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Determinants of Voluntary Delisting In China: A Conceptual Study

Mohd Rashdan Sallehuddin[1], Zhang Xiao Mei[2], Rosli Mohd Saad[3]
[1]*(School of Business Management, Universiti Utara Malaysia, Kedah, Malaysia)*
[2]*(Guizhou University, Guiyang, China)*
[3]*(School of Business Management, Universiti Utara Malaysia, Kedah, Malaysia)*

ABSTRACT: *In recent years, the number of delisting shows dramatically increased in the world particularly in China. This study will discuss on delisting focus in the context of China's New Third Board Market (NTBM). Furthermore, the delisted firms in China's New Third Board Market (NTBM) shows dramatically increased. Moreover, this research is to make propositional statements and propose a framework to be tested empirically in future studies. Based on agency theory, we proposed that there will be positive relationship among board size, board independence, CEO duality and institutional ownership which in turn will positively predict voluntary delisting. The results of the study could strengthen the confidence of investors by examining the corporate governance of firm delist from the NTBM and help them to choose the right firm. This study could assist the management of firms in enhancing the corporate governance as well as improve their capabilities to achieve sustainable and superior performance over their competitors. This paper extends research on voluntary delisting by proposing a model which needs to be tested empirically.*

KEYWORDS: *voluntary delisting, corporate governance, agency theory, NTBM, China.*

I. INTRODUCTION

Delisting is defined as the firm exit from the stock market where it previously listed (Martinez & Serve, 2017). In recent years, the number of delisting shows dramatically increased in the world. According to the report, there are 21280 listed firms delisted from stock markets all over the world from 2007 to October 2018, which has exceeded the number of IPO (16299) in the same period. Current studies have pointed out that delisting is one of the strategic decisions during the company's life cycle (Vismara & Signori, 2014). However, large-scale delisting's can result in depression sentiment in the stock market (Liu & Liu, 2017). To date, the GDP of China has remained the second largest economy in the world and contributes to 15% in the world economy .China's capital market is also the second biggest capital market in the world, playing a pivotal role in economic development (Zhu, 2018). China's NTBM, the official name is National Equities Exchange and Quotations (NEEQ), is an over–the-counter (OTC) market. It is a central foundation of China's multi-level capital markets (Chen& Gu, 2017). A stable multi-level capital market needs a complete OTC market supporting (Wu & Jin, 2017). China's OTC market began to develop after the government of China explicitly set forth the necessity of the development of the multi-level capital market for the first time in the Third Plenary session of the 16th CPC Central Committee (Yang, 2017). After ten years development, in 2013, the completed establishment of NTBM represented China's multi-level capital market was basically formed (Li, Meng, & Wei, 2015).

The NTBM is endowed the historical task for providing financing services to Small-medium enterprises (SMEs) and capital market access for innovative and entrepreneurial enterprises (Yang, 2017). Thus, the market plays a pivotal role in China's capital market by providing a direct-financing channel for SMEs and helping SMEs to address their financing difficulties (Li et al., 2015). Researchers have found that firms listed in NTBM can have these opportunities: (1) Firms listed on the NTBM can raise not only from the NTBM but also improve ability of funding in traditional financing channels by increasing credit grade through going public (Li et al., 2015; Xuan, 2016). (2) The company has to enhance the governance structure and management system to satisfy the requirements established by the stock market, which will improve corporate governance of the company and increase its firm value (Li, 2007). (3) Compare to firms unlisted on the NTBM, firms listed on this market are easier to list on main board markets because of their better corporate governance and reputation (Yan & Tao, 2014). Therefore, the NTBM has attracted a large number of companies to list. Detailed data are listed in Table 1.

Table 1

The development of the New Third Board Market

Year	2012	2013	2014	2015	2016	2017	2018
Number of listed firms	200	356	1572	5129	10163	11630	10691
Total Equity(RMBmillions share)	55.27	97.17	658.35	2959.51	5851.55	6756.73	6324.53

Data Sources: NEEQ. http://www.neeq.com.cn/

Table 1 shows that the number of listings was only 200 in 2012, and after 2013, the number of listings rapidly increase from 356 in 2013 to 11630 in 2017. The total equity of the NTBM also shows the rapid growth trend; the total equity increased from RMB55.27 million in 2012 to RMB 6756.73 million in 2017. However, this kind of growth trend is stopped in 2018, the number of listed firms fell to 10691, about 900 less than in 2017 (11630). The total equity also decreased from RMB 6756.73million in 2017 to RMB 6324.53million in 2018.

Although, previous studies analyzed delisting determinants from different aspects: firm characteristics, corporate governance, culture distance and offering features etc. (Chaplinsky & Ramchand, 2012; Füss, Hommel, & Plagge, 2016; Konno, Itoh, Konno, & Itoh, 2018; Martinez & Serve, 2011; Pour, 2015; Pour & Lasfer, 2013), but the determinants for voluntary delisting remain unclearly (Pour & Lasfer, 2013). Additionally, up to now, most of previous studies have investigated voluntary delisting phenomenon in the context of developed countries, there has been little discussion about this topic in China's NTBM (Zhang, 2015). Therefore, the aim of this study is to explore the determinants of voluntary delisting in the NTBM of China.

II. LITERATURE REVIEW

Structure of China's Capital Market

China's State Council for the first time explicitly proposed the establishment of multi-level capital market to meet the financing needs of different enterprises in 2004 (China's State Council, 2004). China's capital market has formed three main parts: the Main Board Markets (MBM), Growth Enterprise Market (GEM) and the NTBM after more than ten years of construction. The MBM is traded by active competitive bidding and has stringent rules on listing requirements, maintains requirements and disclosures requirements. Shanghai Stock Exchange (SHSE) and Shenzhen Stock Exchange (SZSE) belong to China's MBM, both of which are set up in 1990 and early 1991, respectively, and provide service for large enterprises only (Li, Meng, & Wei, 2015). In the established year of SHSE and SZSE, the listed companies were 8 and 10, respectively. After more than twenty years of development, in 2018, the listed companies in SHSE and SZSE were 1450 and 2134, respectively. The firm seeking an IPO must obtain approval from the corresponding market regulatory authority (CSRC). The admission requirement on the MBM of China is similar stringent to the requirements on the LSE (UK) and NASDAQ (US).

In 2004, the Small and Medium-sized Enterprise Board Market (SMEBM) was established within the SZSE to meet the financing requirement of small-medium enterprises. The listing and information disclosures requirements, the maintain laws and regulations of the SMEBM are same with the SHSE and SZSE except for small stock size and unique transaction and monitoring mechanisms. Actually, SMEBM also is a component of China's Main Board Markets and can be seen as experimentation of Growth Enterprise Market (GEM).

The New Third Board Market

China's National Equities Exchange and Quotations (NEEQ), a Chinese nationwide Over-the-Counter market, is established in 2006. NEEQ is called as New Third Board Market (NTBM). The requirements of the NTBM are looser than other stock markets, such as the MBM, the GEM. The National Equities Exchange and Quotations Co, Ltd. are responsible for NTBM's operation and management (CSRC, 2013a). In 2006, to provide another source of funds raising of start-up firms in Zhongguancun, Pilot Project of Zhongguancun Private Company Share was launched. At the beginning of 2011, the NTBM finished the previous design of regulations and rules. At September 2012, the National Equities Exchange and Quotations System Co., Ltd

(NEEQ Co., Ltd) was set up, which demonstrates the official existence of the NTBM (Li & Qiao, 2016). NEEQ Co., Ltd supervises and provides service to listing firms and other participants, such as lead securities trader. The NTBM provides a highly efficient financing platform for SMEs during their early life. It also provides investment opportunities to institutions and individuals with investment willingness and capacity (Li et al., 2015; Li & Qiao, 2016).

Overview of the Delisting

The choice to go public has achieved many researchers attention. This choice can give rise to many benefits, such as improve financing ability; strengthen corporate governance; reduce capital cost and information asymmetry; broaden the reputation of product and expansion its financial visibility (Boers, Ljungkvist, Brunninge, & Nordqvist, 2017; Bortolon & Junior, 2015; Kalak, Azevedo, & Tunaru, 2018). Kalak et al (2018) purported that the decision that a firm listed on an exchange represents that management of a firm has the confidence in operating well under the stringent regulations and public surveillance. However, Cai, Lee & Valero (2018) thought the goal of the listing choice is to re-balance leverage. Overall, previous researchers conducted a lot of research on going public themes. However, only few empirical articles focus on the reverse transaction: delisting (Ehn, 2016). This study is focusing on the determinants of the voluntary delisting decision in the context of China's NTBM. Before doing further study, it is necessary to ascertain the definition and classification of voluntary delisting.

Delisting can be distinguished into different types in terms with different standards. In accordance with wishes of initiators, delisting can be distinguished into passive delisting and active delisting (Zhou, 2017). Passive delisting means the listed company cannot satisfy the listing standards required by the regulator and stop the listing. Active delisting means the listed company actively apply for delisting to achieve maximum benefits (Zhou, 2017). They were the first to differentiate between delisting involuntarily and voluntarily. The distinction between involuntary delisting and voluntary delisting is the difference between initiator. Involuntary delisting means the firm is forced to exit from stock exchange because it cannot meet the regulatory requirements or has broken regulations. Voluntary delisting refers to the decision of delisting for a firm is decided by itself (Martinez & Serve, 2017).

Corporate Governance in China

Since the Reform and Opening-up after 1978, China began to implement the market economy. China has adopted a set of corporate governance mechanisms to enhance monitoring, and encourage employees to be active and enthusiasm in work to increase firm performance (Mutlu, Van Essen, Peng, Saleh, & Duran, 2018). However, researchers also found that it needs to invoke an institutional-based view to better comprehend the contexture feature of corporate governance issues (Aguilera, Marano, & Haxhi, 2019; Meyer & Peng, 2016). China is a principal context that can advance a dynamical institution-based viewpoint of corporate governance (Mutlu et al., 2018). Generally, after more than fifteen years in the development of corporate governance, the level of corporate governance of companies in China shows steady improvement. "A report on listed companies' Governance Index in China" published by Gao Minghua, follow the international standards of corporate governance. The index includes six sub-indices: Financial Governance Index, Rights Protection Index for minority investors, Executive Compensation Index, Board Governance Index, Capacity index of Enterpriser, and Voluntary Information Disclosure Index. The report shows that Rights Protection Index for minority investors in Chinese listed companies continue to increase in recent four years, from 43.07 in the year 2014 to 52.40 in the year 2017; Board Governance Index and Financial Governance Index show steadily light increase in past three years, separately rise from 50.13(52.79) in the year 2015 to 51.41(53.67) in the year 2017.

The corporate governance code of firms listed on the NTBM emphasizes the protection of the minority investors 'rights and regulates the norms related to takeover and M&A. The code highlights that no organizations or individual can harm the legitimate rights as interests of public companies and their shareholders by takeover or M&A. This code also regulates the norms of stock transfer, directional issuance and information disclosure (NEEQ, 2013). It can be seen from the above discussion, China's government tries its best to establish standard corporate governance to govern companies well and the level of corporate governance achieve a distinct improvement. The NTBM regulates and highlights the additional and special norms related to the special business in this stock market, such as the norms related to stock transfer and takeover. However, the effects of corporate governance in China still exists debate because of the significant difference of the institutional among China and the developed countries (Mutlu et al., 2018; Tsui, 2007).

To ascertain the correlation between corporate governance and voluntary delisting, Moreira et al. (2017) suggested that future studies need to consider the impacts of all corporate governance mechanisms in reducing agency costs and delisting transactions. However, not all indicators of measured corporate governance are essential (Kalyani, Mathur & Gupta, 2018). The monitoring and incentive mechanisms have the relationship with voluntary delisting (Bortolon & Junior, 2015; Tutino, Panetta & Laghi, 2013).

Board Size and Voluntary Delisting

The board size can significantly affect firm's abilities and efficiency of a board's decision-making (Im & Chung, 2017). Previous studies have posited that the board size is not a significant determinant when explaining delisting due to takeover and acquisition (Du, He & Yues, 2013; Sudarsanam, Wright & Huang, 2011). And other researchers found that this relationship is positive (Fidanza, Moressi & Pezzi, 2018b). Furthermore, previous studies failed to find the connection between IPO failure and board size (Djerbi & Anis, 2015). Others stated that the correlations between board size and the probability of survival show nonlinearity shape (Chancharat, Krishnamurti & Tian, 2012).

In summary, previous studies about the correlations of board size and voluntary delisting have no consistency results. Therefore, this study intends to discuss further this relationship. According to the agency theory, large board size can cause higher agency costs that can affect the effectiveness of corporate governance (Beiner, Drobetz, Schmid, & Zimmermann, 2004; Dwivedi & Jain, 2005; Fama & Jensen, 1983; John & Senbet, 1998). The effectiveness of corporate governance can affect the probability of voluntary delisting (Bortolon & Junior, 2015). Thus, the hypothesis of this study is developed as:

Proposition 1**:** *Board size will have a significant correlation on voluntary delisting*

Board Independence and Voluntary Delisting

Board composition has been viewed as an important factor that affected board efficiency (Lorsch & MacIver, 1989). However, previous studies about the results of the effects of insider- and outsider directors on corporate strategy are mixed. Boards with more independent directors are more willing to initiate strategic changes (Johnson, Hoskisson, & Hitt, 1993; Pearce & Zahra, 1992). An alternative perspective pointed out that insider directors can provide better strategic direction by given more knowledge about the firm (Bruni-Bossio & Sheehan, 2013; Muth & Donaldson, 1998; Valenti & Schneider, 2014).

Valenti and Schneider (2014) compared the effects of insider directors on going private transactions between the period of 2008-2011 and 2003-2007 and found that insider percentage on the board had a positive impact on going private transaction in the later period but no impact in the early period. Hostak, Yang & Carr (2013) found that firm delisted from LSE Main market has a higher proportion of independent directors than those did not delist.

In addition, prior researchers have found that board independence is positively connected with the probability of organization survival, but the link is nonlinearity (Chancharat et al., 2012). Other researchers shown that outsider directors can positively affect the probability of survival of reverse mergers in three years (Kim, Lee, Lee, Park & Jambal, 2015). Djerbi and Anis (2015) pointed out that the proportion of independent directors is negatively correlated with post IPO failure risk, which supports the view that external directors can better supervise the management.

In summary, previous studies cannot draw the consistency conclusion about the effects of board independence and voluntary delisting and survival probability. Therefore, the current study wants to do further study about the correlation between board independence and voluntary delisting in the context of China's NTBM. Therefore, this study proposes the following hypothesis:

Proposition 2: Board Independence will have a significant correlation on voluntary delisting.

CEO Duality and Voluntary Delisting

According to the agency theory, CEO duality can result in the agency conflicts between stockholders and managers. Thus, previous researchers suggested that the chairperson and CEO must be a different person (Fama & Jensen, 1983; Jensen, 1993). In the previous research theme related to delisting, previous studies found that CEO duality increases the probability of firm delisting (Djerbi & Anis, 2015; Liu, Lister & Phang, 2013). However, Sudarsanam et al. (2011) noted that the connection between CEO duality and going private is insignificant. In addition, Chancharat et al. (2012) have found that the duality of CEO and the independence of board chairman did not impact the new economy IPO firms' survival. Besides, prior researchers examined the correlations of CEO duality with IPO survival. Bach and Smith (2007) indicated that CEO duality has structural power and upgrades the survival likelihood of high-tech companies. However, other researcher found that the firm with CEO duality is less likely to survive (Pour, 2015). Therefore, the correlation between CEO duality and voluntary delisting still remain incongruent, the present study will ascertain this relationship and enrich the voluntary delisting literature and proposes the following hypothesis:

Proposition 3: There is a significant relationship between CEO duality and voluntary delisting.

Institutional Ownership and Voluntary Delisting

Moon (2006) purposes that private equity investors can provide more efficient monitoring and affect firm delisting decision. Private equity investors are like to seek out board representation to monitor the firm's decisions as strategic partners. Maug (1998) purported that whether institutional investors fulfill their responsibilities to affect corporate decisions is partially depending on the percentage of the share held by them. Firms with low institutional ownership mean firm's monitoring are weak (Cornett, Marcus, Saunders & Tehranian, 2007), and in such corporations, delisting could keep the interests of managers in line with shareholders. Therefore, previous articles suggested that institutional ownership could reduce the probability of voluntary delisting decision because larger institutional ownership means strong monitoring which can protect minority shareholders and prevent managers making voluntary delisting (Bharath & Dittmar, 2010; Mehran & Peristiani, 2010). Whereas, other researchers pointed out that institutional ownership positively affect voluntary delisting (Cumming, Peter, Sannajust, Tarsalewska, 2016; De & Jindra, 2012; Weir, Charlie, Wright & Laing, 2003).

Besides, previous studies found that the correlation between institutional ownership and going private probability is significantly positive (Cumming et al., 2016). However, Rath & Rashid (2016) examined that the percentage of institutional holding has a negative impact on private equity transactions probability because of the effects of their control and information production (Bharath & Dittmar, 2010; Martinez & Serve, 2011; Mehran & Peristiani, 2010; Sudarsanam et al., 2011; Wilson & Wright, 2009). Furthermore, in the going private tender offer, institutional presence can increase the probability of offer rejection, but the percentage of institutional holding only has insignificant impact on the probability of offer rejection (Bajo et al., 2013; Lauterbach & Mugerman, 2018).

To summarize, previous studies did not draw the consistent conclusion of the correlation between institutional ownership and voluntary delisting. As indicated by the agency theory, institutional ownership can affect firm's strategic decision by monitoring (Jensen & Meckling, 1976), and protect minority shareholders, that will reduce the probabilities of firms making going private decision (Bharath & Dittmar, 2010; Lauterbach & Mugerman, 2018; Rath & Rashid, 2016). However, other researchers pointed out that institutional ownership can promote firm making voluntary delisting (Cumming et al., 2016; Weir, Laing, & Wright, 2005). Therefore, the study aims to ascertain the role of institutional ownership in voluntary delisting decision. Accordingly, this study proposes the following hypothesis:

Proposition 4: There is a significant relationship between institutional ownership and voluntary delisting.

Agency Theory

Agency theory is one of the dominant theories in corporate governance research (Bendickson, Muldoon, Liguori, & Davis, 2016; Cuomo, Mallin, & Zattoni, 2016) and cannot be ignored while discussing voluntary delisting. Although some theorist purposed to take advantage of other approaches to conduct voluntary delisting research (Baluja, 2018; Kalak et al., 2018). But agency theory was still the focus of the majority of previous studies (Daugherty & Georgieva, 2011; Djama, Martines & Serve, 2012; Martinez & Serve, 2011; Moreira et al., 2017; Pour & Lasfer, 2013). This theory is stated by Berle & Means (1932) who purported that the base of this theory is the hypothesis of the concept of the separation of ownership and control in modern corporations (Tulung & Ramdani, 2018). In 1976, Jensen and Meckling issued this theory by defining the agency costs and examined its relationship to the "separation and control" problem (Jensen & Meckling, 1976; Yan, 2006). They defined "an agency relationship as a contract under which one or more person (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent"(Jensen & Meckling, 1976). They argued that there exist interests' conflicts between the different contracting parties, including debt holders, the corporate managers and the shareholders. The purpose of agency theory is to regulate the best contract to manage the relationship between principal and agency (Eisenhardt , 1989; Yahya, 2017).

According to the agency theory, delisting can reduce agency conflicts related to cash flow between managers and shareholders (Jensen, 1986). Good corporate governance can alleviate agency conflicts and then improve firm performance (Hussain, Rigoni & Orij, 2018; Jiraporn & Nimmanunta, 2018; Singh & Gaur, 2009). Therefore, corporate governance might have an effect on voluntary delisting. Previous studies have investigated the correlations of many corporate governance mechanisms, for instance, institutional ownership, ownership concentration, insider ownership, etc., with voluntary delisting decisions (Djama, Martinez, & Serve, 2012; Kang & Korea, 2017). However, the results are inconsistent. In summary, as the famous organization theory, agency theory plays a pivotal role in corporate governance research (Cuomo et al., 2016). However, some researchers pointed out that agency theory might be narrow or invalid in corporate governance research

(Aguilera, Florackis, & Kim, 2015; Aguilera & Jackson, 2003; Davis, Schoorman & Donaldson, 1997). Thus, it is warranted to do research by integrating agency theory and other theories (Aguilera et al., 2015; Cuomo et al., 2016). Therefore, this study intends to integrate agency theory to research the determinants of voluntary delisting and the mechanisms of theses determinants affecting voluntary delisting decision.

Proposed Research Framework

Based on the theoretical background and proposition statements made in the preceding section, a proposed research framework is presented in following Figure 1 to depict the basic assumptions that guide this study

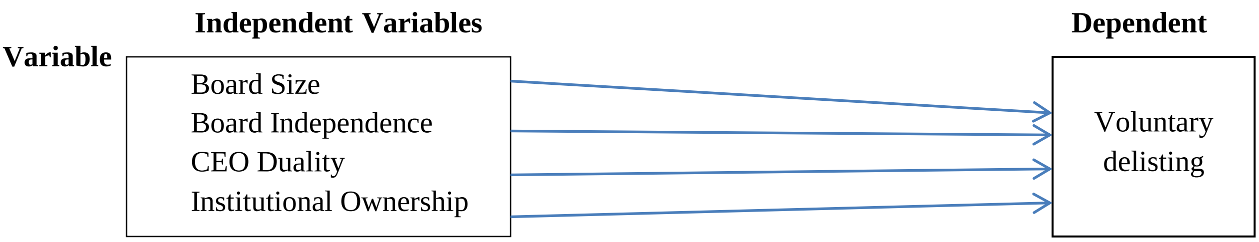

Figure 1: Research Framework

III. METHODS

This article is conceptual in nature because it serves as proposal for empirical investigation. Hence, the researchers reviewed extant literature obtained from scholarly data bases.

IV. CONCLUSION

It is important to note that the proposed research framework seeks to add to the stock of knowledge by integrating agency theory to investigate the relationship between board size, board independence, CEO duality and institutional ownership and voluntary delisting decision. Moreover this study fills the gap by extending voluntary delisting literature to the sample of firm exiting voluntarily from the NTBM in a non-western context of China. To date, lots of previous studies primarily conducted research in developed countries; the research on the determinants of voluntary delisting in the NTBM of China is underdeveloped. Thus, by the time this proposed research framework is tested empirically, it would not only deepen insights into integrating corporate governance building process, but would enhance the understanding of voluntary delisting, as well as provide a wider applicability of agency theory.

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