Governance by One-Lot Shares

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Abstract

Across the world, independent directors are accorded a key role in protecting public investors in firms with a controlling shareholder, but mechanisms on effectively disciplining and incentivizing independent directors to work diligently are lacking. Exploiting a recent novel experiment in China that created a minority activist investor – Securities Investor Service Center (ISC) to protect public investors, we examine how it changes the behaviors of independent directors in board decisions, and resulting financial policies that crucially impact the interests of outside minority investors. The ISC holds one hundred shares in pilot portfolio firms and exercises monitoring in the capacity of a special-identity shareholder. We find that relative to control firms, independent directors of the pilot firms are more likely to cast dissenting votes during the pilot period. Improved monitoring of independent directors and the ISC activism result in reductions in tunneling related-party transactions, earnings management, and the total number of M&As, but an increase in the number of value-enhancing M&As. Overall, the experiment represents a novel and fruitful effort to enhance the protection of public investors.

Keywords: Investor protection; shareholder activism; independent director voting; China; One-lot shares

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