

The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations

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The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations.



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“China is known in the West for many things.
However, a rules-based market for shareholder
activism is not one of them.”



**“PRESIDENT XI JINPING IS (IN)FAMOUS IN THE WEST FOR DEMANDING
‘THAT BUSINESSES CONFORM TO THE AIMS OF THE COMMUNIST
PARTY’”**



“THE NEWLY APPOINTED BOSS OF THE CHINA SECURITIES REGULATORY COMMISSION (CSRC) – CHINA’S EQUIVALENT TO THE US SECURITIES AND EXCHANGE COMMISSION (SEC) – HAS EARNED THE SOBRIQUET ‘BROKER BUTCHER’ FOR HIS ALLEGED ZEALOUS CRACKDOWN ON TRADERS IN THE 2000s”



“WESTERN MEDIA REGULARLY REPORTS ON ‘[B]ILLIONAIRE TYCOONS, INCLUDING JACK MA, THE FOUNDER OF ALIBABA, [BEING] DRIVEN UNDERGROUND OR IMPRISONED AFTER CRITICIZING THE GOVERNMENT’”

“This is not exactly an environment in which one would expect to find a vibrant rules-based market for shareholder activism — especially with state owned enterprises as the target of such activism.”

“Prior to our research, shareholder activism was assumed to be a non-existent or marginal feature of Chinese corporate governance.”

**IN FACT, WESTERN LITERATURE
SUGGESTS THAT MINORITY SHAREHOLDERS IN CHINA ARE
“PASSIVE AND POLITICALLY DISEMPOWERED”**

Minority shareholders in SOEs are “passive and politically disempowered”...even if shareholders exercise their legal rights, government officials may simply refuse to acknowledge them due to political considerations (Howson, 2015)

Private institutional investors as minority shareholders are likely to remain passive in state-owned enterprises due to political pressure and other reasons (Cheng, 2022)

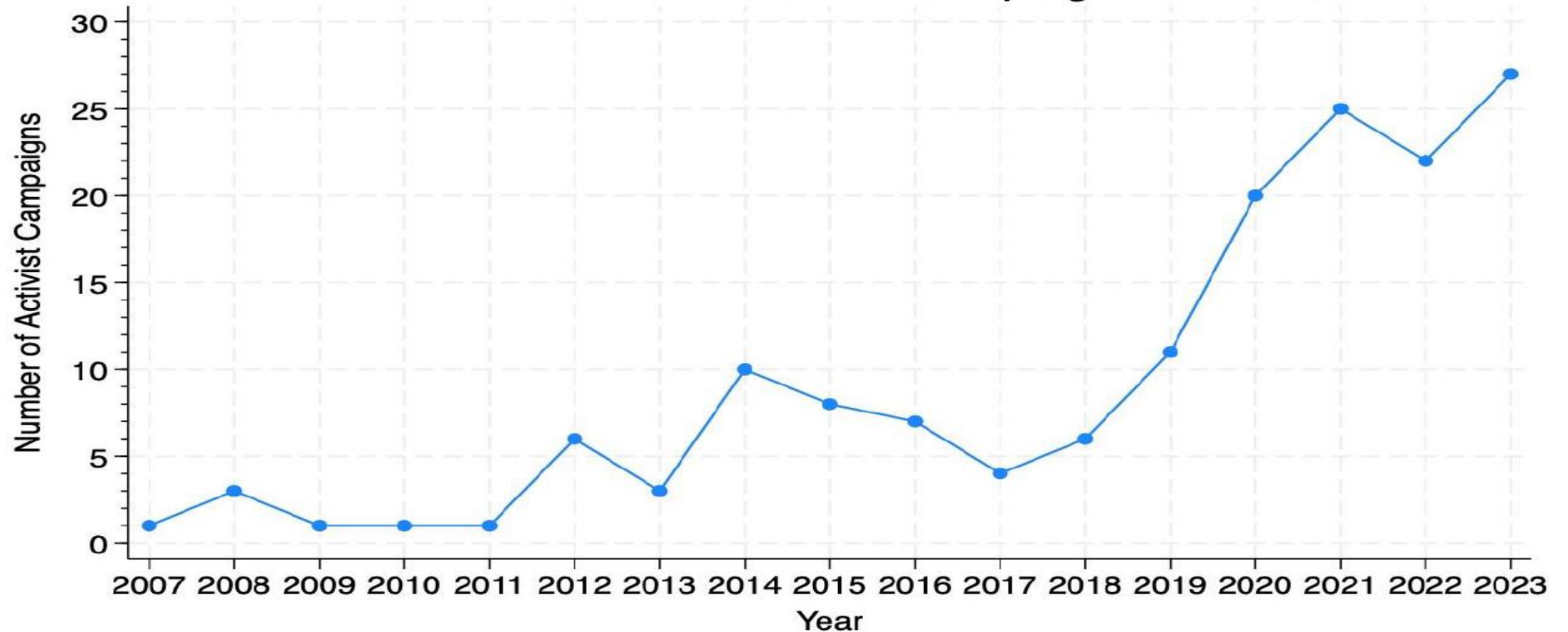
SOME EXCELLENT WESTERN LITERATURE BUT, THE FOCUS OF POLITICS DRIVING CHINESE CORPORATE GOVERNANCE

“Obviously, scholarship examining the influence of the CCP in Chinese corporate governance has significant value. However, just as one who only has a hammer will start seeing every problem as a nail, pundits who view Chinese corporate governance through a political lens risk seeing everything as political”



CONTRARY TO CONVENTIONAL WISDOM: SHAREHOLDER ACTIVISM IN CHINA IS THRIVING

Time Distribution of Activist Campaigns in China



TYPES OF ACTIVIST CAMPAIGNS EXTRAORDINARY BECAUSE ORDINARY

Table 5

Strategy	Definition of Success	Number of campaigns adopting each strategy
Shareholder proposal: director nomination	At least one nominee elected	73
Exercising veto power in MoM votes	Management proposal vetoed	67
Significant shareholder proposal: others	At least one proposal adopted	39
Expressing dissatisfaction publicly	Dissatisfied matter rectified	16
Litigation to invalidate corporate acts	Corporate acts voided by the court	11
Launching tender offers	Sufficient number of stocks tendered to shift target control	3

UNDERAPPRECIATED: CHINA'S FOCUS ON BUILDING A REGULATORY REGIME FOR ADVANCING MINORITY SHAREHOLDERS' RIGHTS

China has built a robust regulatory regime to advance minority shareholders' rights

Government emphasizes importance of building a high-quality and credible regulatory environment for protecting minority shareholders to advance its equity market

Over the past several decades, the Chinese government has built a regulatory architecture to facilitate the growth of institutional investors which “on a day-to-day basis, increasingly appear to work as an effective mechanism to improve corporate governance”—sometimes by engaging in shareholder activism (Lin Lin & Puchniak, 2023)

Chart 1: A-Shares Investors Based on Market Capitalization (2003 to 2018)³⁷

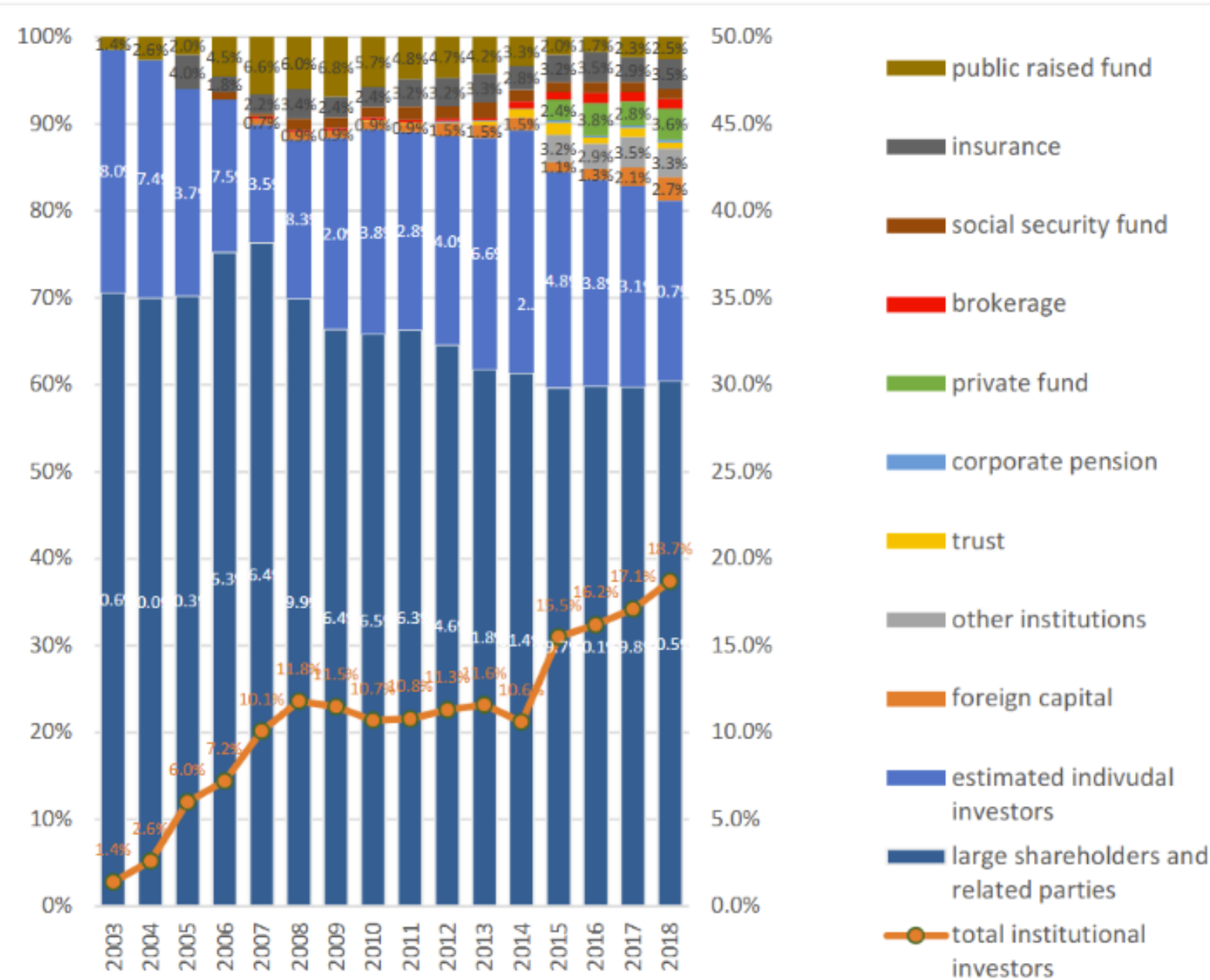
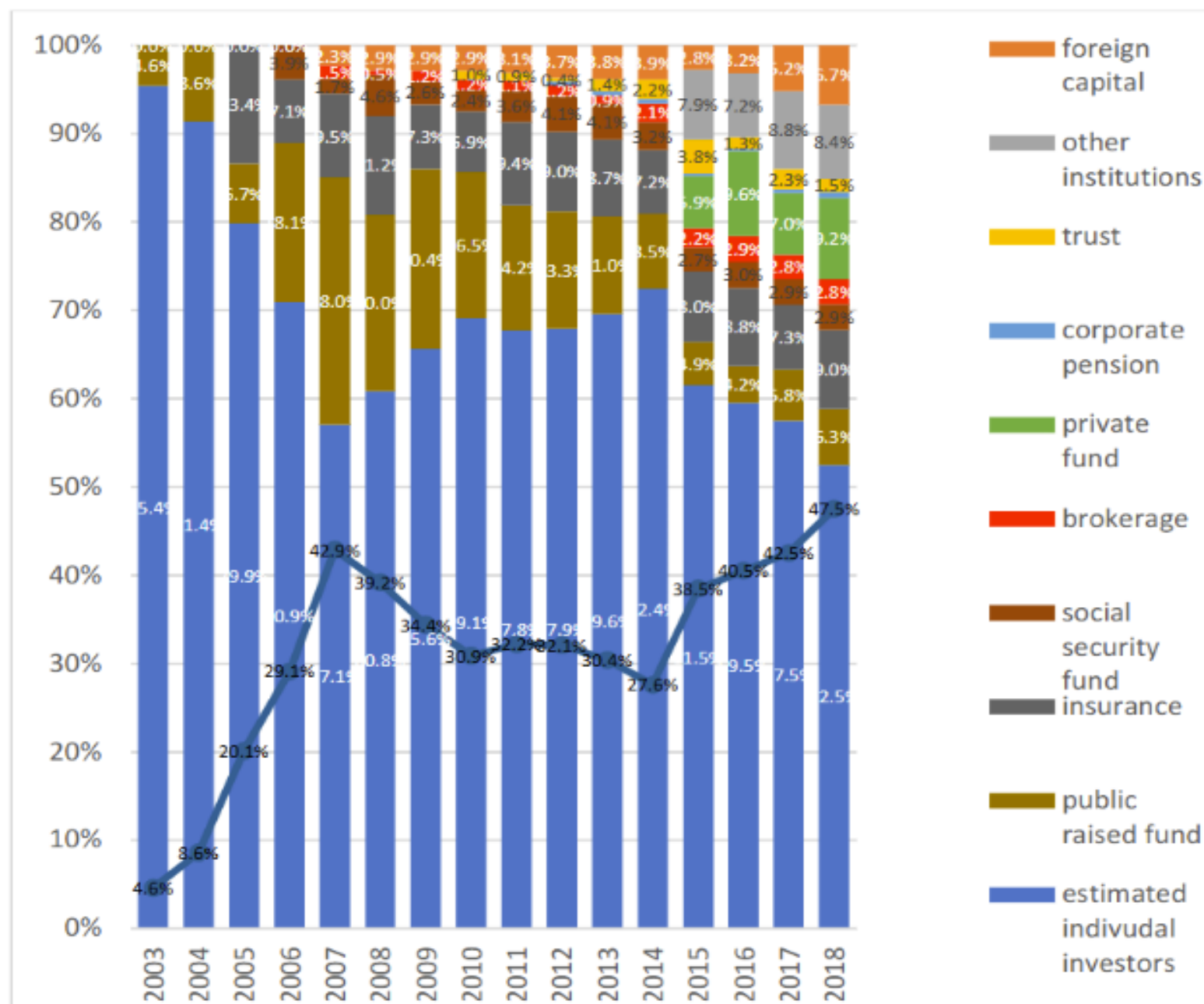


Chart 2: A-Shares Institutional Investors as a Percentage of Free-Float Market (2003 to 2018)³⁹



CHINA'S ROBUST SHAREHOLDERS' RIGHTS OFTEN OVERLOOKED

China has “one of the most robust shareholder–empowering corporate statutes in the world”

The shareholders' meeting is the supreme authority of the company, with the power to decide on fundamental operational matters, profit distribution, and amendments to the articles of association

The board of directors has no discretion to exclude valid shareholder proposals and is obligated to enforce those that receive majority votes (i.e., they are binding)

Chinese company law empowers minority shareholders through mechanisms like cumulative voting in controlled companies, majority of minority approvals, derivative actions, and a low threshold (reduced from 3% to 1% July 1, 2024) for advancing shareholder proposals



TARGET'S STATUS AS AN SOE OR POE APPEARS NOT TO MATTER

Whether the target company is a POE or SOE has no statistically significant effect on the success of the activist campaign

Private shareholders undertake, and more often than not succeed, in activist campaigns against so called “national champions”

78% of activist campaigns against “national champions” were brought by private activist shareholders — 57% of which succeeded

ACTIVIST'S STATUS AS AN SAS OR PAS APPEARS NOT TO MATTER

Over 50% of activist campaigns launched by an ostensibly powerful state-controlled activist investor — that is, a national, rather than local, SAS — failed when the target was a POE

POE using aggressive and illegal tactics to defeat the campaign of a SAS and the state following due process to challenge the sharp practices of the POE in court

- e.g., Innovation Medical Case; Tibetan Development Case

CHINA'S ANSWER TO "ROARING KITTY" "LEGEND OF THE RED SCARF"

Campaign involved retail investors organizing on a social media platform called "snowball" [雪球] to publicly object to the dividend policy of a powerful national champion



Campaign forced the hand of the target's management of the power national champion to adopt a generous dividend payment policy after it did not pay dividends for over a decade

SURPRISE: STATE ON STATE ACTIVISM



FURTHER EVIDENCE SUGGESTING RULES-BASED MARKET

Shareholder activists that hold a larger percentage of the target company's shares have a statistically significant higher chance of succeeding in an activist campaign

The 2019 increase in activist campaigns dovetails with regulatory changes in Chinese corporate governance that increased the incentives for shareholder activism – further suggesting the importance of rules-based market forces

- Chinese corporate governance code made it clear in 2018 that shareholders must “be kept informed”, “participate in corporate decision-making”, have a responsibility to “monitor” company activities, and that shareholder rights cannot be restricted by GM or the board

Targets of successful activist campaigns had a return on investment (ROA) over 50% lower on average than those in unsuccessful campaigns (but not statistically significant)

SUCCESS RATE OF ACTIVIST CAMPAIGNS

PERCENT OF SHAREHOLDINGS SIGNIFICANT BUT POLITICS NOT

Table 8: Multivariate Logit Regression

Dependent Variable: (Partial + Full) Success	I	II	III	IV	V	VI
<u>Score</u>	0.08 (0.43)	0.08 (0.62)	0.12 (0.66)			
State-owned activist				0.11 (0.53)	-0.08 (0.68)	0.04 (0.72)
State-owned target				0.08 (0.79)	-0.05 (1.10)	0.04 (1.30)
Percent of shareholding	0.09 (0.02)***	0.12 (0.02)***	0.12 (0.03)***	0.09 (0.02)***	0.12 (0.03)***	0.12 (0.03)***
ROA of prior quarter		-0.01 (0.04)	-0.01 (0.04)		-0.01 (0.04)	-0.01 (0.04)
Strategic investor			-0.41 (0.75)			-0.43 (1.00)
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo R ²	0.24	0.28	0.28	0.24	0.28	0.28
<u>Obs</u>	140	116	114	140	116	114

Note: Standard errors clustered at the industry level are in parentheses.
 *, **, and *** indicate significance at 10%, 5% and 1% levels respectively.
 One outlier, a successful campaign with an ROA of -2961%, was dropped.

SOME EVIDENCE OF POLITICS BUT RULES-BASED MARKET APPEARS TO BE THE NORM

Not a single case in which a local state-controlled shareholder activist attempted to launch a campaign against a national champion — suggesting political hierarchy

Only a single case involving a national champion (FAW Car) in which politics may provide an explanation

SUCCESS RATE OF ACTIVIST CAMPAIGNS

UNEXPECTED SUCCESS/FAILURE & AN INTERESTING GAP

Table 6

Meaning	Success Rate (Partial Success* Rate)	Standard Deviation of Success Rate (SD of Partial Success* Rate)	Number of Observations	Number of Success Cases (of Partial Success* Cases)
PAS v. POE	37.04% (44.44%)	48.59% (50%)	81	30 (36)
PAS v. Local SOE	43.75% (50%)	51.23% (51.64%)	16	7 (8)
PAS v. Central SOE	42.85% (57.14%)	53.45% (53.45%)	7	3 (4)
Local SAS v. POE	50% (53.57%)	50.92% (50.79%)	28	14 (15)
Local SAS v. Local SOE	55.56% (55.56%)	52.70% (52.70%)	9	5 (5)
Local SAS v. Central SOE	-	-	0	0
Central SAS v. POE	28.57% (42.86%)	48.80% (53.45%)	7	2 (3)
Central SAS v. Local SOE	25% (25%)	50% (50%)	4	1 (1)
Central SAS v. Central SOE	50% (50%)	70.71% (70.71%)	2	1 (1)
Overall	40.91% (47.40%)	49.33% (50.10%)	154**	63 (73)

* Including completely and partially successful campaigns

** Outcomes of two campaigns are pending.



“Although our findings indicate that the CCP has largely allowed space for a rules-based market for shareholder activism, the CCP has not abdicated its ultimate control over China. If allowing a rules-based market for shareholder activism improves Chinese corporate governance, this will likely strengthen China’s economy, which arguably is the primary source of the CCP’s power and legitimacy.”

FANS OF FREE MARKETS SHOULD LOVE OUR FINDINGS



**“THERE IS A REASON WHY THE USSR REGULARLY HAD SHORTAGES
OF TOILET PAPER AND WHY IT DID NOT HAVE SHAREHOLDER
ACTIVISM. CHINA HAS AN ABUNDANCE OF BOTH”**

LIKELY MORE ACTIVISM IN CHINA IN THE FUTURE



**WHICH SLIDE WAS CHANGED DUE TO POLITICAL
SENSITIVITIES?**

Thank You

