Chinese Management Buyouts and Board Transformation

Yao Li
School of Finance
Shanghai University of Finance and Economics
Tel:+86 21 52682325
Email: liyao@mail.shufe.edu.cn

Mike Wright
Centre for Management Buy-out Research
Nottingham University Business School
University of Nottingham
Tel: +44 115 951 5257
Email: mike.wright@nottingham.ac.uk

Louise Scholes
Centre for Management Buy-out Research
Nottingham University Business School
University of Nottingham
Tel: +44 115 8467782
Email: louise.scholes@nottingham.ac.uk

This draft 17th December 2010

Chinese Management Buyouts and Board Transformation

Abstract

We assess the extent to which Chinese MBOs of listed corporations enable a balance to be achieved between facilitating growth and supporting the interests of minority shareholders other than the buyout organization. Using novel, hand-collected data from 19 MBOs of listed corporations in China, a matched sample of 19 non-MBOs and the population of listed corporations, we examine the extent to which boards of directors are changed to bring in executive and outside directors with the skills to grow as well as restructure a business. We also examine the extent to which outside directors become involved in actions to develop the business rather than actions related to fostering the interests of all shareholders. We find in fact little evidence that outside board members have the skills to add value to the MBO firms. Boards appear to focus mainly on related party transactions with some more limited attention to growth strategies. Outside directors do not seem to openly disagree with incumbent managers on the disclosure of their actions but may express their views and exert pressure behind the scenes.

Key Words: Management Buyouts, China, Board, Governance, Listed Companies

Chinese Management Buyouts and Board Transformation

Introduction

Management buyouts (MBOs) involving the acquisition of firms by incumbent managers who take on financial leverage, often with the involvement of private equity firms (Gilligan and Wright, 2010), have become an international phenomenon. Over three decades they have diffused from the US, to Europe and to Asia (Wright, et al., 2007; Strömberg, 2008). From OECD countries they have also played an important role in the transformation of Central and Eastern Europe (Wright et al., 1994) and more recently have emerged in China (Sun et al, 2010).

This international development has been accompanied by considerable debate about their impact. Evidence from developed Western economies generally indicates that they have a positive economic and social impact, particularly in the first wave of the 1980s although the evidence from the second wave is more mixed (Cumming, et al., 2007; Kaplan and Strömberg, 2009; Wood and Wright, 2009). Yet, MBOs may be undertaken to advantage particular groups of stakeholders, notably managers and private equity backers, at the expense of others (Lowenstein, 1985; Bruner and Paine, 1988; Houston and Howe, 1987; Harris and Brown, 1990; Jones and Hunt, 1991; Lee, 1992; TSC, 2007).

For emerging economies, and especially those transitioning from central planning, MBOs raise serious and controversial issues, especially in contexts where the legal and regulatory framework is often weak. The latter enables management to benefit from short-term income redistribution by acquiring undervalued assets (Filatotchev et al., 1994). In contrast to MBOs in Western, developed economies that involve mechanisms to control agency costs (Jensen, 1993), MBOs of listed corporations in transition economies rarely involve the pressure to service debt or the role of active private equity investors. Rather they raise distinctive principal-principal-agency problems that arise where dominant shareholders may act against the interests of minority shareholders (Young et al., 2008). In particular, related party transactions concerning managers as shareholders may involve tunneling, that is the transfer of assets and profits out of firms for the benefit of their controlling shareholders (Djankov et al., 2008).

Indeed, MBOs became a very controversial issue in China in 2004 when Hong

Kong-based professor of corporate governance Larry Lang condemned the MBI (management buy-in) of Kelon, a township and village enterprise, i.e. an enterprise owned at the local government level, listed both in Hong Kong and Shenzhen. As a result, ‘MBO’ became a derogatory term in China. In 2004 the Ministry of Finance (MOF) also stopped approving state-owned enterprise (SOE) share transfers to buyout management. Finally, in 2005, the State-owned Assets Supervision and Administration Committee (SASAC), the new established authority and the ultimate owner of state-owned assets, prohibited MBOs of listed SOEs.

There are, however, major countervailing arguments to these claims. First, MBOs may be necessary to ensure that restructuring occurs in order to avoid firm failure. Indeed, studies of listed corporations in China have identified the importance of ‘propping up’ as an alternative to tunneling (Cheung et al., 2006). Second, specifically in the context of transition economies, the challenge is to enhance enterprise efficiency and performance in areas of the economy that have experienced a persistent dearth of entrepreneurship. Buyouts undertaken by entrepreneurial managers may in these circumstances lead to longer term personal and systemic benefits. Hence, the problem for transition economies is to balance the economic gains of a move to a more free-market system with the agency risks associated with the behavior of agents in those markets (Filatotchev et al., 1994).

In the absence of the pressure of debt and the role of private equity firms, boards assume an important place in MBOs in China in achieving this balance. Yet the role of boards in this context has been neglected. There is therefore a need to assess the extent to which boards in MBOs enable a balance to be achieved between facilitating development of the business whilst maintaining the interests of other (minority) shareholders. Examining the role of boards in MBOs in China also provides potentially interesting insights into the general role of this important governance mechanism in a context removed from the developed Western markets where buyouts emerged that help in understanding the applicability of this concept. Specifically, we examine the following research questions:

Q1: What are the general characteristics of boards after the buyout?

Q2: To what extent are boards of directors in Chinese MBOs changed to bring in outside directors with the skills to grow and restructure a business as well as monitoring management?

Q3: What changes occur in the functioning of boards after an MBO in terms of meeting frequency, the issues addressed by outside directors and the extent to which they challenge executives?

We examine these research questions through a detailed analysis of the nature and behavior of boards in 19 MBOs of listed Chinese corporations compared with a matched sample of 19 non-MBOs and with the population of listed corporations.

This paper unfolds as follows. The following section provides a brief overview of the context in which Chinese MBOs occur. We then review the literature on the role and place of boards in MBOs. Section 4 explains our data sources, while section 5 presents our findings under headings corresponding to the three research questions outlined above. The final section discussions our findings.

Context of Chinese MBOs

The Chinese government, has adopted a gradualist reform strategy (Liu & Sun, 2005), part of which involves *retreating* from state control of small and medium sized enterprises that operate in highly competitive markets[1]. In the early stages of market reforms, the entrepreneurs founding emerging enterprises invested their own money (or borrowed money from the local government)[2] and typically possessed the key managerial or technical capabilities[3], but they were not the legal owners. When these firms were listed on the stock market, their largest shareholder was local (town-village or urban-street) or even the central government. These firms were said to be "wearing the red hat", which provided both protection from political harassment and favorable access to scarce resources including natural monopoly resources, land, 'soft' loans from state-owned banks, independent export-import rights and foreign exchange quotas (Sun et al., 2010). Some large SOEs were floated on the stock market with the state typically maintaining controlling shares, the majority of shares, including management's shares, not being freely tradable (Walter and Howie, 2003)[4].

Incumbent management with good market-oriented capabilities played a key role in saving some non-strategic SOEs from bankruptcy, turning them around and

[1] There seems, unfortunately, to be no precise definition of medium and small enterprises, or of highly competitive industries.

[2] There were no private property rights under Mao's China and concepts of corporation, share, shareholders etc. didn't exist either. Property rights remained ambiguous even after they went public in the early years of 1990s.

[3] In several MBOs the company founders owned critical technical patents and know-how to run the companies.

[4] This government-controlled regulatory framework contrasts markedly with the administratively independent regulatory bodies in the US and UK. The state in China monopolizes access to equity finance since this allows it the final say as to which firms are qualified to raise equity funds through initial public offerings (IPO). Since 2005 reforms have helped ease the non-tradability problem subject to lock-up conditions.

making them relatively competitive. However, management did not receive shares as compensation, and their salaries and bonuses were only at moderate levels.[5]

By the end of the 1990s, these companies were frustrated by a lack of incentives, organizational inefficiency, declines in profit margins, technical upgrading and interference by bureaucratic government decision makings in daily operations[6]. With the progress of market reforms, these organizations had typically reached a critical point where they had to decide between innovation versus non-adaptation and eventual dissolution. Windows of opportunity can emerge where a firm finds new growth and renewal opportunities facilitated by a new ownership structure, such as a buyout (Wright et al., 2000).

Because of the relationships with government, at various levels[7], the success or failure of buyout attempts is heavily influenced by a bargaining or alliance process between entrepreneurs and politicians (Sun et al., 2010). MBO targets were typically purchased at a price based on net assets per share or even at a discount to this, and far below the price of tradable shares. Typically management did not take the companies private as in Western buyouts but bought less than 30%[8] of the total equity through a newly established holding company wholly owned by management or with employees. Management typically paid only around 10% of the total price on deal completion, with the remainder paid in installments. Management obtained finance mainly from personal networks. Banks were strictly forbidden from providing loans for buyouts until November 2008. However, in some township and village enterprise buyouts, management obtained finance from local credit unions or other undisclosed sources.

The Role of the Board in Buyouts

In the Western LBO literature, private equity firms are acknowledged to align the

[5] In 1994 the Ministry of Labor issued a policy that the bonus and salary level of CEO and chairman of SOEs could not exceed 8 times the average employee's income. These policies were canceled at the end of 1990s.

[6] For example in an interview with a reporter during the buyout process, Xiangjian He, the founder and chairman of Midea, admitted that incentives were the most crucial problem he was confronted with before the MBO (*CAIJING*,2000,4).

[7] In a township-village enterprise case, the managers of Midea, the largest air-conditioner and other white goods manufacturer in China, had to say that the relationship between Midea and the town government has always been one of 'mutual respect, mutual help ', 'Each step in the development of Midea depends on the town government's support '. *CAIJING*,2000,4. In another SOE case, Yutong , China's largest bus and coach manufacturer, the MBO process was full of frustration. The municipal government, the agent of the state owner, strongly and firmly supported the MBO while the ultimate owner, central government disapproved. Under a local legal decision the management, implicitly supported by the local government, acquired the original state-owned majority shares and completed the MBO without central government approval.

[8] In our sample the holding companies of the 19 listed companies held an average 28.9% of the equity at the end of 2008. At this level the holding companies can virtually control the listed companies without triggering the 30% threshold of a mandatory tender offer.

interests of managers and investors by applying three sets of changes to the firms in which they invest, categorized by scholars as financial, governance, and operational engineering changes (Kaplan & Strömberg, 2009; Cumming et al., 2007).

The first of these, financial leverage, creates pressure on managers not to waste money on unprofitable projects. The pressure of meeting debt payments reduces the "free cash flow" problems (Jensen, 1986) in which management teams in mature industries with weak corporate governance could dissipate cash flows rather than returning them to investors.

Governance engineering refers to two elements. First, private equity firms typically give the management of portfolio companies a large equity upside through stock and options. Also they require management to make a meaningful investment in the company. Second, the private equity investors control the boards of their portfolios companies and are more actively involved in monitoring than public company boards. Financial and governance engineering have traditionally been viewed as the two main value sources brought by PE firms in buyouts (Kaplan and Strömberg, 2009). But success in private equity transactions is also associated with operational improvements including the introduction of new products and other routine innovations (Wright et al., 1992; Zahra, 1995; Gottschalg, 2007; Meuleman, et al., 2009).

Therefore, the board in a Western PE-backed buyout assumes an important and distinctive role. According to corporate governance life cycle theory, at different stages of their development, firms require different board structures and processes (Lynall et al., 2003). Changes in board composition therefore reflect the strategic challenges and contingencies firms face at different phases in their life-cycle (Zahra et al., 2010). The balance of the monitoring and wealth creation roles of the board may change over this life cycle. There may be important differences between the structure and functioning of a board designed to minimize agency costs through greater monitoring, and a board designed to maximize a firm's rent generating potential through bringing in skills and capabilities that are absent from the internal management team (Barney et al., 2001). In the West, the shift from a listed corporation to an MBO represents an important threshold in a firm's life-cycle that typically involves either restructuring to improve efficiencies and/or the introduction of new growth strategies.

Studies of the role of boards in Western private equity backed buyouts are limited but have examined three broad areas: the size and composition of the board; the role of independent directors; and the functioning of the board. We follow this approach here.

The boards of private equity backed buyouts that were formerly listed corporations in the UK become smaller with fewer outside directors (Cornelli and Karakas, 2008). Representatives from the private equity backers are introduced and non-executive chairs are likely, even though evidence suggests greater duality prior to buyout (Weir and Wright, 2006).

Investors in Western buyouts tend to be more active than in listed corporations, one manifestation of which is more frequent board meetings (Acharya and Kehoe, 2008). The composition and functioning of boards of public-to-private buyout transactions may not be homogeneous but vary according to whether the buyout was aimed at improving efficiencies or exploiting growth opportunities (Wright et al., 2000, 2001). In addition to hiring executives with financial engineering and monitoring skills, private equity firms in Western countries now often hire professionals with operating backgrounds and an industry focus who can adopt a hands-on role in the strategic planning and supervision of portfolio companies. Often operating as board members, they apply their industry knowledge and analytical skills to the most important issues facing a company from a high-level strategic perspective. Acharya et al., (2009) provide evidence from the UK that boards in private equity backed buy-outs play an active role in leading strategy formulation to create value, involving both assisting and challenging management, while boards in publicly listed companies play more of a scrutinizing, follower role. Directors from private equity firms also do not hesitate to replace poorly performing management.

In the MBOs of China's listed companies there is no direct pressure of financial leverage, or governance engineering by PE firms since these factors play little part in these deals[9]. Thus, the board of directors assumes a key role in these companies. This role, however, faces distinctive challenges in the context of the problems arising from the creation of a dominant group of shareholders whose interests may not be closely aligned with other minority shareholders. As a result, we would expect board size to fall following MBO in China and for there to be less pressure to avoid duality of the

[9] Some institutions (like consultant companies, trust companies for financing MBO, investment banks as underwriters and financial consultants for these listed companies) play a similar role in some aspects to PE firms in Chinese MBO. However, they are not PE in essence.

roles of CEO and Chair compared to listed corporations. As a result of this insider dominance, we also expect less pressure to remove executives.

However, there is also a simultaneous need for added value contributions in an environment of entrepreneurial deficits. Thus we also anticipate an increase in the number of independent directors. We anticipate that boards will become more active in assisting management as the entrepreneurial executives noted in the previous section perceive a need to recruit independent directors with expertise in developing businesses. Correspondingly, we would expect there to be an increase in the frequency of board meetings and a high incidence of boards discussing issues relating to business development following MBO. However, insider dominated buyouts may involve potential for tunneling activities, that is appropriating assets by dominant shareholders at the expense of minority shareholders, as well as propping or supporting corporations (Cheung et al., 2006). We may expect that executives in buyouts may be in a stronger position to engage in both tunneling and propping activities than in listed corporations generally. In the absence of outside investors such as private equity firms and the presence of independent directors owing their appointment to the executives, we expect to find little incidence of executives being challenged formally by independent directors. We summarize our variables and expectations in relation to our research questions in Table 1.

INSERT TABLE 1 HERE

Data and Sample

Sample Selection

To examine the nature and role of boards in Chinese MBOs of listed corporations, we focus on a sample of 19 firms. We identify the sample of companies as follows:

1. We define an MBO as an arrangement involving the incumbent management of listed companies acquiring control rights in, and becoming the largest shareholder of, the company through equity transfer.

2. An MBO should be completed before 31 December 2003. By taking end 2003 as our cut-off point we observe at least 4 years of subsequent changes in corporate governance after MBO. Following the controversy of 2004, MBOs completed after 2003 could not obtain approval from the Ministry of Finance (MOF) and later the

SASAC[10]. Management has also taken a variety of other initiatives than MBO to gain control of listed companies[11]. We do not include such companies in our sample.

3. The listed companies published their announcement of completion of the MBO before 2003. Some companies released an intention to implement MBO in 2003, but they have not been approved by the government. We exclude those companies where management was the largest shareholder since inception of the company.

3. We include EMBOs (employee and management buyouts). For some companies, the incumbents control the company through an ESOP (employee stock-ownership plan). But the largest shareholder of the ESOP and the company's actual controller belong to the enterprise's internal management. So an EMBO results in a management buyout.

4. We exclude *de facto* government-controlled MBO companies. Some cases fit the above categories, but the annual report specifically states that de facto control belongs to the state or the state-owned holding companies. In all cases the management appear to be the indirect controllers of the listed companies from the ownership structure, but in their 2005 or 2006 annual report these companies disclose that "the local government/SASAC is the de facto controller through an equity trust or as custodian, etc", or claim that "the management shareholding is just equity incentive behavior (management is not the ultimate controller)" and so on. So these companies cannot be counted as MBO companies.

5. Finally, we exclude a large number of private capital acquisitions of listed companies.

INSERT TABLE 2 HERE

The 19 companies belong to traditional industries such as manufacturing, public transport, aquaculture, etc[12]. For consistency, we use the total equity market capitalization whether shares are freely tradable or not. Market capitalization 1 in

---

[10] In practice, there were several cases of MBOs involving state-owned companies after 2004 because of delays in government approval. However, 2003 is our cut-off.

[11] These can be referred to as "hidden MBO" or "curved MBO". The management became the controlling shareholder through the restructuring of the state-owned or collective-owned parent company. Or the management controlled enterprise acquired the shares through an auction (not through equity transfer) and became the largest shareholder.

[12] One company, Shanghai Pudong Dazhong Taxi Co., completely changed its main line of business from the taxi industry to public utility (gas). Another company, Wuchangyu, changed from aquaculture farming to two major lines of business, aquaculture and real estate.

Table 2 is at 31 December 2003. Market capitalization 2 is at December 31, 2008. After adjusting for appreciation in the RMB exchange rate, the median compound annual growth rate over this period is 9.33%, with a mean of 18.6%. However, in four companies, capitalization dropped. The highest growth rate is 12 times for TBEA, followed by Midea's 6.7 times.

Following Claessens et al. (2000) and Faccio and Lang (2002), we conducted a manual search of annual reports to trace the pyramid ownership structure of the sample companies. In six companies, the ultimate controller was one person (Midea, Fangda, Xiamen Prosolar, Dongting Aquaculture, Wuchangyu, Hongdou). The ultimate controllers of three companies (TBEA, Yongding, Humanwell) are 3-5 core management members. In the other ten companies, the ultimate controllers belong to the management teams or ESOP owned companies.

The mean ownership of the controlling group in the year of the MBO in the sample companies is 26.7%, while the mean control right is 35.1%. The mean control / ownership separation index (C/O) is 1.57. These figures are substantially higher than those found for 9 East Asia countries by Claessens et al. (2000), where the ultimate controller had an average (mean) C/O of 1.25, and for 13 Western European countries of 1.11 by Faccio and Lang (2002).

Board Information

As these companies remain publicly quoted, information on their boards is publicly available.[13] We obtained data on the following measures:

Directors

It is difficult to define the executive directors in Chinese listed companies clearly. Many companies are called 'carve-out' listing (Liu and Sun, 2005), that is the creation of a separate listing of a minority of the equity in a subsidiary company, so many directors are affiliated to the holding companies. The group (parent company) and the listed company are not actually separated. We define strictly an executive director as someone acting as an executive in the listed company (not the group/holding company). Where the director also acts as an executive or director of a subsidiary, if

[13] The Supervisory Boards of Chinese listed companies are very weak and vulnerable. The supervisory board is dominated by insiders (Union members, financial staff). Supervisory board members' pay, job, etc. are de facto decided by the management. So the supervisory board cannot monitor management. At present, Chinese regulators realize that the role of the supervisory board and the role of independent directors overlap. As a result, the supervisory board is gradually being marginalized. We therefore focus upon executive boards.

the subsidiary is consolidated with the listed company, we consider the person as an executive director of the listed company too. Chinese listed companies' annual reports disclose their directors' affiliation with holding companies from 2001 and their directors' biographies from 2004. Background information on directors was collected from IPO prospectuses, annual reports, press releases and other news media.

Frequency of meetings

We obtained data on the frequency of meetings from the CSMAR (china stock market accounting research) database which was developed specially by GTA IT Co. in 1999.

Issues discussed by directors

We also collected information on the issues discussed by the independent directors from the CSMAR database. Disclosures of the issues discussed by the independent directors are categorized as follows:

1. personnel changes (directors, executives);
2. remuneration and stock incentives of senior management and directors;
3. annual report proceedings (financial reports, profit distribution, report supplements and modifications, specific account adjustment, etc.);
4. related-party transactions (including purchases of raw materials, sales, financing, trade mark renting, and a large number of assets acquisition or assets sales with the group/holding company;
5. guarantee items;
6. acquisitions (including acquisition of a company's equity, asset acquisition, joint venture, the capital increase of a invested company);
7. audit items;
8. divestment;
9. equity financing (right offering, seasoned offering, and the allocation of financing);
10. other (such as corporate governance self-examination, and so on);
11. the non-tradable share reform plan[14] and its adjustment.

[14] A distinct feature of Chinese public corporations was the significant constraint on the tradability of corporate stocks, most of which were in government hands. Shares could be transferred among various institutions subject to government approval but after transfer these shares still remain non-tradable on the market. Beginning in September 2005 the CSRC formally started 'the non-tradable share reform', which was

Data on the Matching Pairs and the Population of Chinese Listed Firms

We chose 19 matching pair companies for comparison with the 19 MBO sample. The selection principle is firstly based on the industry code of the China Securities Regulatory Commission (similar to US the 4-digit SIC code), then secondly according to the closest total assets size.

In terms of the population, we chose all the Chinese listed A-share companies on Shanghai and Shenzhen Stock Exchange. The board data are from CSMAR. We obtained the characteristics of independent directors of the population of listed companies from the Shanghai Stock Exchange, 2004 Annual Report on Corporate Governance: Board independence and effectiveness. The report contains data for 2319 independent directors of all 768 listed companies on the Shanghai stock market.

Results: Evidence on the role of boards in Chinese MBOs

General Board Characteristics (Q1)

Characteristics of senior management

We identified 26 key people from the 19 buyouts, according to whether they were chairman of the board or general manager at the time of MBO and had been present in the enterprise for at least five years from two years before MBO. From analysis of their biographies and the annual reports of these companies, these people are the most important leaders in developing their enterprises.

The 26 leaders had a mean age of 45.04 years (median 44 years) at the year of MBO. These individuals are very young given that they have led the enterprises for a long time before MBO. All these enterprises were floated on the stock market in the 1990s. Thus these individuals had developed these enterprises from the beginning of China’s reform program rather than being traditional SOEs management who are mostly officials assigned by the government.

accomplished by the end of 2006. The non-tradable shareholders were thus required to pay a compensation package to those holding tradable shares after active communication with them. On average the tradable shareholders receive approximately 3 for every 10 shares they hold from the non-tradable shareholders as compensation. The lockup period is 12 months for small non-tradable shareholders. But the large non-tradable shareholders(holding greater than 5% of total shares) must hold their shares for at least 36 months once they become tradable.

Board size

The size of the board in MBOs decreases from an average of 10.75 members two years before MBO, to 10.1 at MBO year, to 8.33 individuals by year eight. This decline at time of buyout is consistent with evidence from Western MBOs (where buyouts lose between one and two directors on buyout), although evidence suggests that boards in MBOs in the West are smaller than in China at around five members (Cornelli and Karakas, 2008).

INSERT TABLE 3 HERE

Compared with the matched pairs and the population of listed corporations, the size of the boards of directors in MBOs is not statistically significantly different. But the average size of MBO boards declines faster over time than in non-MBO companies (Table 3).

The Number and Proportion of Executive Directors

The average number of executive directors drops from 3.44 people two years before MBO to 2.33 people eight years after MBO, in other words a fall of just over one person on average. However, the proportion of the executive directors in the board as a whole is almost unchanged. Excluding the period two years before MBO, executive directors accounted on average for 28%-30% of board members over the period to eight years post MBO. This compares with Western MBOs where the number of executives similarly falls by around one person on average but where they account for 47-61% of the board after the buyout (Cornelli and Karakas, 2008).

Duality

Separation of the roles of Chairman and the CEO (usually called 'general manager' in China), regarded as a feature of good governance in the West, was common in companies before and after MBO. Among the 19 companies examined, only two maintained duality, that is lack of separation, throughout the period. Duality existed in only five companies before MBO. There are four cases of duality at MBO year with three cases at year five after MBO. Two of these three companies had duality throughout the period, while one company initially had separation but subsequently restored duality.

The MBO sample, matching companies and the population generally adopt separation of the two functions and we do not find significant differences between the three groups (Table 4). In comparison, public to private buyouts in the UK show a higher incidence of duality before the buyout than listed corporations generally (Weir and Wright, 2006).

INSERT TABLE 4 HERE

Independent Director Characteristics (Q2)

The Number and Proportion of Independent Directors

Good corporate governance in the West requires that a significant proportion of Directors should be independent, in other words not affiliated to incumbent management (e.g. Combined Code, 2003). Whilst the definition of independence of non-executive directors continues to be the subject of debate, it is a relatively clear issue in Chinese listed companies. The China Securities Regulatory Commission (CSRC) issued a decree in June 2001 that recommended that the board of a listed company should include at least two independent directors before June 2002 and the independent directors should comprise not less than a third of the board from June 2003. [15]This approach imitates the 1998 Combined Code in the UK. As most Chinese MBOs happened in 2001 or 2002, they were completed before this legislation came into force.

The number of independent directors increased dramatically from 0.05 on average two years before MBO to an average of 2.37 in the MBO year. The average then slowly rose to 3.33 eight years after buyout. Also notable is the increase in the proportion of the board accounted for by independent directors from 0.5% two years before the MBO to 24.6% in the MBO year. The proportion of the board accounted for by independent directors rose further to 30% one year after the MBO and continued to rise to 40.2 % by year nine. Interestingly, the average proportion of independent directors is above the recommended one third prescribed by the China Securities Regulatory Commission (CSRC).

INSERT TABLE 5 HERE

[15] Before the 2001 decree of CSRC, most Chinese listed companies have no independent director at all.

The proportion of independent directors on the board of the MBO sample is significantly (at 10% significance level) higher than that of the matched companies but is overall not significantly different from that in the population of listed companies (Table 5). The significantly different years in the matched sample were 2002, 2003 and 2005.

The Characteristics of the Independent Directors

Over the period 1999-2008 we identified a total of 120 people who served as independent directors of the 19 MBO companies examined, amounting to 211 person-terms. A term is usually three years. Among the 120 people, 2 (1.7%) served 4 terms, 18 (15%) served 3 terms, 49 (41%) served 2 terms, and 51 (42.5%) served 1 term. According to the CSRC decree of 2001, independent directors can be re-elected for another term, but not exceeding continuous six years. In the UK, directors submit themselves for re-election at least every three years.

The characteristics and background of the independent directors can be divided into the following categories: (a) incumbent management of industrial companies, (b) incumbent management of financial institutions, (c) incumbent government officials; (d) retired management of industrial companies and financial institutions, and retired government officials; (e) scholars; (f) accountants, lawyers, and asset valuers; (g) experts with industrial or international backgrounds.

The composition of the board seems to be constructed according to the skills and experience of the individuals concerned. Incumbent management in other companies or government officials can bring management experience or provide resources relating to network contacts with government. Scholars are affiliated with scientific research institutions and universities. Lawyers, accountants and valuers, with their professional qualifications, are employed in law firms, accounting firms, and asset valuation companies/partnerships. Industry experts work for some research institutions with industrial relations or supported by industrial association[16].

[16] If the expert works at a university research institution with a strong industrial link, we identify them as having industrial expertise. An expert with an international background is identified as working or having worked in overseas organizations or having graduated from an overseas university, or works for Chinese-foreign cooperation agencies. Each director may have multiple backgrounds and so can be ascribed to different categories simultaneously.

INSERT TABLE 6 HERE

Scholars provide the most common background of independent directors at 37.5% of the 120 individuals (Table 6). The second most frequent category (19.2%) is individuals who are incumbent management of industrial companies. Of the four independent directors from financial institutions, one is from a securities company, one from a bank, one from a mutual fund management company, and one from a VC/PE firm[17]. All four are their respective firms' chairman or general manager. The third group is professionals, notably those with an industrial or international background who each account for the 10.8% of independent directors. Lawyers and accountants account for 12.5% and 10%, respectively. The fourth group is retired persons, with retired management accounting for 2.5%, while the retired government officials account for 5%.

There are significant differences in the backgrounds of the independent directors between MBOs and the matching pairs (at 10% significance level, the Pearson Chi-Square test, p = 0.078), and between MBO and the population of listed companies (at 5% significance level, Pearson Chi-Square test, p = 0.034). Specifically, the MBO sample includes more independent directors with an international background and who are incumbent managers in other companies than the matching companies and the overall population. However, MBOs have fewer independent directors who are scholars than the matching companies and the overall population of companies.

The Functioning of the Board (Q3)

We examine three aspects of the functioning of the boards in MBOs: the frequency of board meetings, the nature of the issues addressed by independent directors and the extent to which independent directors challenge management.

The Frequency of Board Meetings

The number of board meetings increases annually from 5.3 times in the year before the buyout, to 7.5 times in the year of the MBO. It then fell slightly up to year 3 after the buyout before rising again to 10.2 times six years after buyout. The increase in the

[17] The VC firm is Shenzhen Capital Group Co, which was founded in 1999.

year of the MBO may reflect the preparations for the MBO.

INSERT TABLE 7 HERE

We find evidence of a significant difference in the frequency of board meetings between the MBOs and matching pairs (at 5% significance level) (Table 7). The MBOs' boards on average held 0.74 more meetings than the matching company each year. There is no significant difference between the board meeting frequency of MBO companies and the population. The frequency of board meetings in Chinese MBOs appears to be less than in Western buyouts which hold an average of 12 formal meetings per year (Acharya and Kehoe, 2008).

Nature of Issues Addressed by Independent Directors

In total, there are 151 disclosure statements relating to the issues discussed by the independent directors of the 19 MBO companies from 2002 to 2008 (Table 8). The 151 disclosures involved a total of 157 distinct items, among which most are related transactions (45%), followed by personnel change (15%). The non-tradable share reform items accounted for 13%. Divestiture accounts for 8%.

INSERT TABLE 8 HERE

The disclosure items of independent directors in MBOs are significantly different from those of the matching companies (at 10% significance level), and the overall company population (at 1% significance level) (Table 8). Compared with the matched pairs and the population companies, we find that independent directors of MBO companies express more views on related-party transactions, divestment, and non-tradable share reform where the independent directors in MBOs appear more concerned about the interests of small/tradable shareholders.

It is unclear whether the related transactions between the holding company and listed company involve expropriation (tunneling) or interest support (propping up), i.e. whether these transactions damage or benefit the company's minority stockholders.

Case study evidence from among the 19 MBO companies is not consistent. Zhu et al. (2006) studied the Yutong buses case and found that after the MBO the related-party transactions, most of which relate to purchasing and sales, frequently took place between the Yutong group (holding company) and the listed company. The listed company's resources were transferred to the parent company or other companies in which the management had significant equity. The related-party transaction is a means to tunnel the private benefit of control for management. But Li (2008) studying the Midea case found that the parent group which is wholly owned by management pays the listed company a charge for use of its trademark, and supports the listed company on brand investments. In this case, the parent company props up the listed company. The 'tunneling or propping up' effects of related-party transactions in MBOs is in need of further fine-grained analysis.[18]

Challenging Executives

Independent directors do not appear overtly to challenge the actions of managers. While their possible opinion choices are categorized as "agree, disagree, reservations, unable to express views" by CSRC, we found that the only category selected was 'agree'. In these companies which are effectively controlled by the owner-managers, there appears to be no publicly recorded opposition. However, this is not unique to MBO companies, but is a general phenomenon in all China's listed companies. However, anecdotal evidence suggests that independent directors may challenge executives behind the scenes. For example, Mr.GU who is a well-known law professor and vice-chancellor of a leading university in Shanghai is reported as stating that independent directors will challenge executives and request further information before a proposal gets to the voting stage, so that few proposals that reach this stage will be controversial[19].

It appears that if an independent director disagrees with executives on items such as an acquisition or a related-party transaction and the conflict cannot be settled, the independent director will choose to resign rather than express an overt opinion in the public disclosure. Thus it appears that independent directors are not able to dismiss executives but may effectively be dismissed by them.[20]

[18] Friedman et al. (2003) developed a model in which controlling shareholders may choose either tunneling or propping depending on the magnitude of an adverse shock and the magnitude of the private benefits of control. Peng et al.(2006) employ connected transaction data from China and show that when listed companies are financially healthy (in financial distress), their controlling shareholders are more likely to conduct connected transactions to tunnel (prop up) their listed companies.

[19] Interview in BOARD, October 2010.

[20] In China listed companies rarely dismiss independent directors. According to Zhi and Tong (2005), independent directors were changed for a total of 427 person/time. Among them only two cases were public dismissals (0.47%). The other reasons for a change of independent directors were: 1. change personnel upon completion of a term

For convenience, we summarize the findings of the study, in comparison with our expectations, in Table 1.

Discussion and Conclusion

Using novel, hand-collected data from 19 MBOs of listed corporations in China, a matched sample of 19 non-MBOs and the population of listed corporations, this article has analyzed the characteristics and behavior of boards of directors in MBOs of Chinese listed corporations and compared these as far as possible with their Chinese non-buyout and Western counterparts.

The major differences between Chinese MBOs and other Chinese listed corporations appear to be a greater proportion of independent directors, more independent directors with internationalization and industry expertise, greater frequency of board meetings and greater focus on discussing related party transactions, tradable share reforms and divestment. However, there are important similarities between Chinese buyouts and other listed Chinese companies. Some of the changes over time and the lack of differences with other non-MBO firms may reflect the introduction of corporate governance regulations for all listed corporations.

By examining MBOs in China our analysis helps identify limits to applying the private equity backed, highly leveraged Western buyout model in a transition economy where important features are absent. We find in line with Western experience (Acharya et al., 2009) that the board post-MBO shrinks, but, in contrast, boards in China remain larger and have greater duality. Executives in Chinese MBOs generally have a long association with the firm. The frequency of Board meetings increases in comparison with matched non-MBO companies but not to the level seen in Western MBOs. While there is evidence of greater management replacement in PE-backed Western buyouts than in Western listed corporations, the dominance of insiders means that this difference is absent in Chinese MBOs.

Our findings resonate with and extend other studies of board structures and processes in China. For example, Firth et al. (2007) find that a greater proportion of outsiders on the boards of Chinese listed corporations is associated with greater earnings informativeness. Chen et al. (2006) show that a greater proportion of outside

(36.3%); 2. resignation (51.5%); 3. undisclosed (11.7%). As the disclosure of the resignation of an independent director will have a negative impact on the capital markets, some directors will be asked to submit their resignation when their term expires or will not disclose at all.

directors are linked to reduced fraud while an increased number of board meetings is associated with more fraud, probably because of the need for greater debate about contentious issues. Our analysis emphasizes the need to recognize that listed corporations in China are heterogeneous as there are important differences between MBOs and other listed corporations. We extend the analysis of Chen et al. (2006) by showing that there are significant differences between MBOs and listed corporations with respect to the role of the board in discussing related party transactions.

Our first two research questions focused on the nature of boards and the extent to which boards of directors are changed to bring in executive and outside directors with the skills to restructure and grow the business. The results were disappointing. Scholars are the most common group of independent directors. Although they may have important social networks, they are likely to know little about the actual operation of the enterprise and with typically heavy teaching, research and administration commitments are likely to have little time to play a full role as an independent director. The effectiveness of independent directors, who are incumbent managers in other companies have business expertise, may also be reduced due to limitations on time and energy. Independent directors from financial institutions also seem under-represented which is surprising, since China has numerous emerging securities companies and fund management companies. Given that China's MBOs are likely to need considerable transformation, we would argue that there is a requirement for more independent directors from financial institutions especially from VC/PE firms. This is consistent with the need for further stimulus to the development of the VC/PE industry in China (Bruton and Ahlstrom, 2003; Wright, 2007). Moves in this direction could contribute to an increase in the frequency of board meetings and more specialist involvement towards levels seen in Western buyouts.

Our third question focused on the functioning of the board and the issues addressed by outside directors. Our evidence shows that post MBO, the attention and time of the independent directors are mostly taken up with related transaction issues between the parent (holding) company and the MBO, significantly more so than in other listed corporations. This is interesting in the context of recent research which indicates that related transactions represent a negative aspect of corporate governance quality (Nikoskelainen and Wright, 2007; Djankov et al., 2008). There also appears to be little overt challenging of management.

Although there appears to be compliance with recently introduced corporate governance regulations on independent directors, they are generally nominated and elected by the majority shareholder. As such the independence of so-called independent directors is undermined, especially from the perspective of minority shareholders. Therefore, we suggest that the China Securities Regulatory Commission (CSRC) establish an independent director bank that provides the independent directors who are responsible directly to minority shareholders. There would be a requirement for the CSRC to select the directors from the bank and recommend them to the listed companies. The companies would then pay the cost to CSRC who in turn would remunerate the independent directors. This separation could provide a means to cut the umbilical cord between independent directors and the majority shareholder or controller.

Further efforts can also be introduced to promote and disseminate good board practice. An example of this approach is the awards for best boards organized by the influential journal “The BOARD”. Indeed, in 2010 one of our sample MBO companies Midea Electrical was the receipt of one of the ten best boards awards. The citation for the award noted that the Board of Directors is proactive and positive in helping Midea make important acquisitions, continuously optimizing the ownership structure, building a professional team of directors, and giving full play to the role of independent directors. Further, Midea promotes equity incentives and has been pursuing a high cash dividend policy to protect the interest of small shareholders.

While we have identified differences in the relative importance on boards of independent directors with different backgrounds based on publicly available data, we have not been able to provide more fine-grained analysis of the activities of these individuals in the process of board activities. Further work is needed on this topic. This would likely involve the need to undertake more longitudinal in-depth analysis of the processes taking place post-MBO, although gaining access to board meetings is notoriously problematical.

Overall, this paper has sought to extend examination of MBOs to the context of MBOs of listed corporations in China. Our evidence indicates that while there has been some development of boards, they do not adequately possess the expertise needed to address both business development and the monitoring of management.

References

Acharya, V. and C. Kehoe: 2008, 'Corporate Governance and Value Creation Evidence from Private Equity', http://www.ecgi.org/competitions/rof/files/Acharya_Kehoe_v5.pdf. Accessed 17 Dec 2010.

Acharya, V., C. Kehoe and A. Reyner: 2009, 'Private Equity ***vs*** PLC Boards in the U.K.: A comparison of practices and effectiveness', *Journal of Applied Corporate Finance **21***(1), 45-56.

Barney, J., M. Wright and D. Ketchen: 2001, 'The Resource Based View of the Firm: Then Years After 1991', *Journal of Management **27***(6), 625-642.

Bruton, G. and D. Ahlstrom: 2003, 'An institutional view of China's venture capital industry Explaining the differences between China and the West', *Journal of Business Venturing **18***(2), 233-259.

Bruner, R. and L. Paine: 1988, 'Management Buyouts and Managerial Ethics', *California Management Review **30***(2), 89-106.

Chen, G.M., M. Firth, D.N. Gao, and O.M. Rui: 2006, 'Ownership structure, Corporate Governance, and Fraud: Evidence from China', *Journal of Corporate Finance **12***, 424-448

Cheung, Y-L., P. R. Rau, and A. Stouraitis: 2006, 'Tunneling, propping, and expropriation: Evidence from connected party transactions in Hong Kong', *Journal of Financial Economics **82***(2), 343-386.

Claessens, S., S. Djankov and L.H.P. Lang: 2000, 'The separation of ownership and control in East Asian corporations', *Journal of Financial Economics **58***(1), 81-112.

Combined Code: 2003, *The Combined Code on Corporate Governance* (Financial Reporting Council, London).

Cornelli, F. and O. Karakas: 2008, 'Private equity and corporate governance: do LBOs have more effective boards?', in J. Lerner and A. Gurung (eds), *The Global Impact of Private Equity Report 2008, Globalization of Alternative Investments. Working Papers Volume 1* (World Economic Forum), pp. 65-84.

Cumming, D., D. S. Siegel and M. Wright: 2007, 'Private equity, leveraged buyouts and governance', *Journal of Corporate Finance **13***(4), 439-460.

Djankov, S., R. La Porta, F. Lopez-de-Silanes, and A. Shleifer: 2008, 'The law and economics of self-dealing', *Journal of Financial Economics **88***(3), 430-465.

Faccio, M. and L. Lang: 2002, 'The ultimate ownership of Western European corporations', *Journal of Financial Economics **65***(3), 365-395.

Filatotchev, I., K. Starkey and M. Wright: 1994, 'The Ethical Challenge of Management Buyouts as a Form of Privatization in Central and Eastern Europe', *Journal of Business Ethics* ***13***(7), 523-532.

Firth, M., P. Fung, and O. Rui: 2007, 'Ownership, Two-Tier Board Structure, and the Informativeness of Earnings – Evidence from China', *Journal of Accounting and Public Policy* ***26***, 463-496.

Gilligan, J. and M. Wright: 2010, *Private equity demystified*. 2nd edition. (London, ICAEW).

Gottschalg, O.: 2007, 'Private equity and leveraged buyouts', *Study for the European Parliament* (IP/A/ECON/IC/2007-25).

Houston, D. and J. Howe: 1987, 'The Ethics of Going Private', *Journal of Business Ethics* ***6***(7), 519-525.

Jensen, M. C.: 1986, 'Agency costs of free cash flow, corporate finance and takeovers', *American Economic Review* ***76***(2), 323-329.

Jensen, M. C.: 1993, 'The modern industrial revolution, exit, and the failure of internal control systems', *Journal of Finance* ***48***(3), 831-880.

Jones, T. and R. Hunt: 1991, 'The Ethics of Management Buyouts Revisited', *Journal of Business Ethics* ***10***(11), 833-840.

Kaplan, S. N. and P. Stromberg: 2009, 'Leveraged buyouts and private equity', *Journal of Economic Perspectives* ***23***(1): 121-146.

Lowenstein, L.: 1985, 'Management Buyouts', *Columbia Law Review* ***85***, 730-784.

Li, Y.: 2008, 'Brand Equity and Property Rights Reform **-** MBO Case Study for Midea Electronics', *Modern Economic Science* (in Chinese) ***30***(1), 77-87.

Liu, G. and P. Sun: 2005, 'Ownership and control of Chinese public corporations: a state-dominated corporate governance system', in K. Keasey, S. Thompson and M. Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley & Sons, Chichester), *pp.* 389-414.

Lynall M., B. Golden, A. Hillman: 2003, 'Board composition from adolescence to maturity: a multitheoretic view', *Academy of Management Review* ***28***(3), 416-431.

Meuleman, M., K. Amess, M. Wright, L. Scholes: 2009, 'Agency, strategic entrepreneurship, and the performance of private equity-backed buyouts', *Entrepreneurship Theory and Practice* ***33***(1), 213-239.

Nikoskelainen, E. and M. Wright: 2007, 'Value creation and corporate governance in leveraged buyouts', *Journal of Corporate Finance* ***13***(4), 2007.

Strömberg, P.: 2008, 'The new demography of private equity', in J. Lerner and A. Gurung (eds), J. Lerner and A. Gurung (eds), *The Global Impact of Private Equity Report 2008, Globalization of Alternative Investments. Working Papers Volume 1* (World Economic Forum), pp. 3-26.

Sun, P., M. Wright and K Mellahi: 2010, 'Is Entrepreneur-Politician Alliance Sustainable During Transition? The Case of Management Buyouts in China', *Management & Organization Review* ***6***(1), 101-122.

TSC: 2007, *Treasury Select Committee Tenth Report of Session 2006-07, Private Equity Vol.1 (together with formal minutes),* HC567-1.

Walter, C.E. and F.J.T. Howie: 2003, *Privatizing China: the stock markets and their role in corporate reform* (John Wiley & Sons (Asia) Pte Ltd, Singapore).

Weir, C. and M. Wright: 2006, 'Governance and takeovers: Are public to private transactions different from traditional acquisitions of listed corporations', *Accounting and Business Research* ***36***(4), 289-308.

Wood, G. and M. Wright: 2010, 'Private Equity and Human Resource Management: An Emerging Agenda', *Human Relations* ***63***(9) 1279–1296.

Wright M., S. Thompson and K. Robbie: 1992, 'Venture capital and management-led leveraged buyouts: A European perspective', *Journal of Business Venturing* ***7***(1), 47-71.

Wright, M., I. Filatotchev, T. Buck and K. Robbie: 1994, 'Accountability and Efficiency in Privatisation by Buy-out in CEE', *Financial Accountability and Management* ***10***(3), 195-214.

Wright, M., R. E. Hoskisson, L. W. Busenitz, and J. Dial: 2000, 'Entrepreneurial growth through privatization: the upside of management buy-outs', *Academy of Management Review* ***25***(3), 591-601.

Wright, M., R. E. Hoskisson and L. W. Busenitz: 2001, 'Firm rebirth: buyouts as facilitators of strategic growth and entrepreneurship', *Academy of Management Executive* ***15***(1), 111-125.

Wright, M., T. Buck and I. Filatotchev: 2005, 'Corporate governance in transition economics', in K. Keasey, S. Thompson and M. Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley & Sons, Chichester), pp. 415-442.

Wright, M.: 2007, 'Venture capital in China: A view from Europe', *Asia Pacific Journal of Management* ***24***(3), 269-281.

Wright, M., A. Burrows, R. Ball, L. Scholes, M. Meuleman and K. Amess: 2007, 'The implications of alternative investment vehicles for corporate governance: a survey of empirical research', *Report prepared for the Steering Group on Corporate Governance* (Paris: OECD).

Zahra, S. A.: 1995, 'Corporate Entrepreneurship and Financial Performance: the case of management leveraged buy-outs', *Journal of Business Venturing* ***10***(3), 225-247.

Zahra, S., I. Filatotchev and M. Wright: 2010, 'How do Threshold Firms Sustain Corporate Entrepreneurship? The Role of Boards and Absorptive Capacity', *Journal of Business Venturing* ***24***(3), 248-260.

Zhu, H.J., J.Y. Chen and L.Y. Yu: 2006, ' The Multiple Game and the Failure in Control when there is an Interest Conflict between the Central Government and Local Governments and State- owned Enterprises—a Case Study of the MBO of Yutong Buses Co.', *Management World* (in Chinese) ***4***, 115-129.

Table 1: Summary of Research Questions, Variables, Expectations and Findings

Research Questions	Variables	Western MBO Expectations	Chinese MBO Expectations	Findings
Q1: General board characteristics	Size	Size declines to smaller than listed corporations	Size declines	Size declines but not significantly different from listed corporations
	No. Executives	Relatively more important	Relatively more important	Relatively more important
	Duality	Less duality following Western buyouts	More duality	No significant differences from other companies
Q2: Independent director characteristics	No. & proportion	Decline with increase of PE directors	Expected increase due to regulatory change	Increases more than in matched companies
	Characteristics	Increase in directors with monitoring and growth expertise	Increase in IDs with growth expertise	Expertise in internationalization and industrial companies most important and more important than in other companies
Q3: The functioning of the board	Meeting frequency	Increases due to more active investors	Modest change	Evidence of increase (matched companies only)
	Issues addressed	In Western buyouts expected to focus on supporting investors – both monitoring and business development issues	Expected increase in issues relating to related transactions and minority shareholders as well to business development issues	Related transactions significantly more important than in other companies;
	Challenging executives	PE directors in Western buyouts expected to challenge executives	Few challenges to executives	Few challenges to executives [in line with listed corporations]

Table 2 The main features of 19 Chinese MBO companies

Company Name	Industry	O	C	C/O	Mrkt ca.1(in millions, US$)	Mrkt ca.2(in millions,US$)	Mrkt ca.2/ Mrkt ca.1
Shenzhen Universe Group Co. , Ltd.	construct and building material	29.68	40	1.35	106	77	0.73
China Fangda Group Co. , Ltd.	conglomerate	24.32	27.36	1.12	129	128	0.99
Shenzhen Huaqiang Industry Co. , Ltd.	audio-visual material	15.01	45	3	260	187	0.72
Shandong Shengli Co. , Ltd.	chemical industry(plastic material)	18.12	18.12	1	153	290	1.90
Guangdong Midea Electric Appliances Co., Ltd.	household electric appliance (white goods)	15.82	30.68	1.94	340	2,291	6.74
Zhengzhou Yutong Bus Co.,Ltd.	bus and coach manufacturing	17.19	17.19	1	225	685	3.04
Wuhan Humanwell Hi-tech Industry Company Limited	medical apparatus and instruments;	22.08	29.76	1.35	116	239	2.06
TeBian Electric Apparatus Stock Co.,Ltd(TBEA)	electric transmission and transformation equipment	21.11	21.11	1	339	4,187	12.35
JiangSu YongDing Company Limited	manufacture of communication Equipment	47.8	47.8	1	215	139	0.65
Xiamen Prosolar Technology Co. ，Ltd.	conglomerate	26.58	49.59	1.87	108	173	1.60
Hunan Dongting Aquaculture Co., Ltd.	aquaculture	23.57	29.9	1.27	87	199	2.29
Hubei Wuchangyu CO.,LTD.	aquaculture	68.69	68.69	1	207	135	0.65
Inner Monglia Eerduosi Cashmere Products Co.,Ltd.	Clothing	43.36	43.8	1.01	386	724	1.88
Jiangsu Hongdou Industry Co.,Ltd.	Clothing	19.31	27.48	1.42	163	202	1.24
Shanghai Dazhong Transportation（Group）Co.,Ltd.	public transportation	5.35	21.61	4.04	388	857	2.21
Shanghai Qiangsheng Holding Co., Ltd.	public transportation	19.36	21.51	1.11	439	1,267	2.89
Shanghai Pudong Dazhong Taxi Co., Ltd	public transportation	11.5	32.87	2.86	271	431	1.59
Sichuan Quanxing Co., Ltd.	foods and beverage	32.79	48.44	1.48	261	801	3.07
Ningbo Shanshan Co.,Ltd.	clothing	45.77	45.77	1	233	299	1.28
		22.08	30.68	1.27	225	290	1.88
		26.71	35.09	1.57	233	701	2.52

Notes: We exclude the year of the MBO for consistency and comparability reasons. Exchange rates used are 1 US dollar = 8.2767 RMB (at 31 December 2003) and 1 US dollar = 6.8346 RMB (at 31 December 2008). RMB appreciated 17.4% against US dollar during the 5 years, but the market capitalization of the 19MBO companies grew 88% (median), or 1.52 times(mean). O represents ownership (cash flow right), C for control (voting) right. And C/O indicates the separation of cash flow right and control right. The greater the C/O value, the greater the degree of separation of two rights.

Table 3: Comparisons of the mean numbers of directors

Year	The number of directors (MBO)	The number of directors (non MBO)	The number of directors (population)
1999	10.57	9.43	9.60
2000	10.65	9.18	9.42
2001	9.68	9.63	9.37
2002	10.11	10.16	9.86
2003	9.84	10.58	9.86
2004	9.63	9.95	9.70
2005	9.16	10.11	9.57
2006	9.05	9.39	9.42
2007	8.79	9.16	9.36
2008	8.53	9.11	9.26
Mean	9.60	9.68	9.54
MBO-non MBO Matched pairs: Mann-Whitney test, z=-0.387(n.s.) **MBO-Population:** Mann-Whitney test, z=-0.782(n.s.)			

Note: To enable comparisons we present data for the three groups of companies as reported in each calendar year. We compare the sample means over the period. Testing MBO-non MBO matched pairs for each year we find no significant differences. Testing MBO-Population for each year we find a weakly significant difference in year 2000 ($p<0.10$).

Table 4: Comparison of Duality

Year	The duality of chairman and CEO (MBO)	The duality of chairman and CEO (non MBO)	The duality of chairman and CEO (the population)
1999	1.64	2.00	1.78
2000	1.75	1.94	1.84
2001	1.79	1.95	1.88
2002	1.84	1.89	1.89
2003	1.89	1.74	1.89
2004	1.89	1.79	1.88
2005	1.89	1.84	1.88
2006	1.79	1.79	1.87
2007	1.79	1.95	1.84
2008	1.84	1.89	1.84
Mean	1.81	1.88	1.86
1=duality, 2=non-duality **MBO-non MBO Matched pairs**: Mann-Whitney test, z=-1.473(n.s.) **MBO-Population:** Mann-Whitney test, z=-1.381(n.s.)			

Note: To enable comparisons we present data for the three groups of companies as reported in each calendar year. We compare the sample means over the period. Testing MBO-non MBO matched pairs for each year we find a significant difference for the year 1999 ($p<0.05$). Testing MBO-Population for each year we find no significant differences.

Table 5: Proportions of Independent Directors (IDs)

Year	The proportion of IDs (MBO)	The proportion of IDs (non-MBO)	The proportion of IDs (population)
1999	0.65%	0.00%	0.81%
2000	1.44%	0.65%	1.74%
2001	8.51%	5.33%	6.29%
2002	27.08%	21.86%	24.14%
2003	34.75%	32.50%	32.77%
2004	35.69%	36.10%	34.20%
2005	36.47%	34.16%	34.81%
2006	36.54%	35.52%	35.23%
2007	37.86%	36.54%	35.82%
2008	37.80%	37.26%	36.20%
Mean	25.68%	23.99%	24.20%
MBO-non MBO Matched pairs: Mann-Whitney test, z=-1.659 (p=0.097) **MBO-Population:** Mann-Whitney test, z=-0.379 (n.s.)			

Note: To enable comparisons we present data for the three groups of companies as reported in each calendar year. We compare the sample means over the period. Testing MBO-non MBO matched pairs for each year we find significant differences for 2002, 2003 and 2005 (p<0.05 or better). Testing MBO-Population for each year we find significant differences in 2003, 2004 and 2005 (p<0.05 or better).

Table 6. The characteristics and categories of independent directors of 19 MBO companies post-MBO (1999-2008)

Characteristics	No.	Proportion (%)	Characteristics	No.	Proportion (%)
Expert: Industrial background	13 (6) [310]	10.8 (9.84) [13.37]	Retired government official	6 (9) [23]	5.0 (14.75) [0.99]
Expert: International background	13 (2) [35]	10.8 (3.28) [1.51]	Incumbent management of financial institutions	4 (2) [181]	3.3 (3.28) [7.81]
Accountant (incl. asset valuer)	14 (10) [172]	11.67 (16.39) [7.42]	Incumbent management of industrial companies	23 (6) [282]	19.2 (9.84) [12.16]
Lawyer	15 (7) [181]	12.5 (11.48) [7.81]	Scholar	45 (31) [894]	37.5 (50.82) [38.55]
Retired management of industrial companies	4 (3) [132]	3.33 (4.92) [5.69]	Other	18 (8) [109]	15..0 (13.11) [4.70]

Note: For MBO companies the proportion is the number of directors with each characteristic divided by 120. Since a director may have multiple backgrounds and so can be ascribed into different categories, the total number of affiliations is 155 and the total percentages exceed 100%. The figures in parentheses are for the 19 matching paired samples in the 2004 annual report. The figures in squared brackets are for 768 listed Chinese firms on Shanghai Stock Exchange in 2004, from: Shanghai Stock Exchange, 2004 Annual Report on Corporate Governance: Board independence and effectiveness.

Table 7: Comparison of frequency of board meetings

Year	the frequency of board meeting (MBO)	the frequency of board meeting (non-MBO)	the frequency of board meeting (population)
2001	6.28	6.05	6.23
2002	8.26	7.50	8.42
2003	6.79	6.42	7.53
2004	6.89	6.84	7.33
2005	7.47	6.53	7.50
2006	8.32	7.42	8.04
2007	9.79	8.58	9.59
2008	10.89	7.84	9.60
Mean	8.09	7.15	8.03
MBO-non MBO Matched pairs: Mann-Whitney test, z=-2.199 (p=0.028) **MBO-Population:** Mann-Whitney test, z=-0.323(n.s.)			

Note: To enable comparisons we present data for the three groups of companies as reported in each calendar year. CSMAR database only provides the number of meetings of the board of directors since 2001. We compare the sample means over the period. Testing MBO-non MBO matched pairs for each year we find a significant difference for 2008 (p<0.01). Testing MBO-Population for each year we find no significant differences.

Table 8: Comparison of Disclosure Statements (by number)

Firm Categ-ories	Type of disclosure statement											Total No.
	1	2	3	4	5	6	7	8	9	10	11	
A	24	1	4	71	10	1	0	13	3	9	21	157
B	34	6	7	72	29	1	1	14	2	3	19	188
C	3288	378	751	6003	2712	350	355	967	797	1028	1160	17789
Pearson Chi-Square test (Asymp.Sig.,2-sided), A-B, p=0.073; A-C, p=0.000												

Note: Firm categories: A: MBO sample, B: the matched companies; C: the population (all listed companies on Shanghai and Shenzhen stock exchange).
The type of disclosure statement is as follows: 1 = personnel changes (directors, executives); 2 = remuneration and stock incentives of senior management and directors; 3 = annual report proceedings (financial reports, profit distribution, report supplements and modifications, specific account adjustment, etc.); 4 = related-party transactions (including purchases of raw materials, sales, financing, trade mark renting, and a large number of assets acquisition or assets sales with the group/holding company; 5=guarantee items; 6 = acquisitions (including acquisition of a company's equity, asset acquisition, joint venture, the capital increase of a invested company); 7=audit items; 8=divestment; 9 =equity financing (right offering, seasoned offering, and the allocation of financing); 10=other (such as corporate governance self-examination, and so on); 11 = the non-tradable share reform plan and its adjustment. The data related to the period 2002-2008 and are from CSMAR