Tunneling, Propping and Expropriation
Evidence from Connected Party Transactions in Hong Kong

Yan-leung Cheung
City University of Hong Kong

P. Raghavendra Rau
Purdue University

and

Aris Stouraitis
City University of Hong Kong

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Summary

We examine a sample of 328 filings of "connected transactions" between Hong Kong listed companies and their controlling shareholders during 1998-2000. We address three questions: What types of connected transactions are likely to lead to expropriation of minority shareholders? Which firms are more likely to expropriate? Does the market anticipate the expropriation? On average, firms earn significant negative excess returns both around the initial announcement of the connected transactions (from −2.5 percent for firms making cash payments to directors to −5.9 percent for firms selling equity stakes to their controlling shareholders) and during the 12-month period following the announcement (from −7.2 percent for firms acquiring assets from their substantial shareholders to −21.9 percent for firms selling assets to them). Excess returns are significantly negatively related to percentage ownership by the controlling shareholder. They are also significantly negatively related to proxies for information disclosure. The likelihood of undertaking connected transactions is higher for firms whose ultimate owners can be traced to mainland China. Finally, we find limited evidence that the market anticipates the expropriation by discounting firms that undertake connected transactions.