

# *The Legacy from the Past: Tradition of Revolution and Minority Shareholder Expropriation*

Yifan Peng<sup>1,a,\*</sup>, Hongmei Liu<sup>1,b</sup>

<sup>1</sup>*School of Accounting, Guizhou University of Finance and Economics, Guiyang, 550025, China*

<sup>a</sup>*pengyifanyiran@163.com*, <sup>b</sup>*julyliuqq@163.com*

*\*Corresponding author*

**Keywords:** Culture; Tradition of Revolution; Minority Shareholder Expropriation; Tunneling; Abnormal Related-Party Transactions; Governance

**Abstract:** The tradition of revolution has not only exerted a profound impact on the Chinese development, but has also gradually permeated into the realm of modern corporate governance. We proposed that informal institutions, such as culture, can explain minority shareholder expropriation. Based on data from Chinese listed firms from 2009 to 2022, we documented that inhibitory effects of tradition of revolution on corporate minority shareholder expropriation. Heterogeneity analysis shows that the baseline results is more pronounced in SOE and in firms where the CEO has been in post for a longer period of time. The findings expand the scope of cultural factors from a financial perspective, providing insights into the significance that Chinese government departments ascribe to the social governance functions of informal institutions.

## 1. Introduction

In contrast to the initial focus of the corporate governance field on type I agency problem, namely instances where management actions may negatively impact the interests of shareholders. La, P. et al. (1999) identified a shift towards a greater emphasis on type II agency problem in emerging markets with more concentrated ownership structure[1]. In such contexts, majority shareholders are in a position to supervise management, thereby reducing the likelihood of type I agency problem occurring. However, majority shareholders' informational and capacity advantages over their smaller counterparts may induce their opportunism, resulting in type II agency problem represented by large shareholders' tunneling.

In recent years, type II agency problem has been frequently encountered, seriously harming the interests of minority shareholders in terms of investment project selection and controlling rights transferring[2], leading to losses or go private and disrupting financial market order[3]. To illustrate, the actual controller of Kangmei Pharmaceutical assumed a substantial portion of the listed company's funds through related-party transactions, ultimately placing the company at risk of bankruptcy reorganization. Consequently, addressing type II agency problem holds considerable practical value.

In contrast, traditional corporate governance theory places emphasis on the mitigation of agency problems through the implementation of formal internal and external governance mechanisms[4],

with minimal consideration given to the role of informal institution in corporate governance. As academic discourse on corporate governance, culture and the role of the informal institution has become increasingly nuanced, scholars in related fields have begun to explore this important phenomenon in greater depth.

In order to gain a comprehensive understanding of the development challenges facing the Chinese economy, it is essential to consider the influence of formal institutions alongside the valuable cultural heritage that has been accumulated in China over millennia[5]. Chinese culture and social norms, nurtured over centuries, align with Williamson's (2000) notion that change occurs very slowly, over centuries or even millennia[6]. China's informal institutions, stabilized under Confucian values, continue to exhibit strong vitality today[5][7]. Confucianism, in particular, has been shown to solve agency problems by fostering moral values[7][8][9][10][11]. Thus, traditional Chinese culture can be expected to explain corporate minority shareholder expropriation.

In China, numerous scholars have concentrated on the notion that exemplary traditional cultures, including confucian culture[12], commercial culture[13], and clan culture[14], have exerted a beneficial influence on the reduction of agency costs for firms and the enhancement of employee incentives, among numerous other aspects. Nevertheless, only a limited number of scholars have directed their attention to the concept of tradition of revolution(TR), which has its roots in the long history of the Chinese nation and has exerted a significant influence on the course of China's developmental trajectory in the 20th century.

In this paper, we employed the difference-in-difference method, as proposed by Wu and Hong(2024)[15], and constructed a sample of 22136 annual observations of firms listed on the Chinese stock market from 2009 to 2022 to test TR on abnormal related-party transactions (AbRPT).Our research found that corporations influenced by TR tend to be less minority shareholder expropriation. This result remains consistent even after accounting for endogeneity issues. Heterogeneity analysis revealed that the impact of property rights and CEO age on the role of TR varies across different contexts.

This study makes several contributions. First, from the perspective of TR, it offers a novel research avenue for curbing minority shareholder expropriation. In contrast to the extensive research examining the influence of cultural factors on economic development and other corporate behaviours, there is a notable scarcity of literature exploring the potential of cultural norms to act as a deterrent to minority shareholder expropriation. Based on Chinese unique institutional context, we used TR, formed under Confucianism, as a proxy for social culture and norms, providing empirical evidence of its impact on large shareholders' tunneling. Second, this study analyses the influence path of macro-political and cultural factors on micro-corporate behaviour from the perspective of abnormal related-party transactions, enriching the existing body of previous research on the impact of socialist culture and economy with Chinese characteristics. Third, practice level. This paper offers a reference point for addressing type II agency problem and provides empirical evidence for the necessity and importance of consolidating the construction of socialist culture with Chinese characteristics and enhancing cultural confidence.

## **2. Literature review and hypotheses development**

### **2.1. Minority shareholder expropriation**

Since Johnson et al. (2000) first proposed the concept of tunneling[16], academic research has focused on tunneling behavior, including related-party transactions of major shareholders and capital withholding. Western research on principal-agent problems primarily concentrates on the context of dispersed corporate shareholdings and type I agency problem between shareholders and management. However, the high concentration of shareholding structures among listed companies

in China, coupled with an inadequate legal protection system. For investors, the lack of robust corporate governance and the concentration of advantageous resources within a company are often controlled by a small number of major shareholders. This can result in minority shareholder expropriation[17].

Previous research on governance approach to large shareholders' tunneling behavior predominantly encompasses two dimensions: internal and external governance. With regard to internal governance, Zhou et al. (2022) discovered that an elevated level of executive integrity is associated with a greater inhibition of minority shareholder expropriation[18]. Furthermore, an increase in the remuneration of independent directors is linked to a heightened degree of large shareholder entrenchment[19].

In terms of external governance, Sun et al.(2020) have demonstrated that the opening of the financial market can serve to inhibit minority shareholder expropriation[20]. In their study, Nie and Pan (2019) examine the efficacy of inquiry letters supervision as a governance tool for influencing tunneling of controlling shareholders[21].

The aforementioned studies have examined the issue of minority shareholder expropriation from a variety of perspectives, but rarely discusses the influence of TR on abnormal related-party transactions, particularly in the current era, which is characterised by a diverse range of cultures and communities across the globe.

## 2.2. TR and minority shareholder expropriation

The inhibitory effect of informal institutions on minority shareholder expropriation has been identified by Chinese scholars. Gu et al.(2024) empirically testing historical Confucian values reduce minority shareholder expropriation in local public firms. TR, a valuable spiritual asset formed during the revolutionary war, represents the fundamental purpose of "serving the people" and the noble qualities of selfless dedication. Its spiritual connotations have far-reaching significance in curbing minority shareholder expropriation. Furthermore, it may be capable of reducing minority shareholder expropriation.

First, TR places significant emphasis on the notion of "service the people," whereby people's interests are held in the highest regard. In the context of corporate governance, this signifies that majority shareholders should espouse a culture of accountability to all stakeholders in the business, rather than pursuing the exclusive maximisation of their personal interests. Minority shareholder expropriation is often detrimental to the rights and interests of minority shareholders, creditors and other stakeholders, and runs counter to the core value of "serving the people" in TR.

Second, TR is characterised by keeping the larger picture in mind and selfless dedication. In terms of corporate governance, TR stipulates that, when exercising their rights, major shareholders should consider the long-term development and social responsibility of the enterprise. Keeping the larger picture in mind means that it is essential that major shareholders adopt a holistic approach to their role, safeguarding the interests of the enterprise as a whole and avoiding any actions that could potentially erode the enterprise's fundamental foundations. The concept of selfless dedication encourages major shareholders to consider the legitimate rights and interests of other stakeholders while pursuing their personal interests. This approach enables the harmonious coexistence of the enterprise and society.

Therefore, we formulated Hypothesis:

*Hypothesis.TR reduces minority shareholder expropriation*

### 3. Research design

#### 3.1. Sample Selection and data source

The effects of the global economic downturn that commenced with the 2008 financial crisis must be taken into account. This study examines Chinese A-share non-financial industry listed firms from 2009-2022. We exclude firms registered outside Chinese mainland and in special treatment (ST) status, and samples with missing variables in the calculation process. Final database consist of 22136 samples at the firm-level. The data used in this study mainly come from the China Stock Market and Accounting Research Database (CSMAR).The principal explanatory variable, designated 'red scenic spots', is derived from the List of National Red Rourism Classic Scenic Spots, published in 2016 by the National Development and Reform Commission(NDRC) and other relevant government departments in China. All continuous variables undergo winsorize at the 1 % to 99 % level.

#### 3.2. Empirical model

We refer to the methodology proposed by Wu Wuqing et al. (2024) and employ a multiple regression model that takes several control variables and fixed effect into account[15]:

$$AbRPT_{i,t} = \beta_0 + \beta_1 DID_{i,t} + X_{i,t} + \mu_i + \delta_t + \varepsilon_{i,t} \quad (1)$$

Where i represents the corporate and t represents the year. In Eq. (1), the dependent variable, AbRPT, is measured using the business index developed by Jian and Wong (2010)[22];  $DID_{i,t} = treat_i \times after_t$  as the core explanatory variable;  $X_{i,t}$  is the multidimensional control variable for firm i in year t ;  $\mu_i$  is the firm-fixed effect;  $\delta_t$  is the time-fixed effect;  $\varepsilon_{i,t}$  is the error term.

Based on the hypothesis, we expect the coefficient of  $DID_{i,t}$  to be significantly negative.

#### 3.3. Variable measurement and descriptive statistics

##### 3.3.1. AbRPT

In regard to the dependent variable, abnormally related-party transactions (AbRPT), this paper draws upon the work of Jian and Wong (2010) and employs Eq. (2) to differentiate between arm's length and AbRPT, thus providing a means of separating the total amount of firms' related-party transactions[22]:

$$RPTsum_{i,t} = \beta_3 + \beta_4 Lev_{i,t} + \beta_5 Size_{i,t} + \beta_6 Mtb_{i,t} + \theta_i + \delta_t + \varepsilon_{i,t} \quad (2)$$

In Eq. (2), the dependent variable is the sum of related-party transactions (RPTsum), while the explanatory variables are asset-liability ratio (Lev), firm size (Size), market-to-book ratio (Mtb), and industry( $\theta_i$ ) and year( $\delta_t$ ) variables, respectively. The predictors of the model are normal related-party transactions, while the residuals are AbRPT.

##### 3.3.2. TR

Tourist attractions and cultural heritage sites serve as invaluable resources and pedagogical tools for disseminating and learning about TR[24]. This paper makes reference to the work of Wu Wuqing et al. (2024), which is based on the List of National Red Rourism Classic Scenic Spots, issued by NDRC and other relevant departments in 2016[15]. The objective is to identify, on a prefecture-level basis, the administrative districts in which the 'red scenic spots' are located. These are distributed across 265 prefecture-level administrative districts, and are therefore considered the

treatment group.

In October 2016, the concept of the Great Long March Spirit was first proposed at a conference commemorating the 80th anniversary of the victory of the Red Army Long March. Since then, the spirit of the Long March has received unprecedented attention [15], and this paper takes the 80th anniversary of the victory of The Long March of the Red Army in 2016 as the point of departure for analysis.

Table 1 reports descriptive statistics of variables used in the baseline regression.

Table 1 Descriptive statistics of variables in baseline regression

	N	Mean	SD	Min	p50	Max
AbRPT	22136	-0.125	2.625	-8.964	0.293	4.532
DID	22136	0.471	0.499	0	0	1
treat	22136	0.761	0.427	0	1	1
time	22136	0.619	0.486	0	1	1
TobinQ	22136	2.151	1.350	0.893	1.724	8.744
Ins	22136	40.35	23.91	0.278	41.52	88.07
Dual	22136	0.298	0.457	0	0	1
Ind	22136	37.41	5.169	33.33	33.33	57.14
Age	22136	9.481	7.132	1	8	27
Lev	22136	0.411	0.203	0.0550	0.399	0.896
Roa	22136	0.0330	0.0650	-0.277	0.0350	0.185
Soe	22136	0.308	0.462	0	0	1
Size	22136	21.85	0.999	19.81	21.77	24.59
Big4	22136	0.0290	0.167	0	0	1
Mng	22136	14.61	19.79	0	1.639	67.75

## 4. Empirical result

### 4.1. Baseline regressions

We used a stepwise control approach to test the competitive hypothesis. As shown in columns (1) to (2) of Table 2, the coefficients of DID are all significantly negative. These results show that firms situated in regions characterised by the 'red scenic spots' exhibit a markedly diminished propensity for minority shareholder expropriation subsequent to the policy point, in comparison to firms situated in regions devoid of such attractions, which providing strong evidence to Hypothesis.

Table 2 Baseline regressions

	AbRPT			
	(1)	(2)	(3)	(4)
DID	-0.344***	-0.269***	-0.164***	-0.154**
	(-4.04)	(-3.37)	(-2.58)	(-2.25)
_cons	-0.467***	6.458***	9.206***	9.413***
	(-7.97)	(13.03)	(5.36)	(5.45)
Year & Stkcd	No	No	Yes	Yes
Obs	22136	22136	22136	21226
Adj-R <sup>2</sup>	0.0047	0.1311	0.5805	0.5784
F	35.79	239.64	9.82	9.43

Robust t-statistics in parentheses, \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## 4.2. Endogenous concerns and Robustness tests

### 4.2.1. Parallel trend test

It is of significant importance to establish the parallel trend test as a prerequisite assumption for difference-in-difference model. This paper verifies the parallel trend test by setting a series of policy point-in-time dummy variables. The regression results are presented in annex, which shows that the interaction term is significantly negative only after 2016, thus satisfying the requirement of parallel trend test.

### 4.2.2. Placebo test

In this study, firms were randomly selected to form a second treatment group 2,000 times, replacing the original treatment group in regressions for placebo tests. As shown in annex, the distribution of the 2000 regression coefficients exhibited a tendency to align with a normal distribution. Furthermore, the absolute values of the majority of the coefficients were found to be considerably smaller than the absolute values of the baseline regression coefficients, with the mean values approximating 0. This outcome successfully passed the placebo test.

### 4.2.3. Propensity score matching

In this study, the treatment group variables were estimated with the control variables in model (1) and matched with one-to-one nearest neighbours. The matched samples were then re-run on the model (1) regression. As shown in columns (4) of Table 1, the coefficient of *DID* significantly negative, ensuring the robustness of the conclusions derived from the baseline regression.

## 5. Heterogeneity analysis

### 5.1. Property rights: SOE versus non-SOE

There are a number of ways in which SOE differ from non-SOE, including in terms of their governance structure. As shown in columns (1) and (2) of Table 3, the coefficients of TR are significantly negative in SOEs (-0.192 with  $t=-2.40$ ) and insignificant in the sample of non-SOEs (0.102 with  $t=0.97$ ).

This phenomenon may be attributed to the fact that the majority of managers in SOE are subjected to the influence and education of TR on an ongoing basis and in an implicit manner. This may contribute to a relatively low degree of minority shareholder expropriation of SOE.

### 5.2. CEO age: Young versus Old

Given that type I agency problem is less prevalent in China, the CEO in Chinese companies is typically aligned with controlling shareholders, and may even be complicit in the latter's minority shareholder expropriation. Furthermore, it can be posited that the older CEO, the closer they lived to the time of the revolutionary events, the stronger the influence of TR, and the more they appreciate the power of spirit and belief in difficult times. It is therefore hypothesised that TR will have a deeper impact on the older generation.

We expect the TR will have a more profound effect on the older demographic. As shown in Table 3, the coefficients of DID are significantly negative in column (1), while in column (2) it is found to be insignificant, it confirms our suspicions.

The significance of differences in  $treat \times time$  coefficients between groups was tested using

empirical p-values, which were obtained by autosampling (bootstrap) 1000 times.

Table 3 Heterogeneity analysis

	AbRPT			
	(1)	(2)	(3)	(4)
	Property Rights		CEO age	
	SOE	non-SOE	Old	Young
DID	0.102	-0.192**	-0.313***	-0.100
	(0.97)	(-2.40)	(-3.17)	(-1.02)
_cons	5.230***	11.288***	8.672***	12.216***
	(2.62)	(3.67)	(4.08)	(3.90)
Year & Stkcd	Yes	Yes	Yes	Yes
Obs	6823	15313	11659	10939
Adj-R <sup>2</sup>	0.6444	0.5451	0.6426	0.5987
F	11.80	8.08	8.93	7.45
Empirical p-value	-0.334***		0.053*	

## 6. Conclusion

Based on the unique research context in China, this study employs a difference-in-difference model to examine how macro-level TR influences micro-level abnormal related-party transactions. Our empirical findings confirm a negative relationship between TR and minority shareholder expropriation. This inhibitory impact is concentrated in firms with older CEOs and lower equity balance degree.

This paper presents empirical evidence for the vitality and influence of TR, offering the following insights:

First, it is recommended that enterprises adopt a proactive approach to integrating TR into their organisational development, thereby establishing a robust foundation for their soft power. As a valuable cultural legacy inherited from China's long history, a systematic exploration of TR can play a pivotal role in the growth and advancement of Chinese enterprises.

Second, an analysis of the cultural context can elucidate the phenomenon of Chinese business development in the context of inadequate legal and financial systems. Chinese Government and other departments should formulate policies that actively promote the positive role of cultural factors with Chinese characteristics.

Finally, future scholars would be well advised to devote greater attention to the spirit of China. The spiritual culture that emerged during China's century-long struggle is imbued with profound implications. It would be a valuable avenue for future research to delve deeper into how this culture can manifest its spiritual influence in other domains and shape corporate behaviour.

## References

- [1] La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer, 1999. *Corporate ownership around the world*, *The journal of finance* 54, 471-517.
- [2] Bebchuk, L. A., R. Kraakman, and G. G. Triantis, 1998. *Stock pyramids, cross-ownership, and dual class equity - The mechanisms and agency costs of separating control from cash-flow rights* (Banff, Canada).
- [3] Bertrand, Marianne, and Sendhil Mullainathan, 2000. *Agents with and without principals*, *American Economic Review* 90, 203-208.
- [4] Shleifer, Andrei, and Robert W Vishny, 1997. *A survey of corporate governance*, *The journal of finance* 52, 737-783.
- [5] Allen, Franklin, Jun Qian, and Meijun Qian, 2005. *Law, finance, and economic growth in China*, *Journal of financial economics* 77, 57-116.

- [6] Williamson, O. E. (2000). *The new institutional economics: Taking stock, looking ahead*. *Journal of Economic Literature*, 38(3), 595-613.
- [7] Gu, Zhihui, Wei Sun, and Frank S Zhou, 2024. *Cultural origin and minority shareholder expropriation: Historical evidence*, *Journal of Accounting Research* 62, 181-228.
- [8] Du, X. (2013). *Does religion matter to owner-manager agency costs? Evidence from China*. *Journal of Business Ethics*, 118(2), 319-347.
- [9] Du, X. (2014). *Does religion mitigate tunneling? Evidence from Chinese Buddhism*. *Journal of Business Ethics*, 125(2), 299-327.
- [10] Du, Xingqiang, 2015. *Does Confucianism reduce minority shareholder expropriation? Evidence from China*, *Journal of Business Ethics* 132, 661-716.
- [11] Hilary, Gilles, and Kai Wai Hui, 2009. *Does religion matter in corporate decision making in America?* *Journal of financial economics* 93, 455-473.
- [12] Gu, Zhihui, 2015. *Confucian ethics and agency costs in the context of globalisation*, *Journal of Management World*, 113-123.
- [13] Liu, Lanyua, Li-an Zhou, and Qi Wu, 2021. *Long-term Economic Consequences of Traditional Business Culture: Evidence from Ming-Qing Guilds*, *Journal of Management World* 37, 106-120+108.
- [14] Pan, Yue, Ruoyu Wong, Xiangge Ji, and Yiyi Dai, 2019. *Clan Culture and the Blood Complex of Family Firm Governance*, *Journal of Management World* 35, 116-135+203-204.
- [15] Wu, Wuqing, and Zhenhan Hong, 2024. *The Contemporary Significance of Revolutionary Culture: Evidence from the Suppression of Corporate Misconduct by the Long March Spirit*, *The Journal of World Economy*, 3-29.
- [16] Johnson, Simon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, 2000. *Tunneling*, *American Economic Review* 90, 22-27.
- [17] Jiang, Fuxiu, Yumbiao Ma, and Yuntong Wang, 2015. *Can exit threats curb controlling shareholders' self-interested behaviour?*, *Journal of Management World*, 147-159.
- [18] Zhou Zejiang, Lei Ling, and Wang Biaohua, 2022. *Does Executive Integrity Restrain Major Shareholders' Tunneling? —Empirical Evidence from Chinese State-owned Listed Companies*, *Management Review* 34, 279-292.
- [19] Lu, Taiping, and Tengfei Ma, 2021. *Independent Director Compensation and Tunneling of Major Shareholders: Incentive or Collusion*, *Finance and Trade Research* 32, 94-105.
- [20] Sun Zeyu, Qi Baolei, and Cui Xiaoyu, 2020. *Opening of Capital Markets and Tunneling by Major Shareholders: Based on Empirical Evidence from the Shanghai - Hong Kong and Shenzhen - Hong Kong Stock Connect Trading System*, *Financial Economics Research* 35, 94-107.
- [21] Nie, Ping, and Zaizhen Pan, 2019. *Inquiry Letters Supervision and Tunneling of Controlling Shareholders: Evidence from Shanghai and Shenzhen Stock Exchange of Annual Report Inquiry*, *Journal of Audit & Economics* 34, 91-103.
- [22] Jian, Ming, and Tak Jun Wong, 2010. *Propping through related party transactions*, *Review of Accounting Studies* 15, 70-105.
- [23] Zhang Ming, Lan Hailin, Chen Weihong, and Zeng Ping, 2021. *Indigenous Religious Tradition and Corporate Tax Avoidance —An Empirical Study Based on 34 100 Monasteries and 8 349Temples in China*, *China Economic Quarterly* 21, 1345-1368.
- [24] Li Houqiang, Hou Shuiping, and Yang Xiannong, 2012. *Carrying forward the Long March Spirit to build a cultural powerhouse*, *Studies in Mao Zedong Thought* 1.