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On the Gaming Behavior of Institutional Investors' Participation in Corporate Governance

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Abstract: Following the very rapid development of the real manufacturing economy in China, institutional investors in China have been expanding rapidly, which is of positive significance for standardizing the financial market and promoting the reform of the market economy and the development of the manufacturing economy. At present, pension funds as well as mutual funds in China take the lead, and investors from various institutions are directing the domestic securities market to implement the institutionalized physical reform of the investment body. However, much of the current equity of enterprises in China, especially most private enterprises, is held by controlling shareholders, with less equity held collectively by these institutional investors. Moreover, with the imperfection of our domestic capital management market, institutional investors tend to be even less motivated as well as less concerned about participating in corporate governance. How to promote the governance effectiveness of institutional investors has been the focus of experts and scholars in the development process of enterprises. Therefore, focusing on the gaming perspective, this paper analyzes in depth the factors that affect the governance behavior of institutional investors, and puts forward relevant suggestions based on the above issues, aiming to give full play to the effectiveness of governance of each institutional investor in enterprises.

Keywords: Institutional Investors; Corporate Governance; Gaming Research

Introduction

Based on the analysis of different institutional investors and their participation in the process of corporate governance, this paper intends to analyze in depth the rational choice of different institutional investors in their participation in corporate governance and the conditions under which they are willing to actively participate and improve the corporate governance process, using the game theory in modern economic theories. The paper also proposes policy recommendations to increase the motivation of investors from different institutions to truly participate in the governance of their companies in the daily production and operation process, based on the results of the analysis of the gaming research.

1. Presentation of Gaming and Governance Issues

With the rapid development of the real manufacturing economy in China, institutional investors in China are expanding rapidly. The increasing scale of institutional investors' shareholding in each company, on the one hand, has greatly improved the management and control of these institutional investors over the management structure of their own listed companies, enabling them to change from passive shareholders to active shareholders; and on the other hand, results in the cost of "voting with their feet" being much higher than before due to the higher shareholding of institutional investors, which forces institutional investors to "vote with their hands" more often, i.e., they need to actively participate in the governance process of their companies so that they can better protect their economic interests. At the same time, these institutional investors, with their large investments, have been more concerned than ever about the actual operational efficiency and performance of their companies, and have shown a strong sense of involvement in the decision-making process of their companies' governance, due to the huge sunk costs brought by the market^[1].

2. Analysis of Reasons for Effectiveness of Institutional Investors in Implementing Governance within Companies

2.1 Different ways to implement governance within the company as an institutional investor

General institutional investors mainly change the internal shareholding structure of listed companies by “voting with their hands”, which indirectly changes the distribution of share power within their companies, thus realizing the supervision and restraint of “insiders” in company management. Theoretically, as shareholders of companies, institutional investors can also intervene in the transmission of interests and decision-making by attending annual and ad hoc meetings of shareholders, which are specifically controlled by the remaining controlling shareholders of their companies. When the majority shareholders of some companies hold a large amount of equity and manage their companies, even if this can solve the problem of “free-riding” of other shareholders with less rights, and then effectively monitor and control the self-interest behavior of the management, so that it is more in line with the interests of shareholders, and can effectively reduce the agency cost of management, it is also at this time that depriving the majority shareholders of their concentrated interests from other shareholders has become the primary management problem, it has been the primary management problem of companies because they may deprive other shareholders of the various benefits centralized in major shareholders.

Majority shareholders can exercise their equity advantage to achieve complete and total control over the management of their companies, yet this both curbs certain conflicts of interest that generally arise between major shareholders and management, and poses some economic efficiency problems that would deprive minority shareholders of their own interests. Thus, institutional investors can effectively monitor the compliance of major shareholders in their management process as representatives of external shareholders’ interest groups, and thus protect other shareholders from infringement of their own rights and interests^[2].

2.2 How Institutional Investors Play a Role in the Governance Process

Bringing the effectiveness of institutional investors into full play in governance can have a very positive impact on improving the management of listed companies, which is often facilitated by the strengths of institutional investors themselves: Institutional investors, through their operations, can change the shareholding distribution structure of listed companies, thus creating a management mechanism of internal checks and balances. In addition, in order to fully protect the rights and interests of investors, national laws and regulations generally stipulate quantitative restrictions on the specific shareholding ratio of institutional investors. Moreover, since institutional investors do not hold a large number of shares in a single listed company out of “prudence”, such a diversified portfolio of investment concepts would not pose any threat to the actual control of those listed companies. However, if compared with other small and medium investors, small and medium investors do not suffer from a loss of a certain degree of concentration of equity rights due to lack of leadership in their actual shareholdings.

There is also a need to overcome the practical difficulties caused by the lack of a legal system in the relevant area. The continuous improvement of the legal system in the field of financial investments can largely protect the economic rights and interests of small and medium-sized shareholders and further reduce the occurrence of corporate governance problems as well as possible serious consequences arising from it thereof. However, due to the late development of China's capital market, the management structure and institutional functions have not been perfect, resulting in imperfect laws and regulations which protect the economic rights and interests of small and medium shareholders, which makes it a common phenomenon to supervise and manage large shareholders with a high percentage of shareholding in listed companies. However, this may cause a “trench effect” in which major shareholders capture the interests of small and medium shareholders and the company for the sake of enhancing their own economic interests.

3. Suggestions for Promoting Institutional Investors to Further Play the Role of Corporate Governance

3.1 Institutional investors are recommended to further increase their specific shareholdings

Currently, in most of the listed companies in China, investors have been basically focusing on personal investment and financial management, whereas the smaller the number of investors, the larger the share occupied by shareholders, resulting in a large gap between the two. Therefore, these institutional investors can act as representatives of external shareholders' interest groups, which can not only form checks and balances on the power of major shareholders inside listed companies and further reduce the actual cost of agency, but also supervise various production and operation activities of company management to a large extent and inhibit the company's surplus management policy. Although the reform of the share split has laid a foundation for institutional investors to increase their shareholding, it is necessary to update the production and management philosophy of major shareholders, and encourage those major shareholders to actively relinquish their rights and flexibly transfer part of their equity to institutional investors, which can enhance the sense of management responsibility of institutional investors and thus improve the governance efficiency of institutional investors in the production and operation of their companies^[3].

3.2 Chinese capital market should be continuously improved, so as to promote the long-term development of institutional investors

The capital market in China is still imperfect in many aspects with a lack of systems and policies, resulting in the uneven development dynamics of institutional investors. The size of securities funds in the capital market is large, yet there is a capital shortage in pension funds, insurance funds, etc. with social security nature, which makes it difficult to meet the actual investment needs of institutions, thus necessitating further perfection of markets in China. The government and administrative organs of China intervene much in the financial market, with strong political undertones, resulting in a weakened discipline mechanism in the capital market in China, a failed market competition mechanism, and an imperfect capital incentive mechanism. Therefore, in the face of these real problems, it is necessary for China to further perfect the laws and regulations in financial-related fields, so as to effectively protect the legitimate economic rights and interests of those institutional investors, to strongly support the long-term development of pension funds, insurance funds and other institutional investors with social security, to further strengthen the level of government supervision, and to crack down on manipulation of the financial market, as well as insider trading and other disruptions to the capital market^[3].

Conclusion

It can be found from the above analysis that China's capital exchange market system has not been perfected and developed enough, so institutional investors are often unwilling and do not have the corresponding capacity to participate in the corporate governance process, requiring further policy support from our country as well as continuous improvement of the market.

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