

A Study of Non-Controlling Major Shareholder Exit Threats and Corporate Internal Controls—Research on the regulatory effect of analysts attention

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Abstract: In recent years, the research theme of the withdrawal of non-controlling major shareholders and threatening to affect the internal governance environment of enterprises has gradually become an emerging research field. Non-controlled major shareholders exert "exit" pressure on the controlling shareholders of the enterprise to force them to give in to irregular behavior, which will have an impact on the internal governance environment of the enterprise. So can this impact ultimately affect the internal control quality of the enterprise? Therefore, from the perspective of the internal control quality of the enterprise, this paper studies whether the withdrawal threat of non-controlling major shareholders has a governance effect on the internal control quality of the enterprise, and further explores its regulatory effect on the above relationship based on the regulatory effect of analysts. Finally, through theoretical analysis and empirical research, it is found that the withdrawal threat of non-controlling major shareholders can improve the internal control quality of the enterprise; second, analysts are concerned about the relationship between the exit threat of non-controlling major shareholders and the internal control quality of the enterprise.

1. Introduction

In recent years, many listed companies in China (such as Luckin Coffee) have been exposed to have been exposed to financial fraud scandals; the first fine issued by the China Securities Regulatory Commission in 2023, Xinyan shares inflated their operating income by 3.3 billion yuan and inflated their total profits by 1.2 billion yuan in five years. These events reflect the failure of internal control of listed companies in China, so external investment Investors are increasingly concerned about what kind of governance environment the internal control system of listed companies can operate efficiently. Edmans A, Manso G (2011) believes that the exit from the threat mechanism will affect the internal governance environment of enterprises and improve the quality of internal control, which has become a cutting-edge research field in international financial and accounting circles^[1]. Before 2005, due to the existence of non-tradable shares, the China Securities Regulatory Commission promoted the reform of non-tradable shares to solve the problem of different rights of the same shares.

The reform made stocks flow, increased the correlation between the wealth and stock prices of controlling major shareholders, and helped to realize the exit behavior. In addition, the Stock Exchange has also implemented a securities lending system, which greatly accelerates the liquidity of listed companies' stocks and helps to realize exit behavior. In 2017, a reduction policy was launched to report and disclose the reduction plan in advance, further strengthening the deterrent of the threat of exit.

However, there are few studies on whether the withdrawal threat of non-controlling major shareholders has a governance effect on the quality of internal control of enterprises. In practice, we often find that controlling shareholders encroach on the interests of small and medium-sized shareholders. Can the withdrawal threat mechanism reduce their self-interest and thus improve the quality of internal control of enterprises? Therefore, based on the perspective of heterogeneity of shareholders, this paper studies the governance effect of the withdrawal threat of non-controlling major shareholders on the internal control quality of enterprises, and further explores the regulatory effect based on the attention of analysts, which has certain theoretical value and practical significance. On the one hand, it expands the research literature on the relationship between the withdrawal threat of non-controlling major shareholders and the quality of internal control of enterprises; on the other hand, it provides useful reference for external investors to analyze the value of enterprises and improve the quality of internal management of enterprises.

2. Research hypothesis

2.1 The withdrawal threat of non-controlling major shareholders and internal control quality

Admati A R, Pfleiderer P (2009) found that exit threats have a certain inhibitory effect for the first type of proxy problems^[2]. Edmans A, Fang V W, Zur E (2013) believes that if the relevant decision-making behavior within the enterprise has caused dissatisfaction among non-controlling major shareholders, they will threaten to withdraw and sometimes sell their shares^[3]. Dou Y, Hope O K, Thomas W B (2018) also proved that exit threats can help improve the disclosure quality of financial statements^[4]. Chen Kejiong (2018) found that corporate decisions will undergo substantial changes due to the exit threat^[5]. By combing the relevant literature, it is found that first of all, there are agency problems such as non-controlling major shareholders and controlling shareholders of enterprises. Exiting the threat can reduce agency costs and improve the quality of internal control of enterprises. Secondly, in order to prevent the decline of their own wealth due to the decline of stock prices, controlling shareholders will take active measures to improve the internal control system, thus improving the quality of internal control. Finally, the quality of financial statements has been improved by non-controlling major shareholders from imposing "exit" pressure to prevent controlling shareholders from managing surpluses. Based on the above analysis, this paper proposes hypothesis 1:

Hypothesis 1: The withdrawal threat of non-controlling major shareholders can improve the quality of internal control of the enterprise, and the two are positively related.

2.2 Regulatory effect of analysts' concerns

Xie Zhen and Xiong Jinwu (2014) found that analysts are very professional. They are not only good at analyzing the disclosed information of listed companies, but also dig deep into undisclosed information^[6]. Chen J, Ding R and Hou W (2016) found that analysts can effectively play the role of external supervision^[7]. Moreover, He Pinglin, Sun Yulong, and Ning Jing (2019) found that analysts' long-term attention can more accurately disclose corporate surplus management behaviors^[8], and Li Chuntao, Song Min and Zhang Xuan (2014) pointed out in their study that the

disclosure of the above behaviors contributed to the improvement of the quality of corporate internal control^[9]. Therefore, the more attention an enterprise is paid to by analysts, the easier it is to expose its irregular internal control behavior. Considering the reputation of the enterprise, the relevant shareholders will strengthen their internal control construction. It can be seen that the external supervision role played by analysts and the supervision effect of the exit threat of non-controlling major shareholders have an alternative role. When analysts pay less attention to the threat of non-controlling major shareholders, the more obvious the effect of the exit threat of non-controlling major shareholders on the improvement of the quality of internal control of the enterprise. Based on the above analysis, this paper proposes hypothesis 2:

Hypothesis 2: Analysts are concerned about the relationship between the withdrawal threat of non-controlling major shareholders and the quality of internal control of the enterprise.

3. Research design

3.1 Sample selection and source of data

This paper takes all listed companies in the Shanghai and Shenzhen A-share market from 2011 to 2022 as a research sample, and treats them as follows: (1) excludes the research samples that have been specially treated by ST and PT from 2011 to 2022; (2) excludes the gold that implements relatively special accounting standards Research samples of the fusion industry; (3) Research samples that are missing from variable data. After the above processing, 28790 data were finally obtained. In addition, in order to reduce the interference of extreme discrete changes to the empirical results, this paper shrinks all the continuous variables in the study sample according to the standard of 1%-99%.

The withdrawal threat data of non-controlling major shareholders is calculated through the relevant data in the CSMAR database. The internal control index data comes from the DIB database, and the data of other variables are from the CSMAR database. The data in this paper is analyzed and processed using StataMP 17.

3.2 Selection of research variables

3.2.1 Explained variable: internal control quality (Icq)

This paper draws on the research of Ling Shixian (2019)^[10] and uses the internal control index/100 to measure the internal control quality of the enterprise. The larger the value, the better the quality of internal control of the enterprise.

3.2.2 Explanatory variable: non-controlling majority shareholder exit threat (ET)

Through combing the literature, it is found that the withdrawal threat of non-shareholder major shareholders is mainly affected by the liquidity of stocks and the degree of competition between non-controlled major shareholders. (1) Stock liquidity (SL). The higher the liquidity of stocks, the greater the possibility of non-controlling major shareholders withdrawing from the enterprise, and the stronger the deterrent effect. This article draws on the research of Cao Zhipeng and Gao Shishi (2021)^[11] and uses the average daily stock turnover rate of circulating stocks to measure the market liquidity of securities. (2) Non-shareholder major shareholder competition (BHC). The fiercer the competition between non-controlling major shareholders, the easier it is to trade the stock, the easier it is to withdraw from the stock, and the stronger the deterrent effect. This paper draws on the research methods of Li Zhuangzhuang and Li Qiang (2020)^[12] to measure (BHC). The specific calculation method is as follows:

$$BHC_{it} = \sum_{K=1}^N \left(\frac{NCLS_{kit}}{SSBH_{it}} \right)^2 \quad (1)$$

Where $NCLS_{kit}$ denotes the proportion of outstanding shares held by the k th non-controlling majority shareholder in the i th firm in year t . $SSBH_{it}$ denotes the sum of the proportion of outstanding shares owned by each majority shareholder in the i th firm in year t . Thus the larger the value of BHC_{it} , the higher the degree of competition among noncontrolling large shareholders.

Finally, this paper draws on the research of Chen Kezhen (2019)^[13] and builds a measurement model (ET) as follows:

$$ET_{it} = SL_{it} \bullet BHC_{it} \quad (2)$$

3.2.3 Moderating variable: analyst focus (Analyst)

This article refers to the research of Chen Fengxia and Wang Peipei (2022)^[14] to measure the attention of analysts by taking the natural logarithm after the current annual number of analysts plus 1.

3.2.4 Control variable

Table 1: Definitions of key variables

	variable name	variable symbol	Variable Definition
Explained variable	Internal control quality	Icq	Internal control index/100
Explanatory variable	non-controlling majority shareholder exit threat	ET	Stock Liquidity (SL) * Non-controlling Large Shareholder Competition (BHC)
Moderating variable	analyst focus	Analyst	Ln (analysts tracking +1)
Control variable	enterprise size	Size	Ln (total assets at year-end)
	the gearing ratio	Debt	Total liabilities/total assets
	the return on assets	ROA	Net profit/average total assets
	number of board meetings	Nbm	Number of board meetings
	the share of independent directors ratio	Dir	Number of independent directors/total number of board members
	complexity of the firm's operating business	Complex	(Net inventories + net accounts receivable)/total assets
	concentration of shareholding	Large	Shareholding of the largest shareholder
	shareholding checks and balances	Balance	Proportion of shares held by the second to tenth largest shareholders
	nature of shareholding	Soe	state-owned enterprises=1, Non-state-owned enterprises=0
	separation of powers	SEP	Difference between control and ownership

This paper draws on the research of Oradi J, Asiaei K, Rezaee Z (2020)^[15] and add the following control variables to the model: (1) enterprise size (Size); (2) the gearing ratio (Debt); (3) the return on assets (ROA); (4) number of board meetings (Nbm); (5) the share of independent directors ratio (Dir); (6) complexity of the firm's operating business (Complex); (7) concentration of shareholding (Large); (8) shareholding checks and balances (Balance); (9) nature of shareholding (Soe); (10) separation of powers (SEP). In addition, year fixed effects (Year) and industry fixed effects (Ind) are also

controlled for. The specific measurement methods of the above variables are shown in Table 1.

3.3 Model design

In order to explore whether the withdrawal of non-controlling major shareholders has a governance effect on the internal control quality of the enterprise, this paper combines the research of Chen Kezhen (2021) ^[16].to carry out a model (3) to verify hypothesis 1.

$$Icq_{it} = a_0 + a_1ET_{it} + a_2Size_{it} + a_3Dbet_{it} + a_4ROA_{it} + a_5Nbm_{it} + a_6Dir_{it} + a_7Complex_{it} + a_8Large_{it} + \sum Year_t + \sum Ind_{it} + \varepsilon_{it} \quad (3)$$

In the model (3), Icq_{it} is the internal control quality of i company in t , and ET_{it} is the exit threat of i company's non-controlling major shareholders in t . The larger ET_{it} indicates that the greater the exit threat. At this time, if the regression coefficient a_1 regression coefficient is significantly positive, it means that the withdrawal threat of non-controlling major shareholders has a positive effect on the internal control quality of the enterprise, and hypothesis 1 is thus proved.

On this basis, to further test hypothesis 2 and to explore what happens to the impact of the threat of exit of non-controlling majority shareholders on the quality of internal control based on the moderating effect of analysts' concerns, the paper develops model (4) to test hypothesis 2.

$$Icq_{it} = a_0 + a_1ET_{it} + a_2ET_{it} * Analyst_{it} + a_3Size_{it} + a_4Dbet_{it} + a_5ROA_{it} + a_6Nbm_{it} + a_7Dir_{it} + a_8Complex_{it} + a_9Large_{it} + a_{10}Analyst_{it} + \sum Year_t + \sum Ind_{it} + \varepsilon_{it} \quad (4)$$

4. Empirical results and analysis

4.1 Descriptive statistical analysis

Table 2: Results of descriptive statistics for the main variables

Variable	N	Mean	SD	Min	p50	Max
Icq	32228	5.206	2.747	0	6.457	8.284
ET	32228	0.001	0.002	0	0	0.009
Size	32228	19.992	7.01	0	22.028	26.36
Debt	32228	0.452	0.205	0.066	0.445	0.957
ROA	32228	0.035	0.065	-0.243	0.03	0.226
Nbm	32228	8.615	4.686	0	8	23
Dir	32228	0.337	0.132	0	0.333	0.6
Complex	32228	0.234	0.179	0	0.216	0.738
Large	32228	31.391	18.037	0	30.433	74.95
Balance	32228	20.724	14.188	0	19.803	54.945
Soe	32228	0.368	0.482	0	0	1
Analyst	32228	1.156	1.197	0	0.693	3.761

The descriptive statistical results are shown in Table 2. They are analyzed from the interpreted variables (Icq). The standard deviation of Icq is 2.747, the maximum value is 8.284, and the minimum value is 0, indicating that the internal control quality of the sample company selected in this paper is quite different, so it is necessary to further explore. Analyzing from the interpreted variable (ET), the maximum value of ET is 0.009, the minimum value is 0, and the mean is 0.001. The statistical results are consistent with the existing research results.

4.2 Correlation analysis

The correlation test results are shown in Table 3. It can be intuitively seen that the interpreted variable (Icq) and the interpreted variable (ET) are positively correlated, which shows that the threat of withdrawal of non-controlling major shareholders has a governance effect on the internal control quality of the enterprise. Therefore, it can be preliminarily concluded that the research hypothesis of this paper is reasonable. In addition, it can be intuitively seen that the absolute value of the correlation coefficient between variables is within 0.8, indicating that the multiple colinear problem does not affect the empirical conclusion. Moreover, this paper also tests the variance expansion factor (see Table 4 for details), which shows that the vif between variables is less than 10, and the mean vif is also less than 10, indicating that there is no multiple colinearity between these variables.

Table 3: Person correlation coefficients between the main variables

	Icq	ET	Size	Nbm	Dir	Complex	Large	Soe	Debt	ROA
Icq	1									
ET	0.007	1								
Size	0.272	-0.042	1							
Nbm	0.034	-0.047	0.266	1						
Dir	0.006	0.047	-0.013	0.026	1					
Complex	-0.008	0.057	-0.018	0.061	0.026	1				
Large	0.074	0.109	0.206	-0.052	0.026	-0.025	1			
Soe	0.129	0.035	0.325	0.026	-0.099	-0.092	0.212	1		
Debt	-0.033	0.021	0.399	0.258	-0.03	0.212	-0.002	0.243	1	
ROA	0.168	-0.033	0.033	-0.09	0.006	-0.038	0.152	-0.098	-0.399	1

Note: Bolded portions indicate significance at the 1% level.

4.3 Multivariate regression analysis

4.3.1 Baseline regression result

Table 4 shows the regression results of the relationship between ET and Icq. In (1), the regression coefficient of ET is 0.01, and the result is significant at 5%, indicating that the two are positively correlated, that is, the withdrawal threat of non-controlling major shareholders can improve the quality of internal control of the enterprise, so hypothesis 1 has been verified.

In addition, through the analysis of the following regression results. It is not difficult to find that control variables such as return on assets (ROA) and company size are positively related to the quality of internal control of the enterprise, while the asset-liability ratio (Debt), complexity of the company's business (Complex) and equity concentration (Large) and other control quality are negatively related to it. The empirical results of this article are generally consistent with the research results of previous literature.

4.3.2 The moderating effect of analysts focus

Table 4(2) shows the regression results of the regulatory effect based on the attention of analysts. This regression result is to take ET, Analyst and ET*Analyst interaction items as interpreted variables and Icq as interpreted variables on the basis of model (4). The results show that the ET*Analyst coefficient is -0.011 and the ET coefficient is 0.013, indicating that when analysts pay less attention, the positive governance effect of the exit threat of non-controlling major shareholders on internal control quality is more prominent, that is, analysts are concerned about the ability to negatively adjust Icq and ET relationship between the two. The Analyst coefficient is 0.197, and the result is significant

at the level of 1%, indicating that analysts' attention and the exit threat of non-controlling major shareholders have the same effect on the quality of internal control, both of which have a positive governance effect. Analysts pay attention to the external supervision role played by and the withdrawal threat of non-controlling major shareholders. Internal supervision has an alternative role. As analysts pay less attention (that is, the number of analysts tracking less and less), the motivation for private interests such as controlling shareholders may become stronger and stronger, so the effect of non-controlling major shareholders on improving the quality of internal control of enterprises through withdrawal threats may become more and more obvious. That is, the less attention analysts pay, the more favorable it is for non-controlling major shareholders to exert exit pressure on controlling shareholders, management and other stakeholders, thus improving the quality of internal control of the enterprise, hypothesis 2 is established.

Table 4: Benchmark regression results

	(1)	(2)
VARIABLES	Icq	Icq
ET	0.010**	0.013***
	(2.099)	(2.870)
Analyst		0.197***
		(12.133)
ET*Analyst		-0.011***
		(-3.689)
Debt	-1.382***	-1.270***
	(-10.133)	(-9.336)
ROA	2.933***	2.064***
	(9.135)	(6.188)
Size	0.625***	0.531***
	(31.826)	(24.947)
Nbm	0.002	-0.001
	(0.493)	(-0.296)
Dir	0.320	0.276
	(1.476)	(1.275)
Complex	-0.488***	-0.481***
	(-3.296)	(-3.251)
Large	-0.004***	-0.003***
	(-3.053)	(-2.944)
Constant	-7.217***	-5.503***
	(-16.401)	(-11.900)
Observations	28,790	28,790
R-squared	0.0756	0.0818
Year FE	YES	YES
Indu FE	YES	YES

Robust z-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

4.4 Robustness check

In order to ensure the reliability of the empirical results of Table 4, this paper adopts the following three methods for robustness testing. (1) Replaced the measurement method of internal control quality, learns from the research of Wang Lina and Xu Guangwei (2023) to use the internal control index (Icq2) to measure the interpreted variables and conduct regression analysis again; (2) add individual fixed effects and conduct re-regression analysis; (3) adopt tendency Score matching

method (PSM), select asset-liability ratio (Debt), rate of return on assets (ROA) and other hypotenuse variable sets, use the logit model to calculate the tendency value, and then carry out the nearest matching, and then carry out a balance test to finally calculate the processing effect.

The robustness test results are shown in Table 5. Columns 2 and 3 reflect the regression results of changing the measurement of interpreted variables into internal control index (Icq2), columns 4 and 5 reflect the regression results of newly added individual fixed effects, and columns 6 and 7 reflect the regression results using the predisposition score matching method. All empirical results show that the coefficients and significance of ET and ET*Analyst have not changed substantially, indicating that the above empirical results are robust.

Table 5: Robustness check

VARIABLES	Replacement of the dependent variable measure		Plus individual fixed effects		Propensity score matching method	
	Icq2	Icq2	Icq	Icq	Icq	Icq
ET	0.010**	0.059*	0.010**	0.045*	0.010**	0.013***
	(2.071)	(1.961)	(2.019)	(1.967)	(2.407)	(3.379)
Analyst		1.751***		0.284***		0.197***
		(14.728)		(13.868)		(13.957)
ET*Analyst		-0.093***		-0.008**		-0.011***
		(-4.119)		(-2.505)		(-3.854)
Controls	YES	YES	YES	YES	YES	YES
Observations	28,790	28,790	32,228	32,228	28,790	28,790
R-squared	0.0829	0.0912	0.356	0.364	0.0756	0.0818
Year FE	YES	YES	YES	YES	YES	YES
Indu FE	YES	YES	YES	YES	YES	YES
Firm FE	NO	NO	YES	YES	NO	NO

Robust z-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

5. Further analysis

On the basis of model (3), this paper adopts the median group test method for further analysis. The regression results of further analysis are shown in Table 6. It is significant at the level. Because the larger the difference between the two powers, the more obvious the separation is, which promotes the incremental effect of the withdrawal threat of non-controlling major shareholders, that is, it more effectively inhibits the control shareholders from implementing irregular internal control behavior. Therefore, the greater the difference, the more obvious the effect of the withdrawal threat of non-controlling major shareholders on the improvement of the quality of internal control of the enterprise.

Table 6: Subgroup test regression results

VARIABLES	Small difference between control and ownership	Large control and ownership differentials
	Icq(1)	Icq(2)
ET	0.006	0.027***
	(0.885)	(3.735)
Controls	YES	YES
Observations	12,677	16,113
R-squared	0.1320	0.0721
Year FE	YES	YES
Indu FE	YES	YES

z-statistics in parentheses

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

6. Conclusions

First, the threat of withdrawal of non-controlling major shareholders can improve the quality of internal control of enterprises. Non-controlling major shareholders exert "exit" pressure on controlling shareholders and management. On the one hand, it can prevent management from managing earnings and improve the quality of financial statements. On the other hand, it can also inhibit the collusion between controlling shareholders and management for fraud and gain for personal gain, reduce the possibility of engaging in irregular behavior, and promote them to actively improve the internal control of the enterprise.

Second, analysts are concerned about the relationship between the withdrawal threat of non-controlling major shareholders and the quality of internal control of the enterprise. The role of external supervision played by analysts and the supervision of non-controlling major shareholders' withdrawal from the threat mechanism has an alternative role. The less analysts pay attention to, the more rampant they are, and the more likely non-controlling major shareholders are to exert exit pressure, thus promoting the quality of internal control of enterprises.

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