Proceedings of the 3rd International Conference on Financial Technology and Business Analysis
DOI: 10.54254/2754-1169/155/2024.20641

Research on the Protection of Minority Shareholders' Rights in the Context of Major Shareholders' Expropriation: A Case Study of Pangda Group

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Abstract: In the context of the rapid development of the capital market and the frequent occurrence of expropriation incidents by major shareholders, this paper analyzes the process and methods by which the major shareholder of Pangda Group expropriates the listed company. Using event study methodology, the excess returns and cumulative excess returns are calculated to assess the negative impact of major shareholders' expropriation behavior on the capital market. The paper also proposes a series of suggestions for the protection of minority shareholders' rights under the expropriation of major shareholders, including the identification of warning signals and strengthening supervision, improving the collective litigation system, and introducing institutional investors to assist minority shareholders in participating in corporate governance and defending their rights. These suggestions aim to provide guidance for the protection of minority shareholders' interests in listed companies and contribute to the maintenance of order and healthy development of the capital market.

Keywords: Expropriation by Major Shareholders, Pangda Group, Protection of Minority Shareholders' Rights

1. Introduction

In China's capital market, there have been frequent incidents where major shareholders expropriate company assets, harming the interests of minority shareholders. These incidents affect the company's operational difficulties, stock price fluctuations, and cause damage to the rights of minority shareholders, disrupting the overall healthy functioning of the capital market. Although with the development of China's capital market, the proportion of minority shareholders in the capital structure of listed companies has been increasing, the natural informational and control advantages of major shareholders make it easier for them to expropriate the company and infringe upon the rights of minority shareholders. Strengthening the protection of minority shareholders' rights and improving supervision efficiency has become an urgent issue that needs to be addressed in the development of the capital market. As a well-established automobile trading company, Pangda Group's size and history make the economic consequences of its major shareholder expropriating the company and the resulting delisting of the company extremely severe, causing significant harm to the interests of minority shareholders. Studying the protection of minority shareholders' rights in the case of Pangda

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Group's expropriation provides insights into the protection of minority shareholders' rights, raises awareness of the issue, and helps maintain fairness and justice in the market.

2. Case Introduction

Pang Da Automobile Trading Group Co., Ltd. was established in 1988 under the name of Lu County Material Bureau Electromechanical Equipment Company. In 1999, it was restructured into a joint-stock company. The founder, Qinghua Pang, served as the chairman and general manager of the company for a long time. Pangda Group was once one of the largest automobile sales groups in mainland China, primarily engaged in automobile sales and services, representing many well-known domestic and international automobile brands. However, since 2017, Pangda Group has fallen into a debt crisis due to poor management. In 2019, the company announced its bankruptcy reorganization process as its debts became excessive. During the restructuring process, Jihong Huang gained actual control of the company through share transfer and business reorganization. In 2023, due to continuous losses, Pangda Group faced delisting by the Shanghai Stock Exchange. On May 20th, 2023, Pangda Group issued an announcement stating that it had received a regulatory letter from the Shanghai Stock Exchange regarding complaints from investors. The letter pointed out that investors had made several allegations against the company, its controlling shareholder, and actual controller, including the illegal misappropriation of listed company funds and assets, as well as attempts to avoid reorganization performance commitments through delisting. This incident led to the damage of the rights of approximately 250,000 shareholders, with stock price declines resulting in a decrease in investment value.

3. Methods of Expropriation

3.1. Capital Circulation to Gain Control

Jihong Huang, the actual controller of Pangda Group, used a series of carefully designed share transfers to gain control of Pangda Group's restructuring entity, Shen Shang Group, in just 23 minutes on April 28, 2019. In this brief period, 257 million yuan circulated through several companies, including Guomin Yunli and Shenzhen Shang Asset Management Co., Ltd., ultimately allowing Jihong Huang to gain actual control over Shen Shang Group. During this process, Huang Jihong leveraged the fund transfers among multiple companies without actually contributing capital, effectively gaining control of Shen Shang Group. This circular flow of funds drained Pangda Group's capital and involved illegal fund transfers and improper acquisition of control.

3.2. Selling Seized Assets

During the reorganization process, Pangda Group raised funds by selling assets, including its 4S stores and other land assets. On April 6, 2021, *ST Pangda's wholly-owned subsidiary Zhongji Xingwang was about to transfer its 100% stake in Zhongji Leye to Baolijia Pu for 655 million yuan, despite the fact that Zhongji Leye had already been seized by the Beijing Second Intermediate People's Court. Nevertheless, the auditing firm did not issue any warning regarding Zhongji Leye's seized status in its audit report on March 30, 2021. This situation sparked doubts about the company's attempt to evade a 3.5 billion yuan performance compensation obligation related to its reorganization and raised concerns about false information disclosure. Despite this, Pangda Group proceeded with asset sales, and the audit report failed to mention the seizure, suggesting concealment of important information.

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3.3. Inflating Assets of the Restructuring Entity and False Information Disclosure

On March 9, 2020, Pangda Group disclosed unaudited financial data in response to an inquiry letter. These data portrayed the financial situation of restructuring investors, such as Shen Shang Group, in a positive light. However, the audit report issued by Shenzhen Dagong Accounting Firm significantly contradicted the financial data disclosed by Pangda Group, revealing that Shen Shang Group was actually in a state of loss. This discrepancy indicated that the company might have concealed related-party relationships or fabricated transactions to indirectly occupy the listed company's funds. The Shanghai Stock Exchange required Pangda Group to review its previous planning activities and provide a detailed response on the prudence and compliance of its buyback announcement decision-making process. However, Pangda Group claimed through the Shanghai Stock Exchange's e-interaction platform and media reports that the buyback funds were already in place, although it had not formally responded to the exchange's inquiry. This behavior misled investors and potentially involved false information disclosure.

3.4. Malicious Delisting to Evade Performance Compensation Obligations

According to Pangda Group's 2022 annual report, the company failed to meet the performance commitment standards set by the restructuring investors, and was supposed to make up for a 3.5 billion yuan performance compensation. However, the company allegedly evaded this obligation through asset sales and malicious delisting.

4. Event Study Analysis of the Impact of Major Shareholders' Expropriation on Pangda Group's Stock Price

When analyzing the impact of the major shareholder's illegal actions on Pangda Group's stock price, the original plan was to set May 20, 2023, the date of the event announcement, as the baseline event date. However, due to insufficient market data within 15 trading days after the event, the analysis was extended to April 22, 2023, when Pangda Group first publicly disclosed that its stock price had fallen below 1 yuan or triggered delisting clauses. From the announcement date until May 19, *ST Pangda's stock price remained below 1 yuan for 17 consecutive trading days. This phenomenon suggests that, starting from April 22, the illegal actions of the major shareholder had a significant economic impact on Pangda Group. Therefore, April 22, 2023, was chosen as the event date. To assess the impact of this event on Pangda Group's stock price, the event window was set as 15 trading days before and after the event, i.e., the event window is [-15, 15]. To more accurately evaluate the specific impact of the event on stock prices, an estimation window of 100 days prior to the event window was chosen, i.e., [-115, -16], to more comprehensively analyze the effect of the major shareholder's violations on Pangda Group's stock price.

To analyze the normal returns of Pangda Group's stock, the following steps were taken:

4.1. Calculate Normal Returns

The normal return is calculated as: $R_{it}=\alpha+\beta*R_{mt}+\varepsilon$. Pangda Group is listed on the Shanghai Stock Exchange, so the Shanghai Composite Index (code: 000001) was used as the benchmark to obtain the market index return (R_{mt}) on day t. Regression analysis of the stock returns and market index returns during the estimation window provided estimates of the model parameters α and β, which were 0.596 and -0.00057, respectively.

4.2. Calculate Abnormal Returns (AR)

The abnormal returns (AR) on day t are calculated as: ARt=Rt-(α+β*Rmt). By substituting the estimated values of α and β into the event window, abnormal returns for each trading day t (ARt) were calculated.

4.3. Calculate Cumulative Abnormal Returns (CAR)

The cumulative abnormal returns (CAR) are calculated as: CAR=∑ARt=∑(Rt-α-β*Rmt). The abnormal returns for all trading days within the event window are summed to obtain the cumulative abnormal returns (CAR). To visually display the regression results during the estimation window, regression analysis was performed in Excel, and the regression fit for Pangda Group during the [-115, -16] estimation window was plotted. This helps to more accurately measure the potential impact of the major shareholder’s violations on Pangda Group’s stock price.

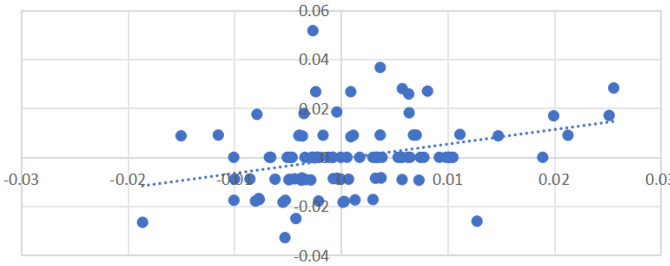

Figure 1: Regression Fit Chart

Based on the results of the regression analysis, the intercept and slope were used to substitute the daily return of the Shanghai Composite Index into the model to calculate Pangda Group's expected returns during the event window. By comparing the actual daily returns with the expected returns, the abnormal returns (AR) were obtained. These abnormal returns were then accumulated to calculate the cumulative abnormal returns (CAR).

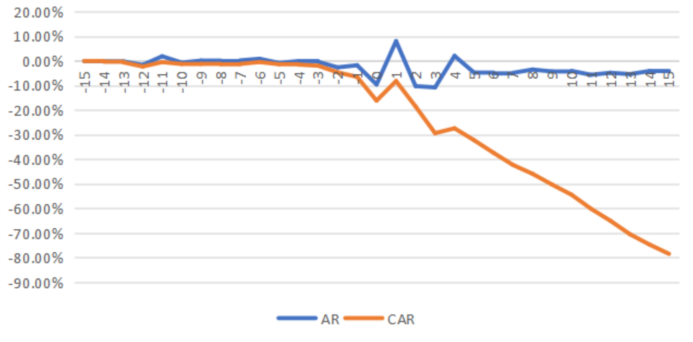

Figure 2: Abnormal Return (AR) and Cumulative Abnormal Return (CAR)

In the period from 15 days to 10 days prior to the event, the cumulative abnormal returns (CAR) and abnormal returns (AR) of Pangda Group’s stock generally remained at a level around 0, indicating that the market's expectations for the group were relatively stable, with no significant fluctuations. However, this stability was disrupted following the occurrence of the event. Shortly after the event, Pangda Group's CAR showed a significant downward trend, suggesting that in the short term after the event, there was a substantial gap between the actual returns of the stock and the expected normal returns. At the same time, the decline in AR also reflected the market’s immediate response to the event, with investors expressing negative evaluations of Pangda Group's prospects. The market

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recognized that this behavior posed a threat to the company’s long-term value and sustainability, leading to a negative reaction, as investors sought to reflect this risk through a decline in the stock price.

The expropriation actions of Pangda Group's major shareholders resulted in a significant loss of shareholder wealth, with an average of 40,000 yuan trapped for each of the 250,000 small shareholders, causing substantial economic damage. Furthermore, Pangda Group's case negatively impacted the credibility of the entire automobile dealership industry, diminishing consumer and investor trust in the industry’s internal management and regulation. This led investors to adopt a more cautious approach toward investing in other listed companies, which in turn affected the stability of the capital market. Such actions challenge the bottom line of legal regulations and raise doubts about the regulatory authorities’ supervisory capacity. Moreover, if such actions are not effectively curtailed, they may encourage other wrongdoers to follow suit, worsening the economic environment and impacting the healthy development of the economy.

5. Recommendations

5.1. Identifying Early Warning Signals of Major Shareholder Expropriation and Strengthening Regulation

During the operation of a company, small and medium shareholders should be alert to a series of abnormal phenomena, which may signal expropriation actions by major shareholders. The most concerning of these phenomena for small and medium shareholders are abnormal fluctuations in stock prices, which are the result of the company’s deteriorating financial situation and major shareholder expropriation behaviors. Attention should be paid to anomalies in financial reports and information disclosures, such as significant discrepancies or misleading information, which may indicate manipulation of information by major shareholders to deceive investors and regulatory authorities. This requires small and medium shareholders to possess some financial knowledge, and regulatory authorities and companies themselves should provide training, either offline or online, to help small and medium shareholders improve their identification skills. On a daily basis, attention should be paid to unusual stock transfers and capital flows within the company, especially frequent large and rapid transfers of capital between affiliated companies, which may indicate that the major shareholder is utilizing company resources to arrange capital transfers. If the invested company undergoes restructuring, and during the process, the major shareholder or related parties gain control rapidly through complex transactions without making an actual financial investment, as in the case of Pangda Group, it suggests that the major shareholder is exploiting the restructuring process for personal gain, which is a sign of impending expropriation. Small and medium shareholders should also be wary of unfulfilled performance commitments and attempts to evade compensation obligations, such as using asset sales to avoid responsibility. If the company suddenly sells important assets, especially disputed or seized assets, it may not only be an attempt to evade obligations but also a tactic to transfer company value by the major shareholder. These signs should all raise the alert of small and medium shareholders. More importantly, companies should establish shareholder protection committees to safeguard the rights of small and medium shareholders, and, in conjunction with internal and external audits, these warning signs should be identified and managed in a timely manner.

The premise for accurately identifying warning signals of major shareholder expropriation is to improve the information disclosure system and the approval processes for related party transactions, thereby creating a transparent and open corporate governance environment. [1] This requires companies to disclose their business conditions, financial reports, and related party transactions, among other information, to all shareholders at the prescribed frequency and in the required format. This includes not only regular annual and quarterly reports but also any significant information that may significantly affect stock prices, typically involving key changes in the company’s operational status, market prospects, and regulatory policies. For example, key contracts signed by the company may signal future revenue increases, major investment decisions reflect the company’s confidence and direction for future development, and the details of related party transactions could influence the market’s perception of the company’s independence and transparency. To prevent the transfer of benefits through related party transactions, a rigorous approval process should be established to manage these transactions. Any related party transaction should be submitted to independent directors or a dedicated committee set up by the board of directors for review to ensure the transparency and reasonableness of the transaction. Additionally, the pricing mechanisms of related party transactions should be monitored by comparing market prices or independent third-party assessments to ensure fairness and prevent harm to the interests of small and medium investors.

5.2. Improving the Class Action System and Relevant Laws and Regulations

To better protect the rights of small and medium shareholders, improvements should be made to the class action system and other related laws. The goal is to make the law a powerful tool for safeguarding the rights of small and medium shareholders. [2] First, the litigation process should be simplified, and the threshold and costs for litigation reduced to allow small and medium shareholders to more easily initiate class actions. Second, the role and resources of investor protection organizations should be strengthened to enable them to represent small and medium shareholders in lawsuits and ensure the fairness of the litigation process. Third, clear standards should be established for calculating losses, ensuring that small and medium shareholders receive reasonable compensation when their rights are violated. In cases where the cost of expropriation by major shareholders is low, a punitive damages system should be introduced to impose harsher penalties for willful violations, serving as a deterrent. At the same time, the quality of information disclosure by listed companies should be improved, a whistleblower protection mechanism should be established, and the scope of class action lawsuits should be expanded. Legal education and public awareness should be strengthened, a model judgment mechanism should be set up, and the effective enforcement of favorable judgments should be ensured. These improvements will help build a more complete and efficient class action system for small and medium shareholders, thus better safeguarding their legitimate rights and interests in the capital market. Furthermore, the law should clearly grant small and medium shareholders the right to access relevant company documents. This right enables small and medium shareholders to independently assess the company’s financial status and promptly detect potential violations. Special media protection laws should also be introduced to protect journalists and media organizations that expose expropriation actions by major shareholders, preventing them from facing retaliation.

The protection of small and medium shareholders' rights requires not only legal support but also an improvement in their own legal awareness and ability to safeguard their rights. Companies or third-party organizations can organize training sessions for small and medium shareholders on rights protection knowledge to help them understand their rights and obligations and how to effectively protect these rights. At the same time, small and medium shareholders should be encouraged to establish communication channels, such as rights protection forums or WeChat groups, to form a rights protection alliance and collectively address potential risks and challenges.

5.3. Introducing Institutional Investors to Strengthen Ownership Structure and Participate in Governance

The participation of institutional investors can compensate for the limitations of small and medium shareholders, enhancing supervision and constraint on major shareholders.[3] At the same time, small and medium shareholders need to improve their information acquisition and evaluation capabilities, actively participate in shareholders' meetings, and unite to form collective power, while paying attention to the independence of corporate governance structures and pursuing rights protection through legal means. However, when facing the risk of major shareholders expropriating listed companies, small and medium shareholders often find it difficult to counteract the major shareholders on their own due to their relatively low shareholding ratios and limited resources. In contrast, institutional investors typically hold a larger share of the company, with superior analytical capabilities and resources, which gives them greater influence in preventing expropriation by major shareholders and in rights protection. Moreover, as Nuraina E. suggests, foreign institutional investors are less likely to be subject to political pressure and are more inclined to negotiate in order to enhance the interests of minority shareholders and protect their reputation. [4] Therefore, by introducing domestic and foreign institutional investors, small and medium shareholders can be better assisted in the corporate governance process, leveraging the stronger negotiation and supervisory power of institutional investors to enhance the collective bargaining and rights protection of small and medium shareholders.

To prevent institutional investors from becoming "accomplices," legislation or self-regulatory rules should be enacted to strengthen their responsibilities and obligations, ensuring that they actively participate in corporate governance when holding shares in listed companies, and monitor and intervene in potential actions that may harm the rights of small and medium shareholders.[5] An effective communication mechanism should be established, such as regularly holding meetings between institutional investors and small and medium shareholders, ensuring that their opinions and suggestions are effectively conveyed. Institutional investors should be encouraged to make long-term investments, with tax incentives and other measures to reduce transaction taxes and fees, thus providing stable financial support and reducing the negative impact of stock price fluctuations on small and medium shareholders. The transparency of institutional investors should be improved, and an investor protection fund should be established, along with enhanced training and educational campaigns for small and medium shareholders. Listed companies should also promptly disclose changes in institutional investors' holdings and their involvement in governance, ensuring that institutional investors play their due role in protecting the interests of small and medium shareholders.

6. Conclusion

Through an in-depth study of the expropriation behavior of major shareholders in Pangda Group, this paper reveals its significant negative impact on the capital market, including a decline in stock value and a weakening of market confidence. To effectively prevent and curb such behavior, several specific recommendations have been proposed. These include identifying early warning signals of expropriation, strengthening regulatory measures, encouraging the introduction of institutional investors to help small and medium shareholders actively participate in corporate governance, enhancing self-rights protection awareness, and improving the class action system and relevant laws and regulations. Additionally, the regulation of institutional investors has been emphasized. By implementing these measures, market transparency can be significantly improved, and protecting investors' interests and ensuring the stability and fairness of the capital market can be achieved.

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