

OPTIMISING SPECIAL VOTING RIGHTS IN DUAL-CLASS SHARE STRUCTURE COMPANIES: A CORPORATE GOVERNANCE PERSPECTIVE FROM CHINA

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Annotation. China has established a pre-access approval system for companies with dual-class share structures that adopt special voting rights. Due to the overly stringent nature of this approval process, few companies opt for the special voting rights system. This paper examines the application of the special voting rights system and dual-class share structures in Chinese companies, as well as the current status of relevant legal texts. Through normative and comparative analysis, it is found that the strict pre-access regulations for the special voting rights system have led to issues such as the overall design deviating from market innovation goals, information disclosure deficiencies resulting in inefficient information utilisation, and insufficient incentives limiting the role of independent directors. These problems hinder the full mobilisation of continuous innovation enthusiasm in tech-driven enterprises and, in the long term, are detrimental to the modernisation of China's capital markets. To address these issues, mechanism design theory should be introduced to transform the regulatory model of the special voting rights system, reconstructing it with an incentive-oriented approach while moderately relaxing pre-access controls. By implementing measures such as incentive compatibility, improving information disclosure, optimising the functions of independent directors, and enhancing judicial remedies, a balanced regulatory environment can be created, achieving a dynamic equilibrium between innovation development and the protection of minority shareholders' interests.

Keywords: dual-class share structure, special voting rights, mechanism design theory, agency costs, incentive compatibility.

JEL classification: K22, G32, G34.

Introduction

In China's dual-class shareholding companies, the special voting rights refer to a differentiated voting arrangement where specific shareholders hold shares with higher voting rights. For the special voting rights system, China adopts strict pre-access controls, which, albeit reasonable, have issues such as insufficient incentives and inefficient information utilisation, contradicting the original intention of stimulating market entities' investment and entrepreneurship. This paper aims to study the issue of the cooling down of dual-class shareholding structures in China's capital market through literature review, comparative analysis, and theoretical framework for mechanism establishment. The value of dual-class shareholding structures has been confirmed by numerous foreign scholars. External investors often willingly relinquish part of their corporate control to protect the unique vision of founders, granting high voting rights to corporate founders (Lund, 2019). Therefore, the dual-class share structure has become a favoured equity framework for tech start-ups to maintain control. However, such an equity structure contradicts the traditional corporate law principle of "one share, one vote", sparking extensive academic debate and becoming one of the most contentious issues in current corporate governance (CG) theory and practice.

This paper reinterprets and contributes to the improvement of the China's special voting system by using the framework of mechanism design theory, drawing on the experience of ex-ante, in-process, and ex-post controls adopted by foreign countries when formulating dual-class share rules. This leads to the proposal of strategies for the optimization of China's special voting rights system. First, the review of current dual-class share rule system in China highlights that the design of China's special voting rights system focuses on addressing inherent flaws in the dual-class share structure, adopting legislative policies that prohibit by principle, allow exceptions, strictly screen, and rigorously regulate. Second, the adoption of such stringent ex-ante control measures is a path dependence under static transaction cost equilibrium theory, and a single-minded understanding of agency costs. Finally, by introducing mechanism design theory, the concept of China's special voting rights system design is adjusted, shifting from "constraint" to "incentive", relaxing ex-ante controls in China's special voting rights.

As mentioned, this article provides a varying array of contributions to the aforementioned issues under study. Firstly, the present study investigates the influence of specific rules on companies with dual-class share structures in the context of pre-access rules. Secondly, the mechanism design theory is introduced, thus placing China's special voting rights system under this framework for an in-depth analysis, optimising the design of the special voting rights system and effectively aligning with the development needs of dual-class share structures. Thirdly, by exploring the Chinese companies' special voting rights, this research helps to base efforts on national realities, foster entrepreneurial spirit, reshape the attractiveness of the dual-class share rule system, promote innovation vitality in Chinese tech companies, and realise prosperity in capital markets. Lastly, this paper also studies Chinese institutional environment, respects shareholders' autonomy, ensures efficiency promotion and risk prevention, balances theory and practice, and more broadly assumes the necessity of introducing dual-class share structures to attain a balance between investor protection and market openness.

1. Literature Review

A dual-class share structure has been widely adopted by numerous emerging tech companies in regions such as the United States, Singapore, and Hong Kong. However, such a share structure differs from the traditional principle of single-class share structure, sparking research enthusiasm among local and foreign scholars.

Current research on dual-class share structures mainly focuses on theoretical foundations, scope of application, and comparative advantages and disadvantages. Specifically, regarding the advantages and disadvantages of dual-class share structures, three different perspectives have emerged. Easterbrook and Fischel (2005) were the first to integrate agency cost theory with one-share-one-vote theory. Representing the proponent side, Fischel (1987) strongly advocates for special voting rights shares, arguing that companies listed on the US stock exchanges with different voting rights can adopt various financing methods based on their own development needs. Prof. Lowenstein, L. (1989) believed that the dual-class share structure contradicts the core values of the company, undermining its legitimacy and efficiency. Lowenstein (1989) advocates that dual-class share structure are detrimental to the supervision of directors or major shareholders. Jeff Gordon (1988) of New York University challenged Prof. Fisher's perspective, arguing that the market pricing function of issuing special voting rights shares is to protect minority shareholders. Issuing stocks is a commitment to investors, and altering the equity structure would harm the interests of minority shareholders, constituting a betrayal of them (Gordon, 1989). Other scholars argue that the issuance of special voting rights shares helps address the issue of diluting control due to financing. Economists such as Andrei Shleifer have also conducted in-depth research on dual-class share structures. The incentive mechanism in dual-class share structure increases agency costs and exacerbates conflicts between major and minority shareholders (La Porta *et al.*, 1998). Some scholars also point out that while adopting such structures can ensure centralised control, it may harm investors' interests.

Foreign scholars focus on the golden rule of "one share, one vote" in companies. Implementing the "one share, one vote" principle can only achieve equal shares but not individual equality among shareholders (Xu, 2019). The "one share, one vote" theory can distinguish differences in residual interests among different shareholders (Smith, 1997). Later, this view was refuted, as the assumption of shareholder homogeneity proved a false proposition. The diversified financing models and financial derivatives generated by capital markets further exacerbate shareholder heterogeneity (Goshen, Squire, 2017). Hence, it is the unique personal factors of shareholders colliding with financial market innovations. Foreign scholars tend to use economic law theories to support or oppose dual-class share structures, such as agency cost theory, using traditional economic utility theory to argue for shareholder primacy. Research applying corporate law theory remains relatively scarce abroad.

Regarding the application scope, dual-class share structures can be applied across various US industries without specific restrictions (Grinapell, 2010). However, the long-term development of the media industry requires historical accumulation; publishing false reports will result in a devastating blow to the firm (Arugaslan *et al.*, 2010). Therefore, dual-class share structures are favoured by the media industry.

Regarding the advantages and issues of dual-class share structures, Lattanzio and Megginson (2017) found that capital restructuring using a dual-class share structure in British companies has positive price effects. Furthermore, Slovin *et al.* (2021) discovered that companies with majority equity adjustments to a dual-class share structure exhibit excellent post-industry-adjustment operating performance and fewer bankruptcy filings. In addition, companies with dual-class share structures have both potential future earnings and higher risks (Echambadi, 2017). Claessens and Djankov (1999) indicated that equity concentration easily exacerbates conflicts between major shareholders and other external shareholders. However, the establishment of independent directors can protect the interests of small and medium shareholders (Xu, 2020). Moreover, the higher the proportion of independent directors in British listed companies, the lower the likelihood of harm to small and medium shareholders. The independent directors should play an indispensable role in corporate operations and non-equitable related-party

transactions (Solomon, 2019). Improving the corporate culture and governance can address internal supervision failure (Holchleitner, 2018).

Chinese scholars have shifted from initial skepticism to risk analysis of dual-class share structures. Thus, scholars actively draw on foreign experiences (Liu, 2015; Wang, 2014) and reflect on the limitations of single-class shares (Zhu *et al.*, 2019). The rationality of special voting rights arrangements was affirmed by Fu and Yang (2021). Based on a critique of the current STAR Market system design, the special voting rights arrangements are incompatible with existing laws. A dual-class share structure leads to moral hazard due to the unequal protection of external investors (Du, Wu, 2018) and regulatory bottom-line competition (Li, 2019). Subsequently, legal control of the risks of special voting rights has been proposed from the aspects of strict market access (Zhang, Luo, 2020), restrictions on the exercise of high voting rights (Lin, Xie, 2020), and judiciary supporting safeguard measures (Zhang, 2017).

Evidently, foreign research primarily focuses on Europe and the US, exploring the rationality of dual-class share structures since their inception. Institutional studies on dual-class share structures cover multiple aspects, mainly focusing on the causes of this system, recognition process, and the protection of minority shareholders. Empirical analyses have been used to highlight the effectiveness of dual-class share structures in corporate management. Simultaneously, it points out several drawbacks, such as insufficient protection for minority shareholders and inadequate internal supervision. The corrective measures mainly involve strengthening securities market regulation. Conversely, domestic research has rarely studied the limitations of special voting rights from a mechanism design theory perspective, failing to examine why special voting rights lack appeal in China's capital market context. The establishment of the STAR Market represents a significant transformation in China's securities market. Therefore, it is necessary to investigate why the current rules on dual-class share structures are not well-received in China's capital market, while also addressing the theoretical concerns surrounding the introduction of dual-class share structures.

2. Research Methodology

In this study, a qualitative (analytical and exploratory) approach is adopted, integrating normative analysis, comparative analysis, and theoretical framework to examine the cooling down of dual-class shareholding structures in China, in order to formulate strategies for optimising the special voting rights system in China. It is grounded in doctrinal legal research approaches, scrutinising regulatory guidelines, statutory provisions, and listing rules associated with Chinese dual-class shareholding companies. Besides, this research extends beyond descriptive analysis by employing mechanism design theory to not only reinterpret but also improve the institutional design of China's special voting rights. In terms of the data sources, this study primarily relies on secondary data, including (1) legal texts and regulatory guidelines encompassing the STAR Market Listing Rules, the Growth Enterprise Market Listing Rules, and the China Securities Regulatory Commission's (CSRC) Guidelines for the Articles of Association of Listed Companies; (2) case data containing publicly available information of 16 companies that adopted dual-class shareholding structures and applied for listing on the STAR Market from March 2019 to March 2025; and (3) extant literature on related empirical and theoretical studies (local and foreign), dual-class share structures, mechanism design theory, and agency cost theory.

The researchers have incorporated an analytical research approach in this study. Firstly, in terms of the normative legal analysis, the existing regulatory framework governing special voting rights in China is critically investigated to point out its limitations, such as insufficient incentives, excessive reliance on ex-ante controls, and deficiencies in information disclosure. Secondly, from the perspective of comparative

analysis, Chinese system is compared with global practices, especially the US model, which balances the autonomy of founders with minority shareholder protection through in-process, ex-ante, and ex-post regulatory measures. Thirdly, in the context of theoretical framework application, the mechanism design theory is used to reinterpret the design and purpose of the special voting rights system. Based on this framework, this study shifts the regulatory philosophy from “constraint-oriented” to “incentive-oriented”, putting forward optimisation strategies that stress information disclosure, incentive compatibility, and balanced risk prevention.

3. Study Results

3.1 Current Institutional Structure of the Dual-Class Share Structure

Article 144 of China’s new Company Law stipulates that companies can issue shares with different voting rights through their articles of association (AoA). However, the overall content is relatively simple. The main rules are scattered across administrative regulations, departmental rules, industry standards, and exchange rules. *Table 1* outlines the regulatory framework of China’s dual-class structures as follows:

Table 1. Regulatory Framework of Dual-Class Share Structures in China

Regulation/Source	Key Provisions	Scope of Control (Pre-issuance / In-process)
Company Law (Art. 144)	Allows issuance of shares with different voting rights through AoA	General principle
STAR Market Implementation Opinions (Art. 5)	Defines special voting rights; matters to be specified in AoA	Pre-issuance
STAR Market Listing Rules (Art. 4.5.2)	Timing and procedures, restrictions, conversion rules	In-process and Pre-issuance
Measures for Continuous Supervision of STAR Market (Art. 7)	Records in AoA for enterprises with special voting rights	In-process
CSRC Pilot Guidance (2019 onwards)	Entry criteria for innovative/tech enterprises	Pre-issuance

Source: created by the authors.

For example, Article 5 of the Implementation Opinions on Establishing the STAR Market and Piloting the Registration System at the Shanghai Stock Exchange defines the meaning of special voting rights and matters that should be specified in the articles of association for STAR Market companies using special voting rights. Article 4.5.2 of the Listing Rules for the STAR Market of the Shanghai Stock Exchange specifies the timing and procedures for setting up special voting rights, restrictions on their establishment, and matters related to conversion. Article 7 of the Measures for the Continuous Supervision of STAR Market Listed Companies outlines the special matters that must be recorded in the AoA for companies with special voting rights. Since the CSRC issued the implementation opinions on the STAR Market in January 2019, it has clarified many requirements for the establishment of the STAR Market. The Growth Enterprise Market and the Beijing Stock Exchange have also successively allowed companies with dual-class share structures to apply for listing.

China’s current dual-class share structure rule system is mainly designed from two aspects: pre-issuance control and in-process control. The content of these regulations is more specific and comprehensive than the new Company Law. Regarding the pre-issuance control, it includes listing standards for issuers, voting

procedures and timing requirements at establishment, holder qualification requirements, voting rights multiplier limits, and provisions on the breakthrough principle, such as not increasing the special voting rights ratio after listing. In terms of the in-process control, it covers transfer restrictions, circumstances under which special voting shares can be converted into common shares, and the scope of voting matters. China has also adopted strict review criteria for technology innovation enterprises applying to the list on the STAR Market. The stringent entry requirement aligns with the CSRC's guidelines on restrictions for pilot enterprises and practices in Hong Kong, China's Special Administrative Region, and Singapore. To protect the interests of small and medium shareholders/investors, multiple pre-issuance control measures have been implemented for the dual-class share structure.

Overall, the current rules aim to achieve "source control" over agency costs related to such structures. During the corporate operational phase, prohibitive regulations are more frequently employed to prevent changes in agency costs. From the perspective of reducing agency costs, these rules have proven effective, although they overlook the competing interests of investor protection and founder attraction. In other words, if the cost of adopting a dual-class share structure is high, founders will opt for alternative equity structures or turn to overseas markets with lower costs.

There is a need to review and analyse the current setup of special voting rights, with the most prominent issue being the agency cost problem. The principle of "one share, one vote" emphasises equal capital ownership while ignoring the substantive equality of individual shareholders. Thus, corporate governance places shareholders on a homogeneous basis of aligned interests for corresponding institutional arrangements. The capital majority rule directly links shareholder rights to their capital contributions. Therefore, the direct way for shareholders to participate in corporate governance is through the exercise of voting rights. However, the controlling shareholders can easily abuse their voting rights. The capital majority rule provides a convenient means for controlling shareholders to abuse their control, hindering the effective realisation of its positive functions. Moreover, minority shareholders bear the risk of poor decision-making, thereby indirectly expanding the scope of controlling shareholder's voting rights. Practically, controlling shareholders often use legal forms to mask illegal purposes. The voting rights structure of a company is clearly powerless against the moral hazard of controlling shareholders. In capital market, the essence of majority rule is formal equality under the guise of equal capital. Wang and Zhao (2011) pointed out, "it is the abstract concept of capital equality that conceals the substantive inequality in rights and obligations among shareholders".

Modern firms emphasise maintaining control rights. The dual-class share structure of listed firms breaks through the rule prohibiting the separation of equity and has an impact on the proportional allocation of shareholders' economic and participatory rights under the principle of "one share, one vote". Even though the essence of special voting rights is the result of mutual agreement among shareholders after "bargaining", the helping company founders maintain control. However, it exacerbates the trend of separating control rights from ownership in corporate governance. In financing models, innovations have given rise to class shareholders, increasing separating the enjoyment and exercise of equity. Consequently, equity is integrated with other property rights, undermining the legal basis for prohibiting voting rights (Zhao, 2013).

The agency costs between founders and other (small and medium) shareholders are manifested in two aspects: internal and external agency costs. From the perspective of internal agency costs, the interest preferences between founders and other shareholders trigger agency conflicts. However, the voting rights of founders lead to decision outcomes often differing from those of other shareholders. At this point, special voting rights facilitate such heterogeneous interest conflict. The rules for allocating control are

shifting from majority rule by capital to majority rule by intellect (Wu, 2019). The agent invests in the firm with the founder's intellect as consideration for transferring part of their control rights. If the firm value realised by the above intellectual capital does not match the agent's consideration, agency costs arise. Based on the external agency cost, the separation of control rights and cash flow rights increases the monitoring costs for other shareholders. Under the majority rule voting mechanism, voting rights were proportional to residual claim rights, incentivising founders to self-monitor. However, such rights externalise what was originally internalised issues. These rights also create agency costs for supervision. Hence, the special voting increases the divergence between voting rights and cash flow rights, affecting the agency relationship between founders and other shareholders in two distinct ways (Wang, 2019).

In China, the dual-class share structure started late. Under the policy guidance of "trial first, then promote," the STAR Market was established as a "pilot field". The STAR Market Listing Rules of the Shanghai Stock Exchange, the Growth Enterprise Market Listing Rules of the Shenzhen Stock Exchange, and the CSRC's revised "Guidelines for the Articles of Association of Listed Companies" were built based on the more mature foreign practices of the operation of dual-class share structures to establish a Chinese-style special voting rights system that covers pre-access rules, thus placing risks under these rules. Current studies in China focus primarily on normative analysis at the institutional level, lacking general discussions on how institutions address practical issues. From March 2019 to March 2025, this study identifies 16 companies that have set up dual-class share structures and are applying for listing on the STAR Market through public searches. *Table 2* demonstrates the adoption of dual-class share structures across Chinese market.

Table 2. Dual-Class Share Structures in China's Capital Market (2019–2025)

Market	Total Listed Companies	Companies with DCS	% with DCS	Examples	Notes
STAR Market (SSE)	586	8	1.37%	Ninebot, UCloud, Huayu Pharmaceutical, Jindian Electric, Aobi Zhongguang, Jingwei Hengrun, Yuncong Tech, SITVIS	JD Digits, Royole, Hesai, Yitu, Shangmi withdrew
Growth Enterprise Market (SZSE)	N/A	0	0%	None	Ban lifted in 2020, no adoption
Beijing Stock Exchange	N/A	Very few (under review)	~0%	None	Still exploratory phase

Source: created by the authors.

There were a total of 586 companies listed on the STAR Market (Shanghai Stock Exchange, March 2025), among which only eight companies adopted a dual-class share structure and successfully went public (UCloud, Ninebot, Jindian Electric, Huayu Pharmaceutical, Aobi Zhongguang, Jingwei Hengrun, Yuncong Technology, and SITVIS). Notably, JD Digits, Royole Technology, and Yitu Technology all withdrew their IPO applications after filing them. The most notable case is that of Hesai Technology, which submitted its STAR Market IPO prospectus to the Shanghai Stock Exchange in January 2021 but voluntarily withdrew its application for listing in March 2021. Instead, it announced its official listing on the NASDAQ Stock Market in February 2023, marking the largest IPO by a Chinese company in the US since Didi's listing in July 2021, with reasons worth exploring. Shangmi Technology was also suspected of having its technological

attributes questioned during the second round of listing review and ultimately withdrew its application. Concurrently, since the Shenzhen Stock Exchange (SZSE) lifted its ban on dual-class share structures on 12 June 2020, no company has adopted a dual-class structure to list on the Growth Enterprise Market of the SZSE, nor has any company used the special voting rights system. This suggests that only 1.37% of companies listed on the STAR Market have adopted a dual-class share structure, which is indeed regrettable. The original intention of the STAR Market was to optimise China's financing structure and thereby facilitate industrial restructuring. Similarly to the United States in the 1980s, China is currently at a critical stage of economic structural transformation. Hence, given the inherent drawbacks of dual-class share structures, it is necessary to strengthen investor protection, although protecting investors and attracting issuers of tech companies may be competing interests. Investor protection can be achieved through the adoption of ex-ante regulatory measures to reduce opportunistic behaviour, but this diminishes the incentive for tech company founders to adopt a dual-class share structure. Therefore, the feasibility of a dual-class share structure in China is low, possibly due to the limited allowance caused by the restrictive ex ante regulatory measures.

3.2 The Specific Issues of Legal Provisions on Dual-Class Share Structure

The legal control deficiencies in addressing the agency costs associated with special voting rights stem from three aspects (see *Table 3*). First, the inherent drawbacks of a dual-class share structure; second, the rule-makers' consistent pursuit of a static equilibrium state of transaction costs; and third, the singularity in understanding agency costs. Under the influence of path dependence, the evolution of corporate governance structures has adapted to China's environment. Based on China's actual situation, both the completeness and enforcement of its legal system have flaws, leading to insufficient protection for small/medium shareholders and creditors. Consequently, influenced by path dependence, there is a spontaneous tilt towards protecting small and medium shareholders in addressing the agency costs associated with special voting rights (Li, 2008). The singularity of the understanding of agency costs in corporate governance also further encourages rule-makers to escape from the path of static control.

Table 3. Agency Cost Issues under Special Voting Rights

Type of Agency Cost	Mechanism	Effect on Shareholders
Internal Agency Costs	Divergence of founder vs minority shareholder interests due to unequal voting	Decisions may not align with shareholder value
External Agency Costs	Separation of control rights from cash flow rights → higher monitoring costs	Burden shifted to minority shareholders
Capability Costs (Principal-agent Cost Theory)	Founders' strategic misjudgment, suboptimal goals	Value loss & monitoring inefficiencies

Source: created by the authors.

3.2.1 The Inherent Defects of Dual-Class Share Structure

Even as the dual-class share structure is being increasingly accepted by countries abroad, relevant legislative designs have all retained certain flexibility to varying degrees. Even though the US allows companies to freely choose their equity systems, it legally treats the dual-class share structure only as an exception to the one-share-one-vote system. Since the application of the dual-class share structure has exposed its inherent developmental drawbacks. This stems from its lifecycle effect of relatively higher value in the early stages and lower value later on (Liu, 2022). Some foreign scholars also believe that during

the post-IPO period, there will be risks of declining investment value, reduced corporate governance efficiency, and increased costs. The primary cause of this phenomenon is the intensity of differences in special voting rights; the greater the separation between voting rights and profit-sharing rights, the more it directly exacerbates agency problems for control shareholders. The value-added effect of companies adopting a dual-class share structure after their IPO gradually diminishes as the founder's shareholding ratio dilutes and the differences in special voting rights widen. Conversely, there is the underlying logic of the rule by man, making it difficult for founders to voluntarily relinquish absolute control over the company. Rational founders should, at the critical point where corporate performance declines, assess the situation to transform the corporate equity structure. The longer the company survives, the more deeply ingrained the view of the controlling power becomes. With the enhancement of special voting rights, the mindset of rule by man grows even more inflated, harming the interests of small/medium shareholders.

These drawbacks stem from a rational analysis of objective reality. Given the notable divergence between voting and self-beneficial rights, which exacerbate the moral hazard of founders and agents. Considering the lifecycle pattern of the dual-class structure, which likely declines after reaching its peak, China's special voting rights focuses on the inherent flaws of the dual-class share structure by adopting policies that prohibit in principle, allow exceptions, and rigorously regulate.

3.2.2 Path Dependence under Static Transaction Cost Equilibrium Theory

Static transaction cost equilibrium theory often finds it difficult to make dynamic predictions. In "The Nature of the Firm" (1937), Coase stated that entrepreneurs constantly experiment, controlling more or less of the transactions to maintain equilibrium. This provides a static analysis of the equilibrium state. However, dynamic factors are also quite important. This static analysis cannot explain the dynamic development of firms with non-equilibrium characteristics (Liu, 2000). A US economist Gregory Noddings proposed the "path dependence" theory of institutions, suggesting that institutional evolution depends on its path because it is driven by people. The path dependence means that once a choice is made, it will be continuously reinforced under the influence of inertia, making it difficult to change easily. Corporate governance has a strong path dependence on legal systems; different paths of dependence can lock corporate governance into an inefficient equilibrium (Deng, 2008). Path dependence forms due to considerations of benefits and costs. Concurrently, constrained by the cost of ex-post supervision and remedies, the norm of Chinese legal control represents a path dependence under static transaction cost equilibrium theory, ignoring the forces: entrepreneurs that could break this equilibrium. This is particularly evident in the complex and stringent pre-transaction rule design for special voting rights, which manifests in the difficulties of information disclosure, irrationality of external investors, and regulatory measures.

The overall transparency of China's capital market is low due to the limited rationality of individuals and the objective existence of information asymmetry. Listed companies often fail to disclose sufficient information, leading regulators to formulate various relevant guidelines. The extensive documentation system has not garnered the cautious attention of investors. Moreover, Chinese investors generally exhibit high trading activity but low professionalisation (Li, 2019), with retail investors focusing on short-term gains and showing indifference towards rights-based rationality, which leads them to "vote with their feet". This prevents regulators from achieving the desired external oversight to constrain internal controllers.

Additionally, the proportion of ex-ante regulation is significantly higher than that of mid-process control and ex-post remedies. Based on the historical evolution of dual-class share structures, China focuses on preventing financial market risks. The formation of a logic centered on ex-ante management is complemented by various mandatory rules. This reflects the prudential balance between shaping market

competitiveness and investor protection by regulatory bodies (Huang, 2017). Due to the “dilemma of collective action” in securities litigation, the phenomenon of “free-riding” is widespread (Feng, Xiong, 2022). Given the frequent securities litigations, judicial relief is weak, resulting in redundant pre-regulatory rules.

The threshold set for pre-event rule-making has received positive feedback, but it also promotes the gradual homogenisation of listed companies. Based on the review of relevant inquiry matters of tech firms applying for listing on the STAR Market with special voting rights, there are already fixed scripts for responses to inquiries from securities exchanges. Many investment firms have even compiled a list of templates for reference, which has led to further locking of securities regulation into a static control model. This has prompted the legislation to form stringent entry rules while ignoring the dynamic changes in the cost of special voting rights proxies.

3.2.3 *The Singularity of the Perception of Agency Costs*

Based on the Chinese legal control, which tends to be static under the ideal of transaction cost equilibrium, the relevant rule designs of the STAR Market and the Growth Enterprise Market focus on constraining the control rights of founders. Agency cost theory dominates research in corporate law and corporate governance structures (Goshen, Squire, 2017). The agency cost theory model directly addresses the direct costs related to managerial disengagement and transfer, and describes the components of agency costs. This analytical framework has led scholars to strongly argue for granting shareholders more power. Although this model explains the scope by simplifying the model, focusing only on the conflict costs within agency costs. Consequently, the sole governance objective is to minimise agency conflict costs.

However, the content of agency costs is far from being so singular. Jensen-McClen’s agency cost theory model also assumes that managers will choose optimal business strategies, while investors exercise effective supervision. In practice, costs arise due to insufficient strategic capabilities of managers and information asymmetry. Therefore, agency cost theory also overlooks capability costs. By analysing the agency cost theory and its flaws and applying it to China’s special voting rights system, such stringent preliminary review restrictions all reflect that rule designers have only seen the significant agency costs criticised by most scholars in the special voting rights system. Prominently, rule makers aim for the optimal allocation of control between managers and investors, with minimising agency costs being the key factor determining the distribution of control. Therefore, allocating more control to founders in a dual-class share structure will inevitably increase agency costs between managers and investors. As a result, regulatory bodies impose strict restrictions on founders, but overlook the hidden monitoring costs (Fu, Wei, 2019). Consequently, the principal-agent cost theory emerged to address the shortcomings of agency cost theory, further illustrating the lackluster design of China’s special voting rules. *Table 4* illustrates the legal and institutional challenges of Chinese dual-class share system.

The principal-agent cost theory highlights that the principal-agent capability cost should be addressed in all corporate governance structures. The principal-agent delegation is considered efficient if the investor grants management control while increasing agency costs. This is reflected in the design of special voting rights. The initial regulations establish corresponding protective barriers to protect the rights of small/medium shareholders. However, these shareholders retain this control under a dual-class share structure. All small/medium shareholders face potential intervention costs due to the heterogeneity of entrepreneurs’ perspectives. Founders may choose suboptimal strategic goals, and the value loss resulting from self-protection further constitutes part of the principal-agent capability cost (Goshen, Squire, 2017).

Table 4. Legal and Institutional Challenges of China's Dual-Class Share System

Problem Area	Explanation	Implications
Excessive Risk Prevention	Stringent restrictions on founders in dual-class firms	Lessens attractiveness of special voting rights
Static Legal Control	Pre-control rules in STAR and GEM reflect a rigid, equilibrium-based approach	Restricts governance flexibility and deters adoption
Narrow Scope of Agency Cost Theory	Focus only on conflict costs & ignoring capability costs	Over-regulations & neglect of hidden costs
Lack of Dynamic Balance	Regulations are unable to reconcile long-term needs with risk control	Companies becoming overcautious, weakening corporate governance

Source: created by the authors.

Overall, all these factors explain why China has implemented strict pre-control measures for setting up special voting rights. Thus, we can profoundly understand that the current rule design fails to adequately balance the agency costs generated by companies adopting the special voting rights system. The burden of pre-control directly makes dual-class share companies extremely cautious and hesitant to proceed. Dual-class share companies adopt the special voting rights governance structure precisely to meet their unique long-term goals. However, the excessive regulation may lead to a lack of intrinsic appeal for such structures, overemphasising potential risk prevention while driving up practical costs. The key to addressing this issue lies in achieving a dynamic balance between objective needs and risk prevention. The role of commercial entities in legislative practice and industry regulation at various levels is becoming increasingly significant. Therefore, the approach to resolving the dilemma of special voting rights in dual-class share companies should be redesigned.

4. Discussion

This paper introduces mechanism design theory to reconstruct the rule design of special voting rights, primarily leveraging the element of incentive compatibility. The mechanism design theory enriches the analytical framework such as how the STAR Market Listing Rules or the Growth Enterprise Market Listing Rules have prominent regulatory characteristics. The incentive-compatible mechanism in the mechanism design theory embodies a mindset of incentives and constraints that is akin to regulatory characteristics (Chen, Wang, 2018). It can also effectively reveal the relationship between information exchange, incentives, and rationality under decentralised resource allocation (Chen, 2020). Few Chinese scholars analyse the regulatory logic of special voting rights from the perspective of the control rights. The regulatory approach for special voting rights focuses on ex-ante regulation to mitigate risks for small/medium shareholders. However, the lukewarm reception of special voting rights in dual-class share structure companies listed on the STAR Market indicates that the current mechanism for special voting rights has not achieved optimal allocation of social resources; instead, it has led to the dilemma of founders listing in the US. Applying the mechanism design theory is of great significance for reconstructing the rules of special voting rights. This theory can help designers create effective mechanisms for information asymmetry. The principle of incentive compatibility should encourage participants to follow the rules and ensure the mechanism stability. Mechanism design theory continuously identifies issues that operate based on the rules. The current system design for special voting rights in China is placed under a static equilibrium analysis framework. However, the mentioned theory focuses on dynamic game evolution processes, especially when it comes to the dual-class share structure firms.

From Static Control to a Dynamic Control Mode. The current regulations on special voting rights have designed the rules for controlling the agency costs of special voting rights in the STAR Market focusing on maintaining an ideal equilibrium. Not only does this fail to incentivise compatibility but also hinders companies with dual-class share structures from listing on the STAR Market, which is detrimental to future control of agency costs. Specifically, a static control model cannot address the diversity and dynamic changes in agency costs, which are a key component of agency costs and are at the core of the special voting rights system. Dynamic changes in agency costs can trigger additional costs, so it is necessary to break the path dependence and focus on changes in agency costs between small and medium shareholders and founders. Since institutional investors have been embedded in the competitive market of incentives, their pursuit of investment returns promotes the improvement of corporate governance (Miao, 2022).

As China's first company to list with a special voting rights structure, UCloud Technology Company has observed the presence of institutional investors such as Legend Boson and Yuanhe Youyun. The relaxation of pre-emptive controls has shifted the focus of regulation to dynamic control during operations. At this point, institutional investors possess more advantages than small and medium shareholders. When more dynamic restrictions are left to the market, institutional investors should take on a role in corporate governance. The development of dual-class shareholding companies cannot do without the institutional investors' support; their interaction helps form a resilient capital market. There is also a need to avoid the blind pursue of efficiency at the expense of investor power. A dynamic balance between relaxing rules and building investor protection is needed largely. Particularly, founders cannot avoid self-interested behaviour. This institutional arrangement is known as incentive compatibility. Thus, loosening pre-regulatory controls and providing founders with full intellectual freedom to create and enhance corporate value is essential. This compensates for the dilution of residual cash distribution rights that founders face due to holding control. Lastly, rule design should shift from static to dynamic control.

From Mandatory to Default Regulations. Mandatory entry regulations have achieved initial success, but they struggle to adapt to the dynamic changes in agency costs. In contrast, default rules can mitigate the effectiveness of mandatory measures, providing founders, small/medium shareholders, and institutional investors channels for smooth negotiation. Such rules alleviate the concerns of rule designers who might "scare off" companies with dual-class share structures planning to list on the STAR Market due to overly stringent rules. Mandatory market capitalisation entry requirements impose a "one-vote veto" on dynamic changes in the market (TaiMei Technology's IPO rejection, 2023). By continuously expanding the space for party autonomy, the conversion can proceed in stages. First, some rules to prevent the separation of control rights and cash flow rights from becoming extreme should be retained. The shareholding ratio of shareholders with special voting rights and ordinary shares should remain unchanged; otherwise, agency costs will increase indefinitely. Second, based on event-based sunset clauses and restrictions on the multiple of special voting rights, these can be adjusted to default rules as the number of listed firms with special voting rights increases. Third, the dilutive sunset clauses can be completed in the first stage and, if market feedback is positive, transformed into default rules.

Changing the Concept and Logic of Information Disclosure System. For companies with a dual-class share structure, information asymmetry directly leads to agency costs between founders and small and medium shareholders, thus the STAR Market imposes stricter requirements on their disclosure of information. With the full implementation of the registration system, more power in assessing company value has been handed over to investors, necessitating vigilance against the "lemon market" (Guo, 2020). Controlling the risk of abuse requires further improvements in the information disclosure system and

enhancing investors' ability to independently identify risks. The special group of Chinese companies listed in the US can broaden our perspective into the American information disclosure system. Facing the diverse regulatory framework of US information disclosure, Chinese companies listed in the US often fail to comply and may even be penalised or delisted. The design of China's special voting rights system is constrained by potential additional regulatory costs during and after transactions. On the premise of improving the quality of ongoing continuous information disclosure, investor confidence will increase. This will break down the information asymmetry between founders, small and medium-sized shareholders, and investors caused by the special voting rights system.

It is essential to clarify the direction and principles of information disclosure. Regulatory authorities should not overly intervene in information that significantly influences investors' value judgments and investment decisions, nor should they make excessive judgments about the corporate equity structure. In practice, there is a number of cases where companies withdraw their listing applications after multiple inquiries regarding the legitimacy of their technological components and the establishment of special voting rights. A "slimming down" of rules is essential to reduce the cost of information disclosure for companies with special voting rights. In addition, there should be a focus on providing detailed disclosure regarding the exercise of special voting rights (Ye, Zhou, 2021). It is necessary to limit the items that need to be disclosed for companies with special voting rights arrangements, mainly disclosing the entities exercising special voting rights. Recently, some regulatory documents issued in China have gradually considered the tendency for information disclosure language to be simple, clear, and easy to understand. However, the STAR Market rules only specify "understandable" lacking specific guidelines. IT should be leveraged to enhance the level of automated information processing, reduce the cost for small and medium shareholders, and for investors to obtain information (Ming, Li, 2021). What is more, while limiting the abuse of special voting rights by founders, it should not affect control over the company. Therefore, the information disclosure should facilitate small and medium shareholders and investors to promptly grasp information related to the company's independence and control (Li, Yang, 2020).

Additionally, the effectiveness of market constraints should be leveraged to achieve an interactive mechanism among multiple entities. In addressing securities disputes, judicial authorities must protect the legitimate interests of listed companies and founders. The ex-post remedies must be utilised to achieve the purpose of supervisory information disclosure. Drawing on practices from the US, individual investment associations should be organized and professionals for training should be hired to enhance investors' awareness of rational investment. Besides, in order to achieve incentive compatibility between corporate value and small/medium shareholders as well as investors, founders need to proactively disclose information.

Incentive Compatibility Mechanism. Independent directors are an imported concept introduced by China to optimise the board structure of listed companies and strengthen internal checks. The securities class action system established by the Securities Law, which came into effect on 1 March 2020, is an important means to protect investors' interests within private enforcement mechanisms. Some scholars advocate abandoning the gatekeeper theory in favour of the head-of-the-evil theory, arguing that it is both fair and incentive-compatible. The independent directors must appropriately exercise their supervisory role, rather than merely serving as "ornaments" or "rubber stamps". Firstly, the selection methods for independent directors should be further detailed in legislation to isolate the relationship between special voting shareholders and independent directors. The Listing Rules explicitly state that when appointing or dismissing independent directors, "the number of votes each special voting share enjoys shall be the same as the number of votes each ordinary share enjoys". Regardless of the hierarchical effectiveness of the

Listing Rules, in a centralised situation within a dual-class share structure company, the right to appoint actually grants it to major shareholders or controlling shareholders. Independent directors need to oversee the shareholders who hold the appointment rights, making their performance predictable (Guo, 2022). Therefore, in order to weaken the influence of special voting shareholders on independent directors, some scholars propose to give the right to nominate independent director candidates to minority shareholders, so as to maintain the independence of independent directors at the source.

Moreover, it is suggested to reset the boundaries of responsibilities for independent directors. Specifically, it is suggested to grant independent directors a certain degree of veto power in operational decisions, but also to ensure that this does not undermine the intended function of special voting rights. Legally, their specific responsibilities should be clearly defined as “reviewing significant matters involving internal conflicts of interest; they should have the right to dissent if the relevant matters are voted on at the shareholders’ meeting with the approval or consent of independent directors”.

Finally, it is necessary to dissolve the false assumption that independent directors are not involved in the interests of the company as “moral persons”. Prominently, there is a need to improve the remuneration of independent directors and establish effective incentive mechanisms. Conversely, it is necessary to adjust the legal liability of independent directors. Hence, the clarity of the legislation can not only incentivise their prudent supervision, but also effectively avoid the risk of accountability.

Conclusions

Employing normative and comparative analysis, this study investigates the application of the special voting rights system and dual-class share structures in Chinese companies and the existing status of related legal texts. The stringent pre-access regulations for the special voting rights system have resulted in concerns such as the overall design deviating from market innovation goals, insufficient incentives restricting the role of independent directors, and information disclosure deficiencies leading to inefficient information utilisation. As a result, these issues obstruct the full mobilisation of continuous innovation enthusiasm in tech-driven enterprises, thereby, adversely affecting the modernisation of Chinese capital markets in the long-run. To resolve these problems, mechanism design theory should be introduced to transform the regulatory model of the special voting rights system, rebuilding it with an incentive-focused approach while moderately relaxing pre-access controls.

This study has presented several implications. The institutional design of Chinese special voting rights is not only constrained by path dependence but also placed under a static equilibrium analysis framework. Consequently, this tilts the rule design towards protecting minority shareholders, neglecting the protection for entrepreneurs and innovative incentives, which, to a certain extent, impedes the formation and operation of a more efficient economic order. Nevertheless, mechanism design theory stresses on dynamic game evolution processes, closely aligning with economic realities, offering novel analytical methods to resolve the agency costs and institutional cooling concerns related to special voting rights. Based on the three elements of mechanism design theory, a re-structuring of the special voting rights system indicates that deficiencies in information disclosure result in inefficient information utilisation; insufficient incentives restrict the performance of independent directors. Therefore, the regulatory philosophy of Chinese special voting rights system should be adjusted to shift from “constraint” to “incentive”, further transforming the control model of the special voting rights. Particularly, pre-emptive regulatory measures should be moderately relaxed to unleash market vitality. By increasing information disclosure and implementing incentive compatibility mechanisms, functions of independent directors can be fully leveraged, transparency and support from small and medium shareholders increased, supervision

and constraints on management strengthened, the risk of founders seeking personal gains prevented, and agency costs triggered by information asymmetry reduced. As the US experience explicitly exhibits, moderately relaxing listing standards does not mean insufficient protection for small/medium shareholders. The incentive compatibility mechanism can seek the greatest common divisor in rule design, creating a balanced regulatory environment, allowing founders to seek their own interests while also assuming those of small/medium shareholders, thereby optimising the profitability of dual-class shareholding companies.

There are certain limitations of the study that need to be addressed. In future studies, researchers need to expand on the content and perspectives of investigating special voting rights system of China. This study mainly proposes optimisation strategies for China's special voting rights system in the context of changing pre-access rules, but the content and research angles of the special voting rights system are not merely confined to pre-access rules. The regulation of special voting rights also involves mid-process control mechanisms and post-event safeguard measures, and issues related to the possible exit problems after and during the implementation of the special voting rights system. Thus, this study acknowledges that further examination of post-event safeguards, mid-process controls, and exit mechanism constitute potential avenues for future studies.

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SPECIALIŲ BALSAVIMO TEISIŲ OPTIMIZAVIMAS DVIEJŲ KLASIŲ AKCIJŲ STRUKTŪROS ĮMONĖSE: KINIJOS ĮMONIŲ VALDYMO PERSPEKTYVA

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Santrauka. Kinija įvedė išankstinio leidimo sistemą įmonėms, turinčioms dviejų klasių akcijų struktūrą ir taikančioms specialias balsavimo teises. Dėl pernelyg griežto leidimų išdavimo proceso vis mažiau įmonių renkasi specialių balsavimo teisių sistemą. Šiame straipsnyje analizuojamas specialių balsavimo teisių sistemos ir dviejų klasių akcijų struktūros taikymas Kinijos įmonėse, taip pat nagrinėjamas susijusių teisės aktų statusas. Atlikus normatyvinę ir lyginamąją analizę nustatyta, kad griežti išankstinio leidimo reikalavimai specialių balsavimo teisių sistemai sukėlė įvairių sunkumų – nukrypimą nuo rinkos inovacijų tikslų, informacijos viešinimo spragas, dėl kurių informacija naudojama neefektyviai, bei nepakankamas paskatas, ribojančias nepriklausomų direktorių vaidmenį. Tai trukdo visapusiškai skatinti nuolatinį technologijų įmonių inovacijų siekį ir ilginiui neigiamai veikia Kinijos kapitalo rinkų modernizaciją. Siekiant išspręsti šias problemas reikėtų įdiegti mechanizmų kūrimo teoriją ir pertvarkyti specialių balsavimo teisių sistemos reguliavimo modelį. Jis galėtų būti pertvarkytas pagal paskatų principą ir šiek tiek sušvelninti prieigos kontrolės reikalavimus. Taikant tokias priemones kaip paskatų suderinamumas, informacijos viešinimo gerinimas, nepriklausomų direktorių funkcijų optimizavimas ir teisinių priemonių tobulinimas, galima sukurti darnią reguliavimo aplinką, įtvirtinti pusiausvyrą tarp inovacijų plėtros ir smulkiųjų akcininkų interesų apsaugos.

Reikšminiai žodžiai: dviejų klasių akcijų struktūra; specialios balsavimo teisės; mechanizmų kūrimo teorija; veiklos išlaidos; paskatų suderinamumas.