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Can Small Shareholders Protect Their Interests from Expropriation: The Case of a Chinese Bank

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ABSTRACT This article examines how small shareholders protected their interests from large shareholders' expropriation by forming an alliance and taking collective action to block a convertible bonds issue by a Chinese bank that they considered harmful. Forming an alliance strengthened small shareholders' network density, enhanced their salience (power, legitimacy, and urgency), and reduced the bank's centrality. This enabled small shareholders to change their strategy from being a subordinator to a compromiser and forced the controlling shareholders and their representatives to change their strategy from a commander to a compromiser. Apart from interest-based motives, the alliance provided small shareholders with identity-based incentives to persistently oppose expropriation by controlling shareholders. This article enriches the literature on small shareholder activism and principal-principal problem.

KEYWORDS expropriation, mutual funds, principal-principal problem, shareholder activism, stakeholders

INTRODUCTION

Prior studies have reported that large shareholders can extract cash by selling assets, goods, or services to the company through self-dealing transactions; obtaining loans on preferential terms; transferring company assets to other companies under their control; and diluting the interests of small shareholders by acquiring additional shares at a preferential price (Berkman, Cole, & Fu, 2009; Jiang, Lee, & Yue, 2010; Wang, 2015). However, these studies assume that small shareholders are either passive or have little power and no incentive to engage in monitoring to protect their interests (Kandel, Massa, & Simonov, 2011).[1] When individual shareholders are prevalent in the ownership structure, institutional shareholders act as small shareholders and their power to monitor corporate insiders is weak (Hamdani & Yafeh, 2013). So far, no studies have examined how small

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shareholders unite themselves and resist large shareholders' expropriation, even though sometimes successfully.

Responding to calls for conducting research on shareholder activism outside developed countries (e.g., Aggarwal, Erel, Ferreira, & Matos, 2011),[2] this article examines how small shareholders protected their interests from large shareholders' expropriation by forming an alliance and taking collective action. Specifically, we undertake a case study of small shareholders' resistance to a convertible bonds issue by a Chinese bank (named as 'ACB') they considered harmful. In this case, initially, the controlling shareholders were in a commanding position and the small shareholders in a subordinating position. Even though a group of small shareholders (i.e., forty-seven mutual funds and one securities company) established an alliance, their fight against the large shareholders would seem to be a lost cause because of the pervasive principal-principal agency problem (i.e., the conflict of interests between large and small shareholders, hereafter as the P-P problem) and weak legal protection of small shareholders in China. But surprisingly, both the large shareholders and small shareholders eventually compromised. This article investigates why and how this change occurred.

China provides an interesting setting for studying small shareholder activism and the P-P problem. First, China's listed firms have concentrated ownership structure. State ownership is prevalent as many listed Chinese companies are state-owned enterprises (SOEs) and tradable shares are mainly held by millions of individuals and mutual funds. Large shareholders often seek to extract private benefits at the expense of small shareholders. Given that government agencies have effective control over company decisions, corporate transparency is low. Further, legal protection of private investors in China is limited. The limited protection of minority rights and low corporate transparency exacerbates the expropriation of small shareholders (Claessens & Fan, 2002). As a result, P-P problems are pervasive as can be seen in many corporate scandals in China in which listed companies together with their large shareholders expropriate small shareholders (e.g., Chen, Hu, & Xiao, 2010). This was why the small shareholders, even after they formed an alliance, felt that they were fighting a lost course in the ACB saga.

Second, with the increasing shareholdings, institutional investors have been becoming important shareholders (e.g., Gillan & Starks, 2000). In developed countries like the US and the UK where a dispersed corporate ownership structure is common, the governance role of active institutional investors (in particular, pension funds) is mainly to monitor managerial inertia (i.e., to help solve the shareholder-management agency problem) because the P-P problem is less important (Cornett, Marcus, & Saunder, 2007; Ferreira & Matos, 2008). The extant literature shows that institutional investors play an important role in monitoring corporate management and improving firm performance (e.g., Bebchuk, Brav, & Jiang, 2015). In contrast, the central agency problem in many emerging markets (like China) is the P-P problem. As a response to the weak corporate governance and

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severe P-P problem, the Chinese regulators encourage the development of institutional investors (especially mutual funds) in the expectation that mutual funds can monitor corporate decisions and protect the benefits of small shareholders (Yuan, Xiao, & Zou, 2008). Previous studies have been inconclusive as to whether mutual funds have lived up to expectations.[3] In reality, small shareholders do fight and sometimes they are successful.[4] The failure to recognize and capture this has not only created a gap in the literature, but could potentially also render the policy recommendations based on existing studies biased and misleading.

In this case study of ACB's convertible bond issuing, we find that during the dispute, small shareholders united as a whole. Before the alliance was formed, ACB could deal with each small shareholder separately, but now it faced a strong alliance. The small shareholders' claims and actions become more salient due to their enhanced power, legitimacy and urgency, which posed serious challenges to large shareholders. Meanwhile, they gained support from the regulators, the media and the public. This increased density of the network and reduced the relative centrality of ACB. Moreover, the alliance's collective action was motivated by the group identity as the guardians of small shareholders, apart from protecting their own interests. This helped bond the small shareholders together and enabled them to persistently oppose the expropriation of large shareholders to the end. As a result, both small and large shareholders made some concessions.

This article contributes to the literature in three ways. First, we extend the literature by focusing on the P-P problem in contrast to the extensive focus on the Principle-Agency (P-A) problem. In general, prior literature assumes that small non-controlling and non-strategic shareholders do not monitor corporate management because of limited power and lack of incentive (Kandel et al., 2011). By extending the analysis to the P-P problem, not only do we shed light on how more powerful principals can pursue actions that harm small principals, we are, to our knowledge, also the first to demonstrate how organized collective activism by small shareholders can be a strong form of resistance to harmful actions by large shareholders. Thus, this study enriches the literature on the P-P problem.

Second, this study adds to the shareholder activism literature that examine the governance role of institutional shareholders (e.g., Admati, Pfleiderer, & Zechner, 1994; Barker, Hendry, Roberts, & Sanderson, 2012; Brav, Jiang, & Kim, 2015; Chung, Kur, & Liu, 2019; Gillan & Stark, 2000; Klein & Zur, 2009; Prevost, Wongchoti, & Marshall, 2016). Prior studies on shareholder activism mostly focus on large institutional investors. Due to the large size of institutional shareholdings, the widely used ways of institutional participation in corporate governance include private negotiation with corporate management (e.g., Barker et al., 2012), voice (e.g., Helwege, Intintoli, & Zhang, 2012), and corporate site visits (Chen, Du, Wang, & Wang, 2016). Being related to, but significantly differing from the above literature, our study provides evidence on small shareholder activism, the collective action against large shareholders taken by forty-seven mutual funds and one securities company who each held no more than 0.5 percent of

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ACB's total shares but who formed an alliance and gained support from regulators, media and the public in the fight.

Third, we integrate a stakeholder network perspective which focuses on stakeholder structural power with (1) a salience perspective in order to identify sources of non-structural power (resource-based power, legitimacy, and urgency), and (2) a stakeholder incentive perspective which underscores interest and identity as motives for small shareholders to resist even when they consider their resistance a lost cause. Apart from moving beyond these perspectives' focus upon managerial action by paying attention to small shareholders' resistance strategies, we show that the combination of the three perspectives enables a more holistic understanding of the changes in the power of the large and small shareholders in the case and the outcome of the fight. For example, neither stakeholder network perspective nor salience perspective alone could explain the strengths of the small shareholder alliance. Neither could explain why small shareholders would continue to fight a lost cause. Our application of these perspectives also enables us to identify several other weaknesses of each individual perspective as detailed in the concluding section.

However, even the combination of the three perspectives cannot fully explain the activities, events, and outcome of the clash between ACB and the alliance. For example, they could not explain why the clash would occur in the first place. The occurrence can be explained by the fact that both the external investor protection and internal corporate governance were weak. In addition, the outcome of the clash (i.e., the large shareholders compromised, and small shareholders got partial victory in the dispute) cannot be well-explained by the combination of the three perspectives either. Specifically, before small shareholders established an alliance, ACB could suppress small shareholders one by one (*gegejipo* in Chinese). Therefore, based on the concepts of network density and centrality, ACB was in a commanding position and the small shareholders were in a subordinating position. With the establishment of an alliance, ACB faced a dense small shareholder network. Their positions should be reversed in theory. However, both of them became compromisers eventually because the control of ACB was in the hands of controlling shareholders, the role of the CSRC as a government department was ambiguous (being a regulator and monitor of the capital market and having the responsibility of promoting the development of institutional investors), and the alliance gained support from the media and public.

This implies that we shall be careful when applying perspectives that are developed in developed markets to emerging markets like China. It also suggests that knowing the Chinese institutional context and unique stakeholders (such as CSRC and media) is crucial in understanding small shareholder activism. Realising this, we contribute an integrated conceptual framework on small shareholder activism in China by combining the three perspectives and the Chinese institutional context and unique stakeholders.

The remainder of the article is organized as follows. The next two sections describe our theoretical framing and research method. The following section

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analyses the case material by first examining the conflict between ACB and small shareholders, then exploring how small shareholders built networks and sought to increase their salience in their fight against ACB. The conclusion sums up our key findings and the limitations of the study.

THEORETICAL BACKGROUND

We have reviewed several perspectives dealing with stakeholder activism but, as discussed later, no perspective alone could capture the variation and richness of the case study, hence we combine three perspectives in our theoretical framing. We use a variant of stakeholder network perspective (Rowley, 1997) to show how small shareholders can increase their structural power when they formed an alliance, supplemented by work on salience (Mitchell, Agle, & Wood, 1997) to identify sources of their non-structural power, and stakeholder group action motives (Rowley & Moldoveanu, 2003) to explain why they resisted to the end even though they felt that they were pursuing a lost cause.

Network Density, Centrality, and Power

Rowley (1997) advances a social network analysis of the relationships between stakeholders and the focal firm that focus on density and centrality. Density is defined as the relative number of ties in the network that links actors together. The greater the network density, the more efficient are communications via the network, the more similar the behaviour of networked individuals, and the greater their ability to monitor and constrain the actions of the focal firm. Centrality is an individual actor's position in the network relative to others as a measure of his/her power. The greater the centrality, the greater the power of the focal firm.

With a few exceptions, researchers have focused on the strategies of the focal firm but not on those of small stakeholders. Rowley hypothesizes that the greater a firm's centrality, the greater its ability to resist stakeholder pressures and identifies four firm response strategies: (1) compromiser in high density/high centrality, (2) commander in low density/high centrality, (3) subordinator in high density/low centrality, and (4) solitarian in low density/low centrality. We propose to use this typology to identify stakeholders' strategy. We expect that their strategy is likely to be the reverse of that of the focal firm in scenarios (2) and (3) and similar in scenarios (1) and (4).

More recent studies have found that whether power is concentrated in the central position of a network depends on factors such as the shape of structure, the type of connection (Willer & Skvoretz, 1997), and the type of power structure (Willer, 1999). In this study, we deal with initially a branch-shaped network where there is a single central position (the bank and its large shareholders) connected to two or more peripheral positions (small shareholders) that are not connected to

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each other. We analyse the change from this branch-shape to other shapes following the formation of a coalition by small shareholders and the attendant redistribution of power.

Salience of Stakeholders

Rowley's (1997) analysis of network structural power is insightful but neglects the role of non-structural elements in networks. Mitchell et al. (1997) identify three non-stationery characteristics of stakeholders as perceived by the focal firm: power, legitimacy, and urgency. Power is defined as the extent to which one party has access to coercive, utilitarian, or normative means to impose its will in a relationship with another party; legitimacy as socially accepted and expected structures or behaviours; and urgency as the degree to which stakeholders' claims call for immediate management attention. They use combinations of these characteristics to predict the degree of salience of stakeholders and the action taken by the focal firm. Latent stakeholders possess only one characteristic and have low salience; expectant stakeholders possess two characteristics and have moderate salience; definitive stakeholders exhibit all three characteristics and have high salience. Focal firm managers may do nothing about latent stakeholders, while expectant stakeholders expect and receive significant managerial attention. Managers must have a clear and immediate mandate to attend, and give priority, to definitive stakeholders' demands.

Eesley and Lenox (2006) argue that legitimacy is not only granted to stakeholders, but also to their actions and empirically demonstrate that stakeholder legitimacy is negatively associated with salience while action legitimacy is positively related to salience. They also argue that it is the urgency of stakeholders' claims rather than the urgency of the stakeholders' group that matters, and that salience depends on the interaction between stakeholders, their demands, and the focal firm. Neville, Bell, and Whitwell (2011) suggest that stakeholders' salience is the prioritization of their claims by managers based on their perception of the degree of stakeholders' power and the moral legitimacy and urgency of the claims.

Incentives for Stakeholders' Actions

In contrast to the above literature's focus on how managers perceive stakeholders' characteristics, Rowley and Moldoveanu (2003) explore motives for group action from stakeholders' perspective by contrasting interest and identity. While stakeholders' interests can motivate them to mobilize, Rowley and Moldoveanu suggest that the *desire* to protect interest does not always translate into action and the *ability* to act collectively depends on resource availability to stakeholders. They argue that stakeholder mobilization could be motivated by a desire to express a collective identity: this explains why some highly discontented stakeholders with access to resources do not act while others mobilize and act despite

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believing that the expected rational benefits from such actions are negligible (lost causes).

The social identity perspective identifies two types of relationships between group identity and group action. Group identity confers solidarity on group members which acts as a catalyst for group action (Fireman & Gamson, 1979). Individual identity is confirmed through group action that expresses the group's uniqueness to non-members (Johnston, Larana, & Gusfield, 1994). Thus, group action could be an end (expression of identity) rather than a means to pursue rational interests. Rowley and Moldoveanu (2003) hypothesize that stakeholder groups with a strong identity are more likely to take group action than those that only represent their membership's interest.

Only by combining the three perspectives can we understand that the strengths of the larger shareholders and the alliance and the changes in their strengths relate to not just structural power, but also non-structural power and why the small shareholders resisted to the end even though they felt that they were pursuing a lost cause. Specifically, the above theoretical framing has several building blocks that we utilize in theorizing our empirics: the density and centrality of network; salience underpinned by power, legitimacy, and urgency; and shareholder activism driven by concern with interest and identity. This article contributes to the literature by providing empirical evidence that explores the utility of bringing these theoretical insights together.

METHODS

We use a case study to address our research questions for three reasons. First, case research is suited to exploring rare and significant phenomena and those not well understood (Yin, 1994) such as the corporate governance role of small investors. Second, case analysis helps us undertake explorative research guided by perspectives to generate conceptual insights. Third, based on events and focused on processes (Stake, 1995), case study helps us understand the processual dynamics of the stakeholder-firm relationship.

We collected data using 25 interviews and archival sources relating to the ACB bond issue proposal. Initially, fifteen interviews were conducted from July 2004 to August 2006: eight face-to-face interviews (each about 90 minutes) in Beijing and seven by telephone (each about one hour). During 2009 and 2010 ten more interviews were held with previous interviewees. The interviewees were participants and non-participants in the event we studied. The participants included six fund managers (P1 to P6), a manager from ACB (P7), and one manager from ACB's bond issue underwriter (P8). The non-participants included two managers (NP1 and NP2) from two securities companies, two board directors (NP3 and NP4) from two listed companies, a government official (NP5) from the China Securities Regulatory Commission (CSRC), a manager from ACB (NP6), and an individual investor (NP7).

The interviews were semi-structured and questions were revised/extended as the interviews progressed. The questions focused on the reasons for the conflict between the funds and the management and controlling shareholders of ACB, why the fund managers took collective action, how the alliance was formed, strategies adopted by the alliance and ACB respectively, and the factors that determined the outcome of the conflict. We also asked questions about the roles of ACB's corporate governance mechanisms in the conflict and the factors that facilitate/constrain shareholder activism. As we were not allowed to tape-record the interviews, extensive notes were taken.

We also consulted complementary data from public sources, especially *Juchao* Information, the bank's annual reports, papers and news published on the Internet, magazines, and newspapers. Interview notes and secondary sources were organised around the key research questions and the themes drawn from our theoretical framing.

CASE ANALYSIS AND RESULTS

In this section, we analyse the processes through which, and strategies by which, small shareholders resisted large shareholders' expropriation. After briefly introducing the conflict between ACB and small shareholders, we apply the combination of the three perspectives to analyse the case. First, we use the concept of the density and centrality of network to analyse mobilization and networking by small shareholders, including the emergence of a network, alternative refinancing proposals and attempts at reconciliation, debating a revised proposal, structural power of the alliance, resolution, and the role of the regulators and the media. Then we use the concepts of shareholder identification and salience to analyse the increased salience for small shareholders to take action. Finally, we analyse the incentives for small shareholders' action.

The Conflict between ACB and Small Shareholders

ACB was founded in the late 1980s as a joint-stock commercial bank wholly owned by state corporate legal entities. It launched its IPO in 2002 and was listed in the Shanghai and Hong Kong Stock Exchanges. In 2009, ACB became one of the most prestigious 600 enterprises worldwide ranked by *Forbes*.

In August 2003, ACB announced in its interim report a proposal to issue five-year convertible bonds of no more than 10 billion *yuan*. Within twenty trading days after the announcement, ACB's share price dropped by 13 percent and its market value declined by 10 billion *yuan*. ACB held a briefing meeting on its interim performance on 12 September 2003, attended by fund managers and individual investors. Seven fund managers from four companies protested against the proposal and made alternative suggestions, which prompted ACB to close the meeting earlier than planned.

From 22 to 29 September 2003, ACB's management paid visits to opposing fund managers seeking to gain their support, but they failed because fund

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managers considered ACB insincere. On 15 October at ACB's interim shareholders' meeting, the bond issue plan was approved despite strong opposition from the fund alliance. The fund alliance held a press conference and issued a joint statement stating their intention to challenge ACB.

From 19 to 27 November 2003, ACB's CEO visited the fund managers again, but the latter insisted their opinions. In February 2004, ACB announced its final, modified proposal, some clauses were modified to satisfy the requirement of the fund alliance. Although the final proposal did not fully satisfy the fund managers, the bank made certain concessions.

Based on the ownership structure of ACB as of 31 Dec. 2003, we find that the percentage of tradable shares was low and ownership of non-tradable shares was highly concentrated. Moreover, its top ten holders of tradable shares owned 4% of total shares and included seven mutual funds (owning 2.75%) and three other companies (owning 1.25%), indicating low power. As the top seven mutual funds held more than two-thirds of the shares owned by the top ten holders of tradable shares, they were expected to take the lead in protecting the interests of small shareholders. Thus, the control of ACB was concentrated in the hands of a few large shareholders, and ACB's board of directors was accountable only to large shareholders. This increased the risk of expropriation of minority rights by majority shareholders as also acknowledged by P6.

In 2003 ACB had thirteen inside directors, nominated by large shareholders, ten of them from large shareholder firms. Thus, large shareholders were able to pass the bond issue proposal (P1). ACB had six independent directors (IDs) nominated by large shareholders and each was paid an annual fee of 80,000 *yuan*. Given their dependence on large shareholders, no IDs objected to ACB's proposal (P6). Meanwhile, ACB had nine supervisory board members, among them four insiders, three employees, and two outsiders. Like in other Chinese companies, supervisory board directors and non-executive directors are often 'captured' and join the insiders' group (NP2).

From the documents published during and after the conflict, there is no evidence that members of ACB's governance structure voted against the measures taken by ACB. This suggests that they were supportive of ACB's initial and revised refinancing plans and changing strategies. This implies that members of ACB's governance structure were merely servants of the controlling shareholders rather than as protectors of small shareholders' interests.

We summarize the conflict between ACB and the alliance in Table 1.

Mobilization and Networking by Small Shareholders

Emergence of a network. Before the fund alliance was formed, ACB exhibited high centrality as the funds were not connected (low density) and their monitoring power was limited. Realising this, seven funds formed an alliance motivated by shared concerns regarding the bond issue proposal in the knowledge that only through

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Table 1. The conflict between ACB and the alliance

Time	*Main Events*	*Outcomes*
26/08/2003	ACB put forward a controversial–10 billion 5 year convertible bonds	Following announcement, ACB's share price dropped dramatically
12/09/2003	ACB held interim performance reporting meeting The alliance formed to protest and put forward an alternative	Meeting finished earlier than planned, giving no responses
22–29/09/2003	ACB's management visited opponents to persuade them to accept bond issue	ACB did not get the anticipated results
15/10/2003	ACB held the interim shareholders' meeting and won approval for the bond issue	ACB's president promised to modify the proposal and consider tradable shareholders' concerns. The alliance held press conference, issuing joint statement and went on fighting
19–27/11/2003	ACB's president visited opponents in Shanghai, Beijing and Shenzhen	The alliance still insisted on their opinions
02/2004	ACB announced final proposal, some clauses were modified	ACB made certain concessions and the alliance achieved some success.

forming a network can they mount effective resistance. The network membership consulted together and produced an alternative refinancing proposal:

> 'Seven fund managers clearly realized that only when they unite could they strengthen the bargaining power against ACB's management…. Before ACB's interim performance reporting meeting, they discussed the initial statement drafted by the four fund managers from one fund company and then formulated an official statement and prepared an alternative refinancing proposal'. (P1)

Naming a network helps provide visibility and strengthens a network's identity. The network was named the 'fund alliance' by the press, and the fund managers embraced this name. They strengthened the alliance via internal communication, discussions, press conferences, and expanded membership.

During ACB's interim reporting meeting, the alliance sent ACB management and underwriter an official statement emphasizing ACB's opportunism and the detrimental impact of the bond issue proposal on the stock market. The statement did not hide the funds alliance' anger and frustration:

> 'We initially thought that ACB, representing a new generation of modern SOEs and international firms, will depart from traditional practice and pioneer new ones, but to our surprise it disregards the market's refinancing capacity and shareholders' interests, attacks prey like a hungry tiger and drains the pond to catch the fish'. (Liu, 2003)

Apart from this written statement, the fund managers spoke on behalf of small shareholders at the meeting and accused ACB of 'circling' money (*quanqian* in Chinese) and greed:

> 'ACB's 10 billion *yuan* convertible bond issue proposal is the best example of listed firms' expropriation. ACB does not consider paying dividends to shareholders, but instead fears lagging behind other companies in circling money. Its behaviour is hardly different from killing the goose to get the golden eggs'. (P3)

The alliance attacked the system of *Tonggu Bu Tongquan* (the same share with different rights). Under this system, due to the split share ownership structure, the holders of non-tradable shares use listed firms to exploit holders of tradable shares because the former acquires shares at a low price compared to the latter:

> 'The holders of tradable shares acquired the shares at 10.5 *yuan* per share, while legal person shareholders acquired non-tradable shares at 1 *yuan* per share at the IPO. This means that the latter profited from increased net assets per share. Now they are allowed to participate in share allocation and so they are able to expropriate [gains] further from holders of tradable shares'. (P3)

The alliance also criticized ACB's management for not communicating with small shareholders before announcing the refinancing proposal (P5). In their statement to ACB, fund managers demanded that the holders of tradable shares be given the right to approve any refinancing proposals as a means of monitoring ACB's decisions that potentially impact their interests.

To sum up, the alliance accused ACB of greed, circling money, and lack of communication with the holders of tradable shares; issues were made serious by the asymmetry in the rights of large shareholders of non-tradable shares compared to small shareholders of tradable shares. Thus, the alliance constructed their position as one where they had no option but to unite and confront ACB.

Alternative refinancing proposals and attempts at reconciliation. The alliance questioned if the purpose of refinancing was to raise capital, why did ACB not issue additional shares? They thus proposed that ACB privately issues 1.5 billion tradable shares at 5–6 *yuan* per share which would raise 7.5–9.0 billion *yuan*. They argued that this proposal had several advantages: it would satisfy core capital adequacy ratio requirements without having the risk of failing to convert the bonds when they become due; it would also protect the benefits of the holders of both tradable and non-tradable shares, as the issuing price which is 1.7 to 2 times the net assets per share is consistent with the international pricing criteria for bank shares. Meanwhile, the price was lower than the market price and thus would reduce the purchasing costs for the holders of tradable shares.

In an allusion to the fierceness of the conflict between ACB and the alliance, the interim meeting smacked of the smell of gun powder (Liu, 2003). At 3:30 pm, the representatives of the holders of tradable shares began to attack ACB's

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proposal and the chair found it difficult to control the meeting. At 4:30 pm, the meeting was closed earlier without reaching a resolution. Responding to criticism from the alliance, ACB's management announced that they would hold a special meeting on the objections of the alliance.

ACB's controlling shareholders and management felt that they were in a commanding position. Before the alliance was formed, ACB exhibited high centrality (Rowley, 1997) because it faced shareholders who each held only a very small proportion of ownership. This is why ACB could announce its proposal without communicating with small shareholders beforehand.

However, the chairman's loss of control of the interim meeting and ACB's willingness to discuss objections to the refinancing proposal suggest that ACB's centrality was beginning to reduce. The weakening centrality is evidenced further by ACB's management visits to the alliance in September 2003. When the visit plan was released, ACB's share price rose by 1.6%. But the alliance considered ACB's management insincere and maintained its stance because the visits were headed not by a vice-CEO as previously announced but by the secretary to the board of directors who was perceived by the alliance to lack the stature to resolve the dispute. Moreover, ACB's management did not alleviate the concerns of the alliance, a sentiment reflected in ACB's share price which dropped by 3.2% on 22 September, the largest drop in the financial sector shares on that day.

It could be argued that these visits were deliberately intended as a publicity exercise by ACB. During the visit on 23 September ACB's management invited a journalist from *Securities Daily* and provided him with a list of justifications for the refinancing proposal (Wu, 2003). First, it was crucial not to go below the regulatory capital adequacy ratio requirement which had deteriorated with the expansion of ACB. Second, the proposed methods of refinancing were more favourable compared with issuing subordinate bonds, overseas listing, non-public issuing, or a rights issue, because convertible bonds would secure investors' principal, pay investors annual interest; and they could choose the best time to convert the bonds into equity shares. Third, convertible bonds could be converted into equity shares, thus offering shareholders a valuable investing choice. Finally, non-concentrated convertible bonds would slow down the expansion of equity capital and protect the rights of existing shareholders.

During the meeting with the journalist, ACB's spokesperson stressed that the bond issue proposal was not designed to 'circle money' from the holders of tradable shares, but to sustain ACB's rapid development and secure the long-term interest of investors. He also stated that ACB could not communicate with the holders of tradable shares before the refinancing proposal was announced because prior disclosure would breach confidentiality rules.

The justifications provided by ACB's management, however, did little to reduce the resistance of the alliance, and instead attracted more criticism. On 23 September the alliance made two alternative proposals for allocating shares: first, allocation at the ratio of 10:8 (i.e., 8 *yuan* per 10 shares) based on net assets to all shareholders with holders of non-tradable shares paying for their refinancing,

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indicating fairness of financial contribution; second, allocation at the ratio of 10:3 (i.e., 3 *yuan* per 10 shares) at the lower price of 5 *yuan* per share only to the holders of tradable shares. On 26 September, a securities company from the alliance submitted a proposal urging ACB's board of directors and the holders of non-tradable shares to take a holistic view of ACB's long-term development and to protect the stakes of small investors.

Debating a revised proposal. An interim shareholders' meeting was held on 15 October 2003; it started at 9:10 am and lasted for over five hours. ACB's CEO acknowledged that he understood why the proposal attracted criticism and noted that it also exposed many weaknesses in the legal system. However, he argued that the refinancing proposal should go ahead as it would be wrong to wait for a perfect legal system to be developed. Importantly, he announced five revisions to the proposal. First, ACB still preferred to issue convertible bonds but, regulations permitting, ACB would apply to issue subordinate bonds partially or wholly. Second, capital raising would not exceed 10 billion *yuan*, and would be determined by the capacity of the market to accommodate the issuing, policy changes and approval requirements. Third, 'the allocation at the ratio of 10:4 (i.e., allocated 4 *yuan* per 10 shares) to existing shareholders' would be revised as 'all the existing shareholders have priority to the bonds with the market buying the remainder' if the securities regulator agreed. Fourth, to increase the conversion premium on bonds to 10 per cent or more, twice as high as what the alliance expected. Finally, the range of the conversion price that the board of directors had the right to adjust would be increased from 20 percent to 25–30 percent. These revisions suggest that ACB sought to accommodate some of the alliance's concerns.

The enlarged alliance, now consisting of forty-seven funds and one securities company, was not satisfied with ACB's concessions. A representative of the alliance put forward an agenda item proposing rejection of ACB's proposal. However, as noted by a journalist (Zhou, 2003), this move was anticipated by ACB for it was dismissed by ACB's lawyer who pointed out that according to *Company Law* shareholders owning ten percent or more shares could propose agenda items to the annual shareholders' meetings. Since this was an interim meeting and the shareholders who put forward the agenda item accounted for only five percent of the shares, this could not be an agenda item. The alliance representative demanded a separate calculation and publication of shareholders' votes on ACB's refinancing proposal classified by tradable and non-tradable shares. But the lawyer considered the request an agenda item and dismissed it.

The holders of tradable shares raised two more objections to the refinancing proposal. The first, considered by the alliance a secret weapon prepared by a law firm, was that this planned bond issue was illegal because it breached Provisions 161 and 172 of the 1993 *Company Law*. The second was that ACB breached the provision of 'treating all shareholders equally' in its articles of association. When some holders of tradable shares asked again for separate calculation and publication of

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their votes and denounced the proposal for exploiting loopholes to benefit large shareholders, their remarks received applause from small shareholders.

Tactically, to pacify the challenges posed by the alliance, ACB's large shareholders arranged employee speeches which claimed that the refinancing proposal complies with the law. Given the overwhelming majority of the holders of non-tradable shares, the refinancing proposal was approved.

Although the request for separate counting and publication of the voting outcome was rejected, after the voting was over the alliance repeated the request in order to protect their information rights. This time, the request was partially accepted: separate statistics of the voting by holders of tradable shares and non-tradable shares would be produced and passed onto the alliance when ready, but the results would not be published in the media to avoid it being recognized as a lawful agenda item. Journalist Zhou (2003) noted that the partial acceptance of the request was probably the only obvious achievement made by the alliance in that meeting.

The alliance held a press conference immediately after the shareholders' meeting. It issued a joint statement that denounced ACB's refusal to publish the votes by shareholder category as an illustration of the problem of protecting small shareholders' rights. The alliance also announced its own calculation of the votes: holders of 0.33 billion tradable shares voted 'no'. The joint statement argued that refinancing proposal approved at the meeting was unlawful, that ACB breached the law and damaged the legal rights and interests of the holders of tradable shares, and that the alliance would reserve the right to protect its rights. It called for the supervising and enforcement agencies to take all shareholders' stakes into account and reject ACB's application for the bond issue. It further urged the regulators to issue new regulations to require the approval of over 50 percent of holders of tradable shares on critical issues such as refinancing.

Responding to the accusations by the alliance at the press conference, the spokesman for ACB said that *Notice on preparation for the issuing of corporate convertible bonds for listed companies* published by the CSRC in 2001 restricted cumulated bond issuing to 40 percent of the company's net assets before a new issue or 80 percent of the net assets after a new issue. As ACB's net assets were 16 billion *yuan* in 2002, ACB could issue bonds of 12.8 billion *yuan*. Therefore, the proposal did not breach the law or mislead investors.

The equity market reacted negatively to the shareholders' meeting's outcome: ACB's share price declined by 3% the day following the meeting. The meeting attracted considerable media attention. A news report (Yang & Jiang, 2003) stated: 'The five hour meeting was full of arguments, resistance, and even obvious verbal abuses….Both sides used legal references as a unique weapon in a battle of words…. It was full of a cloud of smoke without war fire'.

Structural power of the alliance. The allied fund managers built their solidarity through regular meetings and communications before and during ACB's visits:

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'Before the visit, we had a private meeting and discussed how to deal with the visits. We prepared our requests, how to talk with ACB, what feedback should be given and promised to keep in touch all the time during the visits. We had a telephone meeting after each day's visit finished, discussing what ACB talked about that day and whether we needed to adjust our position'. (P4)

The network became a means through which the alliance discussed issues. Interviewee P4 stated that their private meetings helped strengthen the alliance's belief in small shareholder protection, raised their awareness of their fiduciary responsibility, and realized the need to make listed companies and their management care about the interests of small shareholders and to encourage the regulators to minimize the defects of the capital market. The aim was to ensure that the alliance members acted consistently even when they were visited separately by ACB representatives. As a result, ACB had difficulty playing one member of the alliance against another or finding a sympathetic fund manager with whom it can form an alliance. In sum, the alliance's densely tied network exhibited solidarity and constrained ACB's actions (Rowley, 1997).

Similarly, the fund managers organised important meetings and communicated with each other to prepare well for the shareholders' meeting:

'Although we knew that our objections would have no impact on the final result, we thought we should attend the meeting and air our views. We never fought an unprepared battle and so the main members of the alliance held several private meetings to discuss how to perform at the shareholders' meeting'. (P2)

Interviewees indicated that the alliance meetings fulfilled several functions, e.g., to encourage the alliance members to participate in shareholders' meeting, to prepare alternative refinancing proposals, to identify questions to be asked concerning ACB's proposal if the alliance's alternative proposals were rejected, and to prepare a request for separate calculation and publication of the votes by holders of tradable shares. Holding a press conference after the shareholders' meeting was also discussed in order to influence ACB. Once these issues were identified, they were assigned to the main members for preparation because they were well-connected to lawyers and the media:

'The members accepted the tasks happily, finished them on time, and promised that they would attend the shareholders' meeting. Actually they did as they promised. Even though some of them were very busy in those days, they attended the private meetings once they finished their work, or even put their jobs aside, and finished the assigned tasks on time. We called ourselves fighters in the same well-connected trench'. (P2)

The alliance developed a strategy of response to ACB and underscored the importance of efficient internal communication:

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> 'Before the interim shareholders' meeting, we prepared several countermeasures. For example, if the bank did not accept our proposal, we would inquire into the legitimacy of the unrevised proposal; if the proposal was approved, we would hold a press conference to express our dissatisfaction…. The combination of shared expectations, the ease of information exchange among us, and the coalition formation produced strong unified pressures on the bank'. (P3)

These accounts paint a picture of a harmonious, smooth set of relationships within the network, whereby members were self -motivated to do their best and work as hard as possible for the good of all.

Resolution. In response to this resistance, from 19 to 27 November 2003 ACB's CEO visited the alliance to propose revisions to the proposal:

> 'The CEO's visit was sincere. He listened patiently to our views on the allocation ratio to existing shareholders, the conversion premium on bonds, and the range of the conversion price downward, etc. Compared with the previous visit, his visit showed ACB's willingness to take our interests into account. Not only did his sincerity imply our partial victory, but it also strengthened our adherence to our previous opinions'. (P4)

Action taken by adversaries that corresponds with, or comes close to, fund managers' aspirations has the immediate effect of changing their perspective and attitude. In changing the alliance's view of ACB as insincere and opportunistic to being sincere and taking the alliance's interest into account, the distance separating the alliance from ACB shrunk and scope for reaching compromise increased significantly. Also, ACB's changed attitude was claimed by the alliance as a 'partial victory' and a signal of their power and the legitimacy of their demands (Mitchell et al., 1997).

On 18 February 2004, ACB's BoD approved a new version of the refinancing proposal which reduced convertible bonds to 6.5 billion *yuan* but added 3.5 billon subordinate bonds. The new proposal increased the put price and the allocation ratio to existing shareholders and allowed the holders of tradable shares to participate in the allocation twice. Further, it changed the floating range of initial conversion price and tightened the conditions for revising the conversion price downwards. Issuing subordinate bonds was made possible by the stipulation of a new regulation by the China Banking Regulatory Commission.

The new proposal was welcomed by some members of the alliance. However, the alliance's attitude to the new proposal was less straightforward: while the proposal was assessed to have positive points it also gave rise to some concerns. As P4 stated, the alliance's feeling towards 'the new proposal was a mixture of hope and fear'. Positively, ACB responded by meeting some of the alliance requests concerning increased put price of shares and allocation ratio; negatively not permitting the initial conversion price to be reduced in future years could harm the interests of the small shareholders of tradable shares.

The role of the regulators and the media. The alliance also sought support from other stakeholders, in particular the government, the media and the public. The China Securities and Regulatory Commission (CSRC) is the independent securities regulator, with no stake in firms but can impose external control and regulations on them. Chinese companies are controlled politically by the Party/government and they often seek government intervention; so

> 'On the day after the interim shareholders' meeting, the fund managers reported the refinancing proposal to the President of the CSRC. The President expressed his individual support for the collective action of the alliance to protect the interests of small shareholders'. (NP5)

The CSRC is the regulator of both the capital market and listed companies. Due to the pervasive P-P problem, protecting small shareholders is the main theme of Chinese securities market.[5] Consequently, the CSRC needs not only to attract investment, but also to protect the benefits of small shareholder.[6] As the events unfolded, the CSRC was caught in a dilemma. As ACB's proposal complied with the legal procedures formulated by the CSRC, the latter could not reject it. However, if the CSRC accepted the proposal, it would diminish the enthusiasm of small shareholders and eventually damage their interests. After ACB secured the approval of the bond issue proposal, it 'kicked the "hot ball" to the CSRC' (P2), and the CSRC did not clarify its own stand.

Thus, the lack of a clear statement from the CSRC on ACB's proposal was construed by the alliance as 'wordless support'. Also, the support of the CSRC president was capitalized upon by the alliance even though this was a 'personal' opinion. In the search for legitimacy as a source of salience, members of the alliance were prepared to clutch to any straw that comes their way. But these strategies of seeking legitimacy were also tinged with a dose of realism: the recognition that as a referee the CSRC cannot take sides.

Apart from approaching the government, the alliance made use of the media to solicit public support and to gain visibility and legitimacy for their cause. The media formed an important grouping of stakekeepers (Fassin, 2010) as they are a network themselves and disseminate financial information to a broad audience in a timely manner (Zingales, 2000). The strength of the alliance would probably have been much weaker had the media not joined in, although initially the alliance had to work hard to secure media support. The alliance recognised the importance of the media and sought to mobilize media support:

> 'Media attention can affect the public image of managers and board members who are under pressure to obey social norms, and the press' impact heavily affects the reputation of criticised companies'. (P6)

In addition, in China, most media are state-owned, and they are always the voice of the government (Yang, Lu, & Luo, 2014). So, media coverage needs to obey government control requirements. Furthermore, protecting the interests of small

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shareholders is the main theme of Chinese securities market and it has been encouraged by the CSRC for many years. Therefore, the media provided their support to the alliance. Newspapers and journals, including *Securities Market Weekly*, *Financial Times*, *China Daily*, *China Securities Daily*, and *China Securities Journal*, published reports on the events. The media amplified the effect of the small shareholders' action by publicising their opposition to ACB to the public.

However, the alliance recognised that not all media sided with them:

> 'During the conflict, some newspapers thought that it was reasonable for the bank to raise additional capital for long-term purposes and the bank's proposal complied with the legal procedures formulated by the CSRC, therefore they provided supports to the bank. Furthermore, the bank was powerful in the banking industry and it had resources to gain the support from some media'. (P2)

In the battle over legitimacy, the media became a target whose capture by either side was deemed crucial given the ability of the media to publicize debate, and the importance of legitimacy for salience (Mitchell et al., 1997). ACB felt it necessary to clarify its image to the public and contest the claim by the alliance that it circled money, and by arranging media interviews. As a result, ACB also sought media support:

> 'Only some newspapers supported our refinancing proposal. We were under a lot of pressure from many news reports and our case attracted unprecedented attention… Under that pressure, we made effort to get media support through which we informed the public that we did not "circle money" and our proposal did not harm the bank's shareholders. We communicated directly with the shareholders via internet and secured most shareholders' understanding; we also invited some newspapers to undertake interviews on the necessity of issuing convertible bonds; and the media reported our views on the alliance's joint statement after the shareholders' meeting'. (P7)

In sum, despite some media support for ACB, the forging of the alliance and the growth in its membership increased the density of the network and reduced ACB's centrality. The increased strength of the alliance was evident in its repeated conflict with the controlling shareholders over the refinancing proposal during the interim performance reporting meeting, the visits by the secretary of ACB's board to the alliance, the interim shareholders' meeting, and the press conference. The alliance mobilized a number of means including the press conference, oral protests, and proposing agenda items and written objections. The alliance also received support from the CSRC, the media, individual shareholders, and the academics. As a result, it enhanced legitimacy while ACB's controlling shareholders lose structural power.

Pfeffer and Slaancik (1978) argue that firms often engage in negotiations with their exchange partners to reduce uncertainty. ACB's management and large shareholders initially assumed a commanding position which was later threatened by the formation of the alliance. ACB's response to the alliance was a mixture of strategies and tactics including both defense/legitimation and conciliation. ACB's

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strategy of defense/legitimation included closing the interim reporting meeting earlier when it got out of control, providing the media with justifications for the refinancing proposal, appointing lawyers to defend its proposal, mobilizing its employees to make favourable speeches, highlighting the defects of the legal system; and resorting to the law to justify its actions.

ACB's reconciliation strategy included visits by its managers to fund managers to renegotiate the refinancing proposal, and its CEO's willingness to revise the proposal, with ACB eventually offering concessions. Facing a dense stakeholder network, ACB's centrality was reduced.

Increased Salience for Small Shareholders to Take Action

The network concept provides a structural explanation of the increased power of networked small shareholders over ACB. However, it still begs the question: What elements made the alliance stronger than individual shareholders? We address this question by drawing on the concept of stakeholder salience (Eesley & Lenox, 2006; Mitchell et al., 1997; Neville et al., 2011).

As no mutual fund held more than 0.5% of the total shares, individual funds had little impact on ACB's behaviour. However, the funds' resource-based power (Eesley & Lenox, 2006) was significantly enhanced when they formed the alliance as the forty-seven funds held 0.37 billion shares (5% of ACB's total shares). Some fund managers were among the top 10 holders of tradable shares, each with own specific characteristics and private resources including connections. Four members were from one fund family, the largest in China with a major impact on its industry. Therefore, the group's power was greater than the combined proportion of shares held by them. This is particularly so when the non-tradable shares were not actively traded on the market and thus the trading behaviour of the holders of tradable shares could exert a strong influence on the market price. This power was augmented because the alliance members were resource-rich (Eesley & Lenox, 2006).

According to NP7, mutual funds are basically professional investors relative to individual investors. In addition to public information, different funds have different ways (such as corporate site visits, negotiation with corporate managers through calls) to obtain private information about the investees. With these ways, they have more close observations of investees' operations. Once they are united, they become more powerful by sharing these resources and their bargain power is improved as well because the added shareholdings are greatly increased.

Individual funds were legitimate stakeholders of ACB and their legitimacy increased when they formed a group. Their resistance was legitimate because ACB's unilateral action threatened their interests. This legitimacy was attributed to the growth of the alliance and the support they received from individual investors which indicated social acceptance of shareholder activism (Neville et al., 2011):

> 'Lots of individual investors showed great support in various ways. For example, they left messages on our web pages and spoke at the shareholders' meeting.

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> This suggests that our group actions and claims met social norms, values and beliefs…. Our morally legitimate claim should be attended to because it was the right thing to do and other stakeholders were likely to take up the cause and pressurise the bank if it was not addressed'. (P2)

Claims to legitimacy are here clothed in the demands of the alliance being construed as consistent with meeting social norms, values and beliefs. By implication, this argument constructs ABC's action as illegitimate and unfair because it is counter to social norms and values. As Mitchell et al. (1997) argue, shareholder legitimacy is one important factor in their salience. The alliance argument paints with their own stance as the right one, hence the support of individual investors.

The challenge posed by the alliance was also serious because their claim was both timely and important, as the funds suffered a loss of more than 400 million *yuan* in one month after ACB announced the proposal. Passing this proposal would have inflicted more losses on small shareholders. The alliance mobilized resources, sought the support of government, regulators, and the public, by making their complaints public and by taking timely action:

> 'We held many meetings continuously to discuss how to deal with the bank's visits and the shareholders' meeting. We searched for support from the government and the public. Only in this way could our claims attract immediate and close attention from the public, the bank, and the regulators'. (P2)

Given that the alliance and its claim possessed all three elements of salience (power, legitimacy, and urgency), the alliance was a definitive stakeholder with a high salient request that compelled ACB to address it urgently (Mitchell et al., 1997). ACB realized that its first issue proposal and initial lack of attention to the demands of the alliance were costly as reflected in the drop in its share price:

> 'When the proposal was passed in spite of angry small shareholders, the market reacted negatively to the outcome. Only when the revised proposal was closer to what the alliance had asked for, did the stock price increase gradually. We should have addressed the alliance' request urgently and satisfactorily'. (NP6)

In the above quote, ACB's post-hoc assessment of their action before and after the compromise acknowledges what went wrong. Here, the consequences of ACB's revised proposal were measured in terms of their popularity in the industry and the pricing of its shares by the market.

The media was used by the alliance to express their identity. As a powerful monitoring institution, the media reported regularly on the conflict, thereby becoming expectant stakeholders with moderate salience. ACB exchanged their ideas with investors through the media, hoping to gain their support: 'The weak can always receive sympathy. Through media reports, the public became supporters of the alliance. This will destroy our reputation in the market'. (NP6)

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The increasing salience of stakeholder network increased their network's density and decreased ACB's centrality. According to NP2, since the size of the alliance became bigger and bigger, their bargain power became stronger and stronger; meanwhile, the alliance's requests were legitimate and urgent, being sided with the media. Under that circumstance, the influence of the alliance became much powerful and ACB had to seriously consider all parties' interests and gave a satisfactory answer to the alliance.

In sum, before the small shareholders established an alliance, ACB could suppress small shareholders one by one (*gegejipo* in Chinese). Therefore, based on the concepts of network density and centrality, ACB was in a commanding position and the small shareholders were in a subordinating position. With the establishment of an alliance, small shareholders increased their structural power by increasing the density of their network and gained their non-structural power by increasing the salience of the network including legitimacy, while ACB lost its structural power over individual small investors and the centrality of ACB decreased. Their positions should be reversed in theory. However, both of them became compromisers eventually, in the Chinese institutional context. This reconciliation through concessions was a pragmatic recognition by ACB that the resistance of the alliance could not be silenced without concessions.

Incentives for Small Shareholders to Take Action

Given that members of the alliance suspected that the outcome of resistance against ACB's refinancing proposal was doomed from the outset, why did they contest it? The literature offers two possible explanations: interest-based and identity-based (Rowley & Moldoveanu, 2003). In the ACB case, both explanations are relevant. The alliance felt that it was its duty to protect the interests of small shareholders:

> 'We are the guardians of small shareholders and should look after our stakes with care, attention, and scrutiny. We derived our power of group action from the representation of the interests of the individual shareholders'. (P3)

While convertible bonds help reduce the adverse selection costs associated with equity issues (Stein, 1992), a large-scale issue may seriously affect the interest of the holders of ACB's tradable shares. First, the holders of tradable shares already suffered a loss (negative market reaction) following the unexpected announcement of the 10 billion *yuan* bond issue proposal. Since the refinancing scale revealed the extent of the divergence between actual and expected internally generated cash flows, the larger the unexpected funding, the larger the decline in the market value of tradable shares. ACB's capital adequacy ratio had been declining due to the fast expanding loan business and ACB's need for capital injection. The timing of the announcement was not good as the stock market was experiencing a significant downward correction and over 30 companies intended to issue

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convertibles far exceeding market capacity. Controlling shareholders were shielded from this short-term market decline as they held non-publicly-tradable shares.

Second, there was likely a long-term adverse effect on the holders of tradable shares as convertible bonds represent an indirect mechanism for implementing equity financing that mitigates the adverse-selection costs associated with direct equity sales (Stein, 1992). Convertible bonds, like the ACB issue, often have a built-in call option for the issuer and the issuer often exercises the call option to force bondholders to convert their bonds into equity (ibid). If this happens, the holders of tradable shares would suffer from dilution in interest because the share base becomes larger. *Prima facie*, the interests of large holders of non-tradable shares may also be diluted but this is unlikely to be a major concern given their significant (non-tradable) ownership and their capacity to extract private benefits of control not available to small holders of tradable shares.

The fund managers' action was also identity-driven. Like individual shareholders, the funds operated individually, but being in the same industry brought them in regular contact with each other thereby creating a feeling of sameness.

Before the formation of the alliance, some individual institutional investors (e.g., P2) confronted ACB but with no success. In the alliance, members became better connected, with their group identity conferring solidarity on them (Fireman & Gamson, 1979). The formation of solidarity among group members creates a strong culture (Johnston et al., 1994). The stronger the group's culture, the more salient the group is to its members and the more willing and eager are the members to create, and engage in, group activities (Ashforth & Kreiner, 1999). Therefore, the resistance by the alliance was identity confirming. By forming the alliance, the funds came to know each other 'as a collective in terms of shared perception of their discontent and possible solutions' (Rowley & Moldoveanu, 2003: 208). After its formation, the alliance created 'individual commitment and a feeling of solidarity' which emerges 'among individuals through group affiliation' and 'acts as a powerful catalyst for collective action' (ibid), ensuring that members worked diligently together: 'During the process of the fight, all of us were happy to complete the allocated tasks. As one fund manager said jokingly, "I never worked with such great enthusiasm before"'. (P2)

Interviewee P4 indicated that holding private meetings strengthened the alliance's belief in small shareholders protection, raised their awareness of their fiduciary responsibility, and realized the need to make companies care about the interests of small shareholders and encourage the regulators to minimize the defects of the capital market. This ensured that the alliance acted consistently even when they were visited separately by the representatives of ACB who attempted to break the alliance:

> 'After joining the alliance, we deeply felt its strength and were clearly aware of our identity: being the guardians of small investors. Everyone in the alliance was

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> full of enthusiasm and seemed to be pursuing a cause or principle that had intrinsic value independent of the related outcome'. (P5)

Recognition by the alliance of their identity as 'the guardians of small investors' was manifest in their robust and united stance against ACB, especially after their alternative refinancing proposals and share allocations (discussed above) were rejected:

> 'Now [after these rejections] we had a definite and uniform attitude and left the bank with one choice: if the bank planned to raise additional funds, the large shareholders must pay for the cost. In doing so, we did not only protect our interests, but we also expressed our identity… Although being fully aware of the futility of the attempt to veto the proposal, we insisted on protesting in order to make our voices heard on behalf of the holders of tradable shares'! (P3)

In short, stakeholder mobilization in this case was motivated by the desire to both protect small shareholders and to express their collective identity, even though they felt they were fighting a lost cause.

These quotes show that shared interests and identity-based motives were the glue that cemented the alliance managers so that they acted in concert as evident in their determination to fight against ACB's proposal. Despite their small shareholdings, they became aware of their strength as a group: 'Small shareholders represented by mutual funds are like sleepy lions in China. Once they are awake, one cannot ignore their influence' (NP3). This was also evident in their unity in dealing with the visits by the secretary to ACB's BoD. The visits were intended to break up the newly formed alliance but ACB failed: 'ACB tried to destroy our alliance one by one, but this was impossible as we had formed a strong and united alliance' (P4).

While interest-based motives played a cementing role in holding members of the alliance together, interest alone is insufficient to explain the alliance's resolve. We argue that identity also played a key part in sustaining the alliance's resistance. The ACB case was assessed by the alliance as un-winnable due to the overwhelming ownership of non-tradable shareholdings. Identity-based motives gave the resistance a new meaning – it was a fight for justice and fairness of the securities system. Consider the interim shareholders' meeting as an example. Journalist Zhou (2003) noted: 'Right at the start, the meeting entered a strange and fantastic state where the excited, loudly speaking holders of tradable shares were doomed to fail, whereas the low-key and cautiously speaking and behaving bank management were certain to win'. This observation was echoed by Yang and Jiang (2003): 'The segregation of the shares and pitfalls of the system means that the fight by the holders of tradable shares was just like Don Quixote fighting against a windmill'. It was the alliance's concern with shared interests and aspiration to express their identity that underpinned their actions against all the odds.

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DISCUSSION

This article examines how small shareholders protected their interests from expropriation by large shareholders in a case study of ACB's refinancing proposal. We analyse the processes through which, and strategies by which, small shareholders resist large shareholders' expropriation. Drawing on a theoretical framing that combines stakeholder network perspective, salience perspective, and stakeholder incentive perspective, this article shows that in China where a central agency problem is the conflict between large and small shareholders, united small shareholders can play an important role in monitoring large shareholders and their agents to protect their own interests and alleviate expropriation of small shareholders by large ones. Due to the weak legal protection in China, the impact of individual small shareholders is limited but when united their claims and actions become more salient because their power, legitimacy, and urgency are enhanced. Facing ACB, the alliance became a united whole. As a result, the initially fan-shaped network, in which individual funds and other small investors were powerless and ignored by ACB, became a one-to-one relation in which the united funds and other small investors could pose real challenges to ACB. As the alliance gained additional support from the media, the public and the regulator, the density of the network increased and the relative centrality of ACB was reduced, leading both to adopt a compromiser strategy. As a result, the ACB lost its structural power over individual small investors. The formation and action of the alliance also heightened the salience of the small shareholders' claims. Moreover, apart from protecting their own interests, the actions of the alliance were motivated by their group identity as the guardians of small shareholders. This helped bond the alliance together in their resistance against ACB. The end result was that both parties achieved some measure of success. This result of the dispute is counterintuitive considering the serious P-P problem, weak corporate control, and limited investor protection in China.

Our theoretical and case analyses provide the basis for us to construct an integrated framework that depicts the context, large and small shareholders, the strategies the focal company and the small shareholder alliance may adopt, the role of CSRC and the media, and outcome of this dispute (see Figure 1). The figure takes into account the influence of the context on stakeholder activism which is markedly different from developed economies in which the stakeholder models were developed. In China, the P-P problem is prominent, yet internal and external corporate governance mechanisms are weak. As a result, there are many corporate wrongdoings and they can be concealed for long periods. This partly explains why ACB's large shareholders and management did not communicate with small shareholders beforehand, why ACB's independent directors and supervisory board members did not oppose the refinancing proposal even though it would do harm to small investors, and why the alliance members recognised that their fight against the large shareholders was doomed at the outset, which means that

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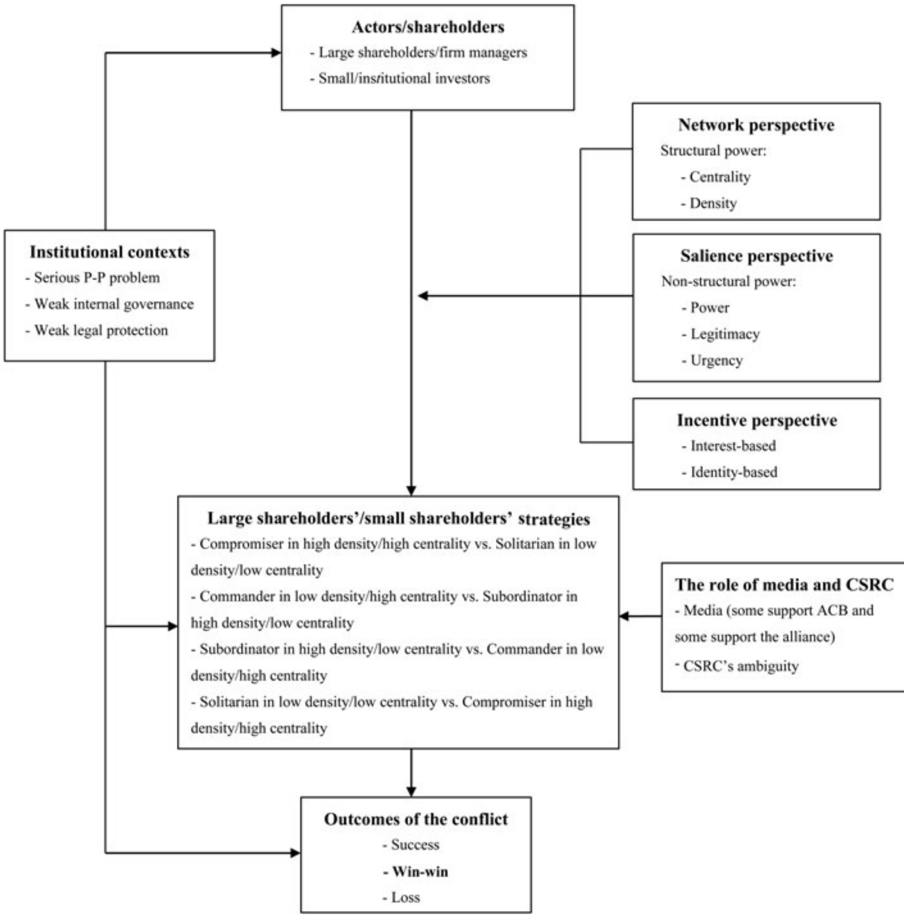

Figure 1. An integrated framework of small shareholder activism in China

the stakeholder incentive perspective is particularly useful in the Chinese context. A further contextual factor relates to the CSRC's dilemma in that it had to perform a dual role: attract investment (especially that by institutional investors) and protect small shareholders while affording banks the space to take business decisions. Another reason for the CSRC's dilemma was the lack of consistent regulations which created an extra barrier for the alliance. Our study provides insights into the vague, yet significant role that the CSRC played in small shareholder activism and the strategies used by the alliance and large shareholders in winning CSRC's support. We also show that the media and public can also be crucial to either side of the clash and hence both sides fought to win their support. If the role of the CSRC and the media changes, ACB and the alliance may adopt different strategies. If the CSRC were the protector of small shareholders, ACB's refinancing proposal might be denied by the alliance at the shareholders' meeting. Also, if the media were one-sided to the alliance, accompanied with the CSRC's ambiguous attitude, it might take longer to resolve the dispute because this scenario would

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throw the CSRC into a more difficult position and ACB might make more concessions in the end.

Our framework still retains the three perspectives used in the case analysis. We find that each adopted perspective could provide insights into some aspects of the ACB clash; but only when used together they provide us with a more holistic understanding of the case. Specifically, while the stakeholder network perspective is useful for understanding the structural power of the alliance (and the loss of power of ACB), the salience perspective points to sources of its non-structural power, and the stakeholder incentive perspective explains why it pursued a lost cause. The integration of the three perspectives leads to the strategies of ACB and the alliance. However, our analyses show that the strategies of ACB and the alliance (and the outcome of the struggle) are influenced by not only their structural power, but also by their non-structural power, the context and the alliance's incentives, as Figure 1 shows.

However, the article also shows that while the theoretical framing we use provides powerful insights, it (and the three perspectives therein) also has limitations. First, every stakeholder's role is temporary, and is context and issue specific (Fassin, 2010). Rowley and Moldoveanu's (2003) framework does not consider that interests and identities of network members may not be uniform and permanent (e.g., compare interests and identities of the members of the funds alliance and those of the media and public and the differences in the interests and identities among media institutions) and it does not address how, or the process through which, the interests and identities are aligned and united. Second, Rowley's (1997) stakeholder network perspective does not distinguish between temporary networks (such as the alliance) and permanent networks (such as shareholder associations or fund associations) and their different effects. To counter controlling shareholders' exploitation, a permanent network, which was lacking when the ACB saga occurred, may be a useful mechanism. In addition, the perspective focuses on the clashes between the two sides (stakeholders and the company) but neglects the internal structure and activities of either side, such as leadership and internal conflicts. This limits our understanding of important issues such as how networks are formed and how strategies are developed and changed.

From a policy perspective, our findings suggest that as the Chinese government is developing financial institutions as a corporate governance mechanism, it is important to provide appropriate institutional mechanisms through which financial institutions are networked and united (e.g., to allow them to set up associations and to encourage institutional investors to actively participate in corporate governance) in order to challenge behavior by corporations. Furthermore, the current regulations stipulate that the market value of mutual funds' shareholdings in one listed company cannot exceed 10 percent of its total net assets. The securities regulators should relax the limit of institutional investors' ownership stakes in individual firms to increase the shareholdings of institutional investors. These two measures will likely strengthen social identity, power, urgency and legitimacy of financial institutions in the fulfillment of their corporate governance role.

Nevertheless, our results should be interpreted with caution. First, the institutions for investor protection are much weaker in China than that of developed markets. Second, Chinese institutional investors are still young with a short history. They are usually small shareholders and lack expertise to negotiate with controlling shareholders. Thus, our findings may not be generalizable to developed markets due to the institutional differences between China and the developed markets. Instead our findings should be more relevant for those markets with weaker investor protection and severe P-P problem.

NOTES

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[1] However, the literature suggests that managers cater to the preferences of small shareholder base when their number is sufficiently large, to preserve corporate reputation (Lee, 2010), or when there is a high degree of age similarity among the firm's current small shareholders.

[2] Smith (1996) describes 'shareholder activism' as the increase in monitoring by traditionally passive financial institutions. In this study, small shareholders (i.e., mutual funds and securities companies) persistently resisted the financial proposal of ACB that would damage their benefits and got partial victory in the end.

[3] While some researchers (e.g. Gen, 2002; Tenev, Zhang, & Brevort, 2002) assert that Chinese mutual funds are passive, are short-term investors, and play no role in firm performance due to their small market presence, Yuan et al. (2008) find that mutual funds' ownership has a significant and positive effect on firm performance.

[4] For example, including institutional investors, the holders of tradable shares of Beiqi Foton Motor Co., Ltd. (600166) blocked the proposal of raising additional 1.1 billion *yuan*'s equity funds at the interim shareholders' meeting in September 2004 (Yuan, 2004). In 2003, Guoyuan Securities Company successfully vetoed the financing proposal of COSCO Shipping Co. Ltd (600428), which attempted to purchase assets from its related parties (Xu, 2003).

[5] *Corporate Law* in China has formulated clauses to give special protection to the interests of small shareholders. For example, Clause No. 34 allows shareholders to review accounting books of listed companies; No. 153 notes that shareholders can sue listed companies if their benefits are damaged if corporate management break the laws, regulations, or articles of association.

[6] As there is a diffuse corporate ownership in the US and UK, P-P problem is less important (Yuan et al., 2008). Therefore, one of the missions of the securities regulators in the US and UK is to protect all investors. In contrast, the main role of CSRC is to protect the benefits of small shareholders due to the serious P-P problem in China.

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