7, 1)</td>
</tr>
<tr>
<td>3</td>
<td>Controlling shareholders</td>
<td>P&gt;=30%</td>
<td>N/A</td>
<td>P&lt;30%</td>
</tr>
<tr>
<td>4</td>
<td>Years after IPO</td>
<td>5&gt;Y</td>
<td>10&gt;Y&gt;=5</td>
<td>Y&gt;10</td>
</tr>
<tr>
<td>5</td>
<td>State-owned feature</td>
<td>N</td>
<td>N/A</td>
<td>Y</td>
</tr>
<tr>
<td>6</td>
<td>EBIT</td>
<td>Below industry average</td>
<td>On average (within the range of 10%)</td>
<td>Above industry average</td>
</tr>
<tr>
<td>7</td>
<td>Size of Non-tradable shares</td>
<td>S&gt;=30%</td>
<td>N/A</td>
<td>S&lt;30%</td>
</tr>
<tr>
<td>8</td>
<td>Leverage Ratio</td>
<td>Above industry average</td>
<td>On average (within the range of 10%)</td>
<td>Below industry average</td>
</tr>
<tr>
<td>9</td>
<td>Free Cash Flow</td>
<td>Above industry average</td>
<td>On average (within the range of 10%)</td>
<td>Below industry average</td>
</tr>
</tbody>
</table>
Table 2
Descriptive Statistics

Table 2 highlights descriptive statistics on all of the nine variables used for MBRPS.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs.</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct Control</td>
<td>819</td>
<td>42%</td>
<td>16%</td>
<td>6%</td>
<td>84%</td>
</tr>
<tr>
<td>Non-Tradable Shares</td>
<td>819</td>
<td>59%</td>
<td>12%</td>
<td>0%</td>
<td>91%</td>
</tr>
<tr>
<td>GovtControlled</td>
<td>820</td>
<td>35%</td>
<td>26%</td>
<td>0%</td>
<td>85%</td>
</tr>
<tr>
<td>IPO_Years</td>
<td>838</td>
<td>6</td>
<td>4</td>
<td>0</td>
<td>14</td>
</tr>
<tr>
<td>Number of Shareholders</td>
<td>819</td>
<td>41693</td>
<td>46090</td>
<td>3126</td>
<td>578642</td>
</tr>
<tr>
<td>MarketCap_M</td>
<td>829</td>
<td>2812</td>
<td>12141</td>
<td>137</td>
<td>309492</td>
</tr>
<tr>
<td>DebtRatio</td>
<td>819</td>
<td>59%</td>
<td>75%</td>
<td>4%</td>
<td>47%</td>
</tr>
<tr>
<td>EBIT_M</td>
<td>819</td>
<td>284</td>
<td>2496</td>
<td>-1334</td>
<td>66629</td>
</tr>
<tr>
<td>FreeCF_M</td>
<td>819</td>
<td>107</td>
<td>1026</td>
<td>-3705</td>
<td>20202</td>
</tr>
</tbody>
</table>
Table 3 Event Study

In Panel A, analysis tests multiple event windows in order to find out CAR to the changes considering the fact that the information dissemination degree may vary in different markets. It highlights that there is significant cumulative abnormal return five days before and after the event. CAR (Cumulative Abnormal Return): actual return less expected return in an event window. Panel B provides ownership concentration as a dimension to test how the firms with a greater possibility of triggering the MBR performed in the respective periods. Event Window shows the period crossing the event day, which is defined as day 0. Percentage of direct control describes the size the control block. Panel C provides the size of non-tradable shares as a dimension to test how the firms with a greater possibility of triggering the MBR performed in the respective periods. P-values are in parentheses. ***, **, and * indicates statistical significance of 1%, 5%, and 10% respectively.

Panel A Event Study with Whole Sample (Kp test)

<table>
<thead>
<tr>
<th>Event Windows</th>
<th>(-1,1)</th>
<th>(-1,0)</th>
<th>(0,1)</th>
<th>(-3,3)</th>
<th>(-5,5)</th>
<th>(-5,0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAR</td>
<td>2.97%</td>
<td>8.8%**</td>
<td>-5.53%</td>
<td>7.88%</td>
<td>22.73%**</td>
<td>13.84%**</td>
</tr>
<tr>
<td>P-Value</td>
<td>(0.5341)</td>
<td>(0.0242)</td>
<td>(0.1564)</td>
<td>(0.2809)</td>
<td>(0.013)</td>
<td>0.0408</td>
</tr>
</tbody>
</table>

Panel B Event Study with Groups by Direct Control Ownership

<table>
<thead>
<tr>
<th>Event Windows</th>
<th>(-1,1)</th>
<th>(-1,0)</th>
<th>(0,1)</th>
<th>(-3,3)</th>
<th>(-5,5)</th>
<th>(-5,0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>percent of direct control</td>
<td>2.89%</td>
<td>8.75%**</td>
<td>-5.57%</td>
<td>7.76%</td>
<td>22.62%**</td>
<td>13.75%**</td>
</tr>
<tr>
<td>&gt;50% (obs=307)</td>
<td>(0.5341)</td>
<td>(0.0212)</td>
<td>(0.1427)</td>
<td>(0.2747)</td>
<td>(0.0111)</td>
<td>(0.0366)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Event Windows</th>
<th>(-1,1)</th>
<th>(-1,0)</th>
<th>(0,1)</th>
<th>(-3,3)</th>
<th>(-5,5)</th>
<th>(-5,0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>percent of direct control</td>
<td>-0.30%</td>
<td>-0.96%</td>
<td>1.48%</td>
<td>-4.26%</td>
<td>-4.83%</td>
<td>-0.13%</td>
</tr>
<tr>
<td>&lt;50% (obs=532)</td>
<td>(0.9501)</td>
<td>(0.8094)</td>
<td>(0.7088)</td>
<td>(0.5656)</td>
<td>(0.6030)</td>
<td>(0.9850)</td>
</tr>
</tbody>
</table>

Panel C Event Study with Groups by Direct Control Ownership

<table>
<thead>
<tr>
<th>Event Windows</th>
<th>(-1,1)</th>
<th>(-1,0)</th>
<th>(0,1)</th>
<th>(-3,3)</th>
<th>(-5,5)</th>
<th>(-5,0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>percent of Non-tradable</td>
<td>-15.55%</td>
<td>8.81%**</td>
<td>-5.53%</td>
<td>7.89%</td>
<td>22.73%**</td>
<td>13.84%**</td>
</tr>
<tr>
<td>Shares&gt;50% (obs=157)</td>
<td>(0.5304)</td>
<td>(0.0236)</td>
<td>(0.1555)</td>
<td>(0.2787)</td>
<td>(0.0128)</td>
<td>(0.0401)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Event Windows</th>
<th>(-1,1)</th>
<th>(-1,0)</th>
<th>(0,1)</th>
<th>(-3,3)</th>
<th>(-5,5)</th>
<th>(-5,0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>percent of Non-tradable</td>
<td>0.10%</td>
<td>0.77%</td>
<td>-0.82%</td>
<td>-8.02%</td>
<td>-2.62%</td>
<td>-2.49%</td>
</tr>
<tr>
<td>Shares&lt;50% (obs=682)</td>
<td>(0.9840)</td>
<td>(0.8454)</td>
<td>(0.8366)</td>
<td>(0.2788)</td>
<td>(0.7774)</td>
<td>(0.7168)</td>
</tr>
</tbody>
</table>
Table 3

Companies with direct control ownership > 50%

This table shows the result of T-test to see if the sample means in all controlled variables are significantly different.

<table>
<thead>
<tr>
<th></th>
<th>&gt;0.5</th>
<th>&lt;0.5</th>
<th>t-statistics</th>
<th>p-value for the mean difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Observations</td>
<td>307</td>
<td>532</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct Ownership Pct</td>
<td>0.60</td>
<td>0.32</td>
<td>44.22</td>
<td>0.0000</td>
</tr>
<tr>
<td>Market Cap (Millions’)</td>
<td>4601.47</td>
<td>1812.60</td>
<td>3.19</td>
<td>0.0015</td>
</tr>
<tr>
<td>IPO Years</td>
<td>6.37</td>
<td>6.69</td>
<td>-2.38</td>
<td>0.0174</td>
</tr>
<tr>
<td>Number of Shareholders(10000's)</td>
<td>4.55</td>
<td>3.96</td>
<td>1.73</td>
<td>0.0839</td>
</tr>
<tr>
<td>Government Controlled (Pet)</td>
<td>0.52</td>
<td>0.25</td>
<td>16.41</td>
<td>0.0000</td>
</tr>
<tr>
<td>EBIT (Millions’)</td>
<td>623.70</td>
<td>101.05</td>
<td>2.87</td>
<td>0.0042</td>
</tr>
<tr>
<td>Debt Ratio</td>
<td>0.53</td>
<td>0.62</td>
<td>-1.57</td>
<td>0.1164</td>
</tr>
<tr>
<td>FCF (Millions’)</td>
<td>256.19</td>
<td>26.68</td>
<td>3.07</td>
<td>0.0022</td>
</tr>
<tr>
<td></td>
<td>t-statistics</td>
<td>p-value for mean difference</td>
<td>p-value for the mean difference</td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td>--------------</td>
<td>-----------------------------</td>
<td>--------------------------------</td>
<td></td>
</tr>
<tr>
<td>Number of Observations</td>
<td>157</td>
<td>682</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Tradable Shares Pct</td>
<td>0.64</td>
<td>0.40</td>
<td>33.54</td>
<td>0.0000</td>
</tr>
<tr>
<td>Market Cap (Millions')</td>
<td>3085.93</td>
<td>1656.38</td>
<td>1.34</td>
<td>0.1821</td>
</tr>
<tr>
<td>IPO Years</td>
<td>6.02</td>
<td>8.35</td>
<td>-7.57</td>
<td>0.0000</td>
</tr>
<tr>
<td>Number of Shareholders(10000's)</td>
<td>3.81</td>
<td>5.66</td>
<td>-4.60</td>
<td>0.0000</td>
</tr>
<tr>
<td>Government Controlled (Pct)</td>
<td>0.38</td>
<td>0.20</td>
<td>8.28</td>
<td>0.0000</td>
</tr>
<tr>
<td>EBIT (Millions')</td>
<td>317.77</td>
<td>317.77</td>
<td>0.7838</td>
<td>0.4334</td>
</tr>
<tr>
<td>Debt Ratio</td>
<td>0.57</td>
<td>0.63</td>
<td>-0.84</td>
<td>0.4028</td>
</tr>
<tr>
<td>FCF (Millions')</td>
<td>124.39</td>
<td>35.35</td>
<td>0.98</td>
<td>0.3263</td>
</tr>
</tbody>
</table>

Table 4
Companies with Non-Tradable Shares > 50%
Table 5
Determinants of Cumulative Abnormal Returns

This table shows the results on the correlation between Cumulative Abnormal Returns (CAR) and the determinants selected based on the probability of being under a tender offer in Table 1. The Takeover Score variable is a number calculating through summing up all factors of an individual company MBRPS listed in Table 1. The coefficients are estimated in step (4) and (5). The difference between step (4) and (5) is we only put the factors with significance in testing the determinants in previous three steps in calculating step (5), while in step (4) puts all factors in Table 1 to construct a score. Additionally, three steps were processed in Table 5 to increase the control number in order to determine the consistency of the significance of the coefficients in the regression. In the first step, the number of shareholders as well as the percentage of director control to find significance were put in. Subsequently, it added the percentage of non-tradable shares and the firm size with the two previous variables to find the coefficients. The third step is the comprehensive multivariate regression, which considers all factors that were recognized as having the effect of triggering the MBR. N_shareholder_score means number of shareholders score. DirectControl_Pct_Shares stands for the score based on the control size. And, Non Tradable_Pct is the percentage of non-tradable share in a firm. The coefficients are reported in the table. P-values are reported in parentheses. ***, **, and * indicates statistical significance of 1%, 5%, and 10% respectively.

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
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<tbody>
<tr>
<td>Takeover_Score</td>
<td></td>
<td></td>
<td></td>
<td>0.001**</td>
<td>0.03***</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(0.036)</td>
<td>(0.009)</td>
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<tr>
<td>N_shareholders_Score</td>
<td>0.013*</td>
<td>0.021***</td>
<td>0.016**</td>
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<td></td>
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<tr>
<td></td>
<td>(0.064)</td>
<td>(0.007)</td>
<td>(0.035)</td>
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<tr>
<td>DirectControl_Pct_Shares</td>
<td>0.000**</td>
<td>0.000*</td>
<td>0.000**</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>(0.013)</td>
<td>(0.064)</td>
<td>(0.022)</td>
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<td></td>
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<tr>
<td>NonTradable_Pct</td>
<td>-0.023</td>
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</tr>
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<td>(0.105)</td>
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<td>Firm_Size</td>
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<td>0.009**</td>
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<td>(0.010)</td>
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<tr>
<td>EBIT</td>
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(Continued)
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<th>Model Column</th>
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<th>Estimation 2</th>
<th>Estimation 3</th>
<th>Estimation 4</th>
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<tbody>
<tr>
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<td>(0.890)</td>
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<td></td>
<td></td>
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<td>-0.103***</td>
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<td>(0.000)</td>
<td>(0.023)</td>
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<td>768</td>
<td>768</td>
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<td>0.02</td>
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<tr>
<td>adjr2</td>
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<td>0.04</td>
<td>0.04</td>
<td>0.01</td>
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REFERENCE LIST


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