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RESEARCH ARTICLE

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The cross holding of company shares
—A preliminary legal study of Japan and China

Abstract Cross shareholding is a practice whereby pairs of companies exchange holding of shares. It is vitally important to recognize that cross shareholding has both positive and negative effects, the latter of which demand particular scrutiny. This article tries to suggest a possible framework for the regulation of cross shareholding in China, by mainly applying lessons and implications from the experiences of Japan, where cross-holding has contributed to the spike and collapse of its economy. Currency appreciation, accounting rules changes and capital market restructuring are putting China in the similar shoes. Targeting at different situations, hereby a spectrum of rules has been proposed.

Keywords cross-holding, company capital structure, corporate governance, capital market, parent-subsidiary conglomerate

摘要 交叉持股是指两家以上公司基于特定目的、相互持有对方发行的股份从而形成彼此投资，其对于公司治理、资本结构等会产生正、反两方面的影响，后者尤其值得关注。交叉持股在日本最为普遍，在该国经济社会发展变迁中作用突出、教训深刻，而本币升值、会计政策调整、资本市场变化等因素也将推动其在中国的应用。通过剖析日本交叉持股的经验教训，可针对不同情况为中国法律规范交叉持股提供一项框架性建议。

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关键词 交叉持股，公司资本制度，公司治理，资本市场，母子公司

In conjunction with the State Owned Enterprise ("SOE") reform in China, shares of former SOE's have been re-allocated from the State to private enterprises and individuals, resulting in a diversification of shareholders and an emerging takeover market. In recent years, the cross shareholding between companies, particularly listed companies, has become common and drawn increasing attention. In Japan, however, cross shareholding has long been used to deter hostile takeover and strengthen the relationship between enterprises. Despite its benefits, cross shareholding has also been criticized for its unfavorable effects, such as poor performance, distorted corporate governance and emasculation of capital. After the Japanese economy bubble burst in the early 1990s, Japan began to restructure its corporate governance system and part of this restructuring involved unwinding the traditional cross shareholding scheme. Nevertheless, in recent years, there have been reports of a renaissance of cross shareholding in Japan. Largely based on the experience of Japan, this paper examines the pros and cons of cross shareholding in the context of China and proposes a possible framework of legal restrictions.

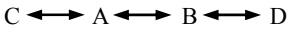
1 Introduction

Cross shareholding (CS)[1] is a practice whereby pairs of firms exchange shares with one another. This practice has been carried out, for instance, as a way to strengthen the relationship between companies or sometimes banks. Besides Bank-Affiliated Cross Shareholding ("BACS"), cross shareholding can also be divided into two categories: (1) Cross shareholding between members of a corporate conglomerate group (Vertical CS), and (2) cross shareholding which reflects business relationships outsides a conglomerate such as between suppliers and customers (Horizontal CS). (Scher, 2001)

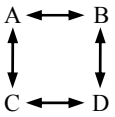
The different structures of cross shareholding can also be illustrated graphically as the following six categories. (Shen, 2004)

1. Simple type

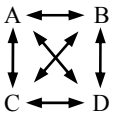
2. Straight type



3. Circulation type

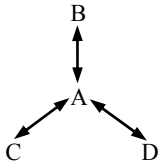


4. Web type

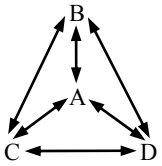


[1] It is also referred to as mutual shareholding, reciprocal shareholding, inter-corporate shareholding, interlocking shareholding, etc.

5. Radiation type



6. Moditied radiation type



Historically, cross shareholding has been developed in numerous countries, including Germany and Japan. For instance, in Japan, one traditional type of cross shareholding after World War II is usually referred to as the "Japanese Main Bank System," and another type can be described as the cross ownership between companies and non-bank companies, which has been gaining increasing popularity in the country. On the other hand, in countries such as the United States and United Kingdom, cross shareholding has not been typically used to strengthen the relationship between companies or for any other purposes.

Generally speaking, there are numerous benefits and disadvantages of cross shareholding. With regard to the pros, (1) cross shareholding can strengthen and stabilize the relationship between business entities, which can lead to a decrease in trading costs; (2) it can be effective in warding off the danger of hostile takeovers and help cultivate a long term strategy for the company; (3) it can provide a stable source of funding for businesses by ensuring that the partners will be stable investors (Scher, 2001); and (4) it allows the company to reach a higher share price with less dividend distribution, which in turn allows the company to raise more money in secondary offerings or secure an advantage in share swap takeovers.

With regard to the cons, (1) cross shareholding can overinflate or multi-count the capital and endanger the outsiders such as the company's creditors;[2] (2) it can damage and even defraud existing shareholders since cross shareholding represents an offsetting exchange of stock between companies, in most cases entailing no injection of new outside capital (Scher, 2001); (3) it creates problems concerning corporate governance, such as minority shareholders' impotence in checking the company's management, which fosters insider control as a result; and (4) it can have negative effects on the capital market. To further expand on this fourth disadvantage, because shares crossly held of a company are rarely traded on the stock exchange, the effective market in each company's stock is restricted to a fraction of the firm's outstanding shares. Thus, speculators can manipulate the market price more easily, which would tend to discourage

[2] Pushing this situation to an extreme, suppose Company A holds 100% of Company B's shares, and vice versa. In this case, each company can have nothing except the paper certificates for shares of the other.

outside investors.

Empirical studies reveal that the way in which companies hold their own and other companies' shares reflects the way in which they realize their corporate governance as well as their country's industrial structure, financial system and employment system. (Okabe, 2002) Therefore, in order to understand how cross shareholding works in a certain country, it is crucial to investigate not only how the companies hold their shares but also the nature of their country's abovementioned systems. With these goals in mind, this paper will then explore the origin, evolution, and current development of cross shareholding in Japan.

2 Cross shareholding in Japan: Rise and downfall

Japan realized miraculous economic growth from the 1950s to 1970s. One important characteristic in those periods was the "long term relationship between business entities", often referred to as "*keiretsu*," or "affiliated relationship." Moreover, the so-called "main bank system" in which companies have close relationships with a specific bank was also one of the fundamental characteristics of the Japanese economic miracle. The practice of cross shareholding was a cornerstone to the creation of both the *keiretsu* and the main bank system in Japan after the Second World War. See Table 1.

Table 1 Six major postwar *keiretsu*

Name	Bank	Major group companies
Mitsubishi	Mitsubishi Bank (until 1996) Bank of Tokyo-Mitsubishi (1996–2005) Bank of Tokyo-Mitsubishi UFJ (2006–)	Mitsubishi Corporation, Kirin Brewery, Mitsubishi Electric, Mitsubishi Fuso, Mitsubishi Motors, Nippon Yusen, Nippon Oil, Tokio Marine and Fire Insurance, Nikon, Mitsubishi Chemical, Mitsubishi Estate, Mitsubishi Heavy Industries, Mitsubishi Rayon Co., Ltd., Mitsubishi Materials Corp., Mitsubishi Paper Mills Ltd., Pacific Consultants International Ltd.
Mitsui	Mitsui Bank (until 1990) Sakura Bank (1990–2001) Sumitomo Mitsui Bank (2001–)	Fuji Photo Film, Mitsui Real Estate, Mitsukoshi, Suntory, Toshiba, Toyota
Sumitomo	Sumitomo Bank (until 2001) Sumitomo Mitsui Bank (2001–)	Asahi Breweries, Hanshin Railway, Keihan Railway, Mazda, Nankai Railway, NEC, Nippon Koei, Sumitomo Real Estate

(*To be continued*)

(*Continued*)

Name	Bank	Major group companies
Fuyo	Fuji Bank (until 2000) Mizuho Bank (2000–)	Canon, Hitachi, Marubeni, Matsuya, Nissan, Ricoh, Tobu Railway, Yamaha
Dai-Ichi Kangyo	Dai-Ichi Kangyo Bank (until 2000) Mizuho Bank (2000–)	Fujitsu, Hitachi, Isuzu, Itochu, Tokyo Electric Power
Sanwa ("Midorikai")	Sanwa Bank (until 2002) UFJ Bank (2002–2006) Bank of Tokyo-Mitsubishi UFJ (2006–)	Hankyu Railway, Keisei Railway, Kobe Steel, Konica Minolta, Kyocera, Orix, Shin-Maywa, Takashimaya

3 History of cross shareholding in Japan

The following sections explain how cross shareholding came to be accepted by companies and became so common in Japan. (Yoshikawa, 2005)

3.1 Birth of cross shareholding (1950s—1960s)

In the post-war period, cross shareholding had grown out of the dissolution of the Japanese industrial conglomerates, or "*zaibatsu*." The *zaibatsu* were holding companies which held shares in controlled companies. After the Second World War, the General Head Quarters ("GHQ") dissolved *zaibatsu* for the purpose of diversifying shareholders. As a result, the ratio of individual shareholders dramatically increased. However, it was not easy for such individuals to continue holding their shares since the economy at that time was quite unstable and the individual shareholders were vulnerable to economic loss. Soon these individual shareholders began selling their shares. In 1953, the Japanese Anti-Monopoly Act was revised, which allowed companies to invest in stocks of other companies. Under such circumstances, the former *zaibatsu* groups such as Sumitomo, Mitsui, and Mitsubishi resumed collecting shares in the market and reorganized the dissolved affiliated groups by way of cross shareholding in the group companies, leading to the creation of the *keiretsu* system. (Miwa, Ramseyer, 2002) This marked the birth of cross shareholding in Japan in the post-war period.

3.2 Rapid growth of cross shareholding (1960s—1970s)

The rapid growth of cross shareholding was precipitated by the collapse of share prices in the early 1960s. In order to boost the Japanese security market, two special organizations were set up by the government: The Japan Cooperative Securities Co. and Japan Securities Holding Association. These organizations

tried to buy shares in the market and afterwards sold them to affiliated companies and banks. This practice led to an increase in cross shareholding. Also, Japan's accession to the Organization for Economic Cooperation and Development ("OECD") caused gradual deregulation of Japanese capital markets. As a result, the possibility of hostile takeovers by foreign entities increased. Facing such circumstances, Japanese companies tried to guard against the danger of hostile takeover by way of cross shareholding with other companies such as *keiretsu* companies and main banks. (Miyashita, Russell, 1994; Gilson, Roe, 1993)

3.3 Peak of cross shareholding and bubble economy (1970s—1980s)

After the first oil shock in 1973, equity finance became more and more common and was supported by the purchase of shares by banks. As a result, the ratio of shareholding by financial institutions dramatically increased. (Aoki, Patrick, 1994) At the same time, banks themselves tried to issue their own new stocks, thereby creating even more cross shareholding.

3.4 Gradual unwinding of cross shareholding (1990s—Present)

After the burst of the bubble economy in Japan during the early 1990s, the stock prices dropped, which ignited the selling of shares by companies. This soon led to a decrease in the ratio of cross shareholding by companies. There was a large sell-off of shares by companies in 1993 which was accelerated in 1997, causing a major economic depression during that period in Japan. The ratio of cross shareholding decreased in terms of both frequency and amount.

4 Contribution by Keiretsu and main bank system

While it is true that the practice of cross shareholding caused the expansion of Japanese bubble economy in the late 1980s to the early 1990s and led to a major economic downturn in Japan, it is also undeniable that cross shareholding played an important role in the development of the Japanese post-war economy.

The *Keiretsu* system represented an affiliation of group companies. Cross shareholding normally occurs when two or more companies have a reciprocal business relationship, such as a lender-borrower or supplier-buyer relationship. Once such companies start cross shareholding, each becomes a stable shareholder with respect to its counterpart. Here, "stable shareholder" means a shareholder which meets the following standards (Okabe, 2002):

(1) The shareholder is held as an "insider" friendly to the management side.

(2) The shareholder agrees that it will not sell to those who can take action against the will of the management of the company, especially those who plan to embark on a hostile takeover.
(3) The shareholder agrees that in the event it needs to sell its share, it will inform the company of its intention.

Consequent upon the stable shareholding of a company by means of cross shareholding, the following advantages can be realized (Okabe, 2002):

(1) The company can minimize the threat of a hostile takeover.
(2) The management side of the company can exercise wide discretion and do business with prospects of long-term interest, which could contribute to the competitiveness of Japanese companies.

The post-war relationship of the main bank with other companies in its group was once conducive to the firms and society as well. (Okabe, 2002)

(1) A main bank relationship enables the group companies to obtain financial capital effectively.
(2) The main bank of a company group can monitor the group companies' management. Thus, the main bank system can play a key role in corporate governance.
(3) Should one of the group companies suffer a financial crisis, the main bank can rescue this company by offering financial assistance.

One should also note the interaction between cross shareholding and the Long-Term Employment System in Japan, also known as the "lifetime employment system". (Okabe, 2002)

(1) In a situation where the directors are free from pressure and competition in a capital market, they will be able to conduct corporate business in such a way as to almost perfectly implement the policy and agenda of management.
(2) In Japan, such directors are supposed to be selected from employees of the company.
(3) Such directors naturally have the view that the company is comprised of not only shareholders but also other stakeholders like employees.
(4) The directors place more importance on employees rather than shareholders, which leads to a more stable employment system.

Under the abovementioned long-term employment system, a stable relationship between employer and employee can be realized. This contributed to the miraculous growth of Japanese economy from the 1950s to 1970s.

5 Reasons of unwinding cross shareholding

Each institution has its own boundary. For example, it should be noted that main banks perform two different roles: As "lender" of the group companies and as "shareholder" of the companies which borrow money from the bank. Thus, any move by the main bank to suddenly call in the company's debts can lead to severe conflict with other shareholders of the company. Thus, such conflict of interests is inherent in the main bank system.

After decades of rapid growth, cross shareholding's inherently negative impact on the company's corporate governance eventually outweighed its positive contributions. Because of the lack of adequate supervision by the shareholders and the disempowerment of market discipline, the performance of Japanese companies inevitably became worse, resulting from the inefficiency of management. Nevertheless, the drastic appreciation of the Japanese Yen and over-affluence of currency liquidity disguised the underlying conjuncture. Thus, gambling on land and stocks went awry. Stock prices greatly overdraft the virtual growth of performance, and finally began nose-diving.

The vicious circle reinforced itself. In the face of a sharp decline in stock prices and long-term depression of Japanese economy, companies started to be conscious about the risk from cross shareholding. In particular, the banks which had played a central role in cross holding were forced to recognize its inherent risks. First, there was a risk that banks could not meet the capital adequacy standard of Basel Accord, since the price fall in cross-held shares caused the fall of banks' capital base. Second, the decline of a bank's capital ratio affected the bank's reputation in the relevant market, resulting in the very dangerous prospect of a funding squeeze.

The new accounting and financial standards of Japan around 1999–2000 magnified the risks of cross shareholding, which were reformed for the purpose of adjusting the Japanese financial system in line with international standards. This reform was called the "financial big bang". Pursuant to the new standards, financial assets had to be evaluated based on market value rather than acquisition cost. Under this regime, the price of cross-held shares fell sharply, and holding such shares had a negative effect on the equity capital of the company. Thus, the change in financial regulation became a catalyst for companies to sell cross-held shares.

6 Trend, variation and legal measures in Japan

6.1 Trend and circumfluence

Since the early 1990s, the criticism has been raised that for both banks and

non-banks, the rates of return from cross-held shares were very small, especially in the depression after the debacle of the bubble economy in Japan. It became necessary to achieve capital gains by selling cross-held shares. The abovementioned capital adequacy rule and adoption of the market-value accounting rule of stock evaluation were also instrumental in the unwinding of cross shareholding.

In addition to these changes, there were several measures introduced around 2000. (Scher, 2001) For example, in order to promote the sales of cross-held shares held by banks, the Japanese government established special organizations to purchase stocks which were held by banks and other entities. Such organizations started purchasing in January 2002. The Japanese central bank, the Bank of Japan ("BOJ"), also began purchasing such stocks. The total sum of purchases by these two organizations was up to about US $19 billion from 2002 to 2004 and this had a very significant impact on reducing the amount of cross shareholding in Japan.

The unwinding triggered reciprocal reactions. As a company sells stocks of its counterpart company, the counterpart company loses the incentives to keep stocks of the first company. In many cases, these released stocks ended up being purchased by foreign investors, who were much more willing to become involved in the management. Thus, the management was forced to do business with strict consideration of principles governing the effectiveness of capital and asset management such as Return on Equity (ROE) or Return on Asset (ROA). Additionally, as the unwinding of cross shareholding advances, the traditional lifetime employment system in Japan is being eroded. Thus, the unwinding of cross holding has caused significant changes not only in a pure economic sense but also in the social system itself.

With importance, there were some notable differences in the approach towards the unwinding of cross shareholding. For example, non-bank organizations including private enterprises sold more shares in banks than shares in non-banks. Additionally, banks were reluctant to sell their shares in non-bank entities. Finally, cross shareholding arrangements among non-bank entities did not undergo significant change. (Okabe, 2002)

Ironically, the change in shareholding structure somehow led to a resurgence of cross shareholding lately. Since for many foreign investors one of the main purposes of participation in the company as a shareholder is short-term investment, the potential for merger and acquisitions or hostile takeover has grown dramatically. Due to the need of defense against hostile takeover and in order to strengthen business relationships, in some industries the degree of cross holding has even been increasing, such as within the steel, electrical devices, and transportation equipment industries. For instance, in March 2005, Nippon Oil Corporation and Cosmo Oil Co., Ltd. announced that they intended to strengthen

the relationship between both companies and at the same time prepare against a possible hostile takeover. Likewise, in March 2006, the Japanese "Big Three" steel manufacturers, Nippon Steel Corp., Sumitomo Metal Industries Ltd., and Kobe Steel Ltd., announced that they had started to cooperate in the steel industry through cross shareholding. Other examples include Toyota, Matsushita, etc.

6.2 Legal restrictions on cross shareholding

In Japan, there was no restriction on cross shareholding until 1981. The revision of the Japanese Commercial Code in 1981 introduced two kinds of restrictions: (1) Restriction on possession and (2) restriction on exercising shareholder's rights. The Japanese Commercial Code was revised again in 2005 and a new Companies Act was enacted at the same time. The said restrictions were then incorporated into the Companies Act.

6.2.1 Restriction on possession

Article 135 of Companies Act states that:

> A Subsidiary may not acquire the shares of a Stock Company that is its Parent Company (hereinafter in this article referred to as "Parent Company's Shares"). (Exception clause omitted)

Article 2, Section 1(iii) (the definition of "Subsidiary") states that:

> "Subsidiary" means any entity which is prescribed by the applicable Ordinance of the Ministry of Justice as the juridical person the management of which is controlled by a Company, including, but not limited to, a Stock Company a majority of all votes in which are owned by the Company.

6.2.2 Restriction on exercising shareholder's right

Article 308, Section 1 of Companies Act:

> Shareholders (excluding the shareholder prescribed by the applicable Ordinance of the Ministry of Justice as the entity in a relationship that may allow the Stock Company to have substantial control of such entity through the holding of one quarter or more of the votes of all shareholders of such entity or other reasons) shall be entitled to one vote for each one share they hold at the shareholders meeting; provided, however, that, in cases where a Share Unit is

provided for in the articles of incorporation, they shall be entitled to one vote for each one unit of the shares. (Emphasis added)

Some critics opined that even where the amount of shareholding does not exceed 25% of the total number of issued shares, there would still be serious problems concerning corporate governance. Especially looking back on the issues raised by the main bank system, even if the ratio of possession was merely 10% or so, major problems would occur because of the intimacy of the relationship between the bank and the company. In this respect, it sounds like that this restriction underestimates serious problems arising from cross shareholding. However, if the threshold were to be lowered to a level such as 15% or 10%, positive effects of cross shareholding would have been cornered, and the rebuke on over-regulation would definitely have been uttered.

6.2.3 Other rules

Japanese banks and insurance companies have traditionally had significant impact on the management of their client companies. Considering this issue, the Bank Law and Insurance Business Law stipulate as follows:

Article 16-3, Section 1 of Bank Law:

> Bank or its subsidiary may not acquire the shares of a company in excess of 5% of all votes of the company ("5% Rule").

Article 107, Section 1 of Insurance Business Law:

> Insurance company or its subsidiary may not acquire the shares of a company in excess of 10% of all votes of the company ("10% Rule").

7 Regulation for China: Increased necessity and proposed framework

7.1 Experiences from Japan and other countries

Generally speaking, the abovementioned change and legal restriction could be evaluated as beneficial to the Japanese economy in the long term. With the collapse of the main bank system, Japanese companies had to find another efficient way to obtain financing. At the same time, banks, which were previously protected by a series of governmental regulations, were faced with a

huge management challenge. Under such circumstances, both companies and banks had to strive hard to maximize the efficiency of their management, which in the long run can bring more competitiveness to Japanese companies and banks in the international arena. As for the stock market, the unwinding of cross shareholding did not cause major damages to the intrinsic value of the corporation, though the temporary turmoil increased. Nevertheless, the more stock that is traded and the more active the market becomes as a result, the better it is for the whole market.

Many other countries have set restrictions on cross shareholding in one form or another. In Germany, for example, cross shareholding is not prohibited, even between parent and subsidiary, but exercising shareholder's rights is limited to 25% and prohibited in the case of a parent and subsidiary. In France, both holding and exercising are restricted to 10%, though not entirely prohibited. Such variance may be derived from the difference in the treatment of cross shareholding amongst countries. In Germany, cross shareholding has traditionally been seen as a fundamental practice in business that strengthens the relationship between companies and enables the company to get reasonable funding from the group bank.

In the US, cross shareholding itself is not generally prohibited, but exercising rights is subject to restrictions in the case of Vertical CS. It should be noted that the US used to have the so called "Glass-Steagall Act," which prohibited banks from doing business in investment and holding shares in other business entities. Although the Act was repealed in 1999, strong restrictions exist for commercial banks to hold shares of non-financial industries. Therefore US banks are reluctant to hold other entities' share for the purpose of cross shareholding. (Lown, 2000) For the UK, Vertical CS is generally prohibited.

7.2 History and status quo of cross shareholding in China

Starting from 1987, China implemented a policy of diversifying the company ownership system, and the traditional planned economy regime began to be transformed. In 1994, Chinese Company Law took effect, representing such change, which was then substantially revised in 2005.

In order to adapt companies in China to the market economy, it was necessary to first solve the most prominent problem of SOEs. Since most of the SOE shares were held by the government, SOEs were free from competition and protected against pressures from other shareholders. This led to an inefficiency of management and poor economic performance from SOEs. Cross shareholding was regarded as one of the most efficient ways to diversify the ownership of SOEs. (Wang, 2003) Along with SOE reform, the Chinese government took steps to reform corporations whose performance was unsatisfactory, by encouraging

such companies to make cross shareholding arrangements with other strongly performing companies. As a result, many companies were reorganized as company groups through cross shareholding. (Zhang, Han, 2005) Among the others, the Shenzhen government proposed an opinion in 2001 regarding acceleration of corporate governance reform, wherein cross shareholding was encouraged. (Shen, 2004)

This trend was accelerated by China's accession to the WTO in 2001. As a series of deregulation measures for foreign investment, M&A became more common in China, bringing with it an increased potential for hostile takeover. In this situation, companies are willing to make cross shareholding arrangements as a defense against hostile takeovers. As a result, cross shareholding has become a common practice in China. At the end of 2006, 178 listed companies were disclosed to be among Top 10 shareholders of 295 listed companies. In 2007, 78% of all the 1450 listed companies (namely, 1135 listed companies) held shares of other companies (listed or unlisted) at different ratios. Cross shareholding has greatly exacerbated the capital market volatility after 2006, pushing the index to its peak in October 2007 and drawing it down dramatically since then.

7.3 Proposed approaches for Chinese regulations

Currently in Chinese laws there is no specific provision which regulates cross shareholding. As discussed above, there are both advantages and disadvantages for cross shareholding. It is important to strike a subtle balance between practical necessity and deterring unfavorable effects, bearing in mind various factors such as degree of development of the economy, structure of shareholders, character of the company (for example, bank or non-bank), market condition (for example, mature or immature, how M&A is functioning, etc.), and the public policy which the government wants to promote. Taking these issues into consideration, this paper proposes the following regulatory framework on cross shareholding for China.

(1) For bank-affiliated cross shareholding ("BACS"). Within the current Chinese Commercial Bank Law, Article 43 provides that:

> Commercial banks shall not be permitted to engage in trust investments and stock operations and shall not be permitted to invest in real estate within the territory of the People's Republic of China that is not for their own use, shall not be permitted to invest in non-banking financial institutions and enterprises within the territory of the People's Republic of China. The foregoing shall not apply where the State has rules stipulating otherwise.

Such general prohibition on commercial banks from investing in non-banking financial institutions and enterprises by and large makes the BACS a moot question nowadays in China. This author suggests that if and when the State does provide some exception in the future to allow commercial banks to hold shares of ordinary companies, the latter should be barred from having shares of the banks, or could at the most hold them under some percentage limit (e.g., 1%).

(2) For corporate conglomerate cross shareholding (Vertical CS). In the case of a parent-subsidiary relationship, the unfavorable effects of cross shareholding on corporate governance could be significant. Therefore, one possible position could be the general prohibition on Vertical CS, like such as in the UK. Nevertheless, the most difficult part lies in how to identify the conglomerate relationship, in particular cases other than the 50% or more shareholding – the simplest situation. Chinese Company Law (Article 217) and the Enterprise Accounting Principle (No. 33) of Ministry of Finance make use of the concept of "control," namely, the ability to hold actual control of the acts of the company by means of investment relations, agreements, or any other arrangements. The control concept is obviously more inclusive yet illusive, leaving the identification a tough job. Therefore out of the pragmatism, the alternative might be some certain ceiling restriction on possession, such as 25%.

(3) For non-conglomerate cross shareholding (Horizontal CS). In such situation, there is a much milder intervention: The ill effects of cross shareholding gradually give way to the positive values of due business relationship—restrictions on exercising shareholder's right are appropriate only when necessary. To add some flexibility, there could be different thresholds for different companies. For example, the threshold for listed and non-listed companies could be 10% and 20%, respectively. (Ye, 2007) Furthermore, other concerns such as disclosure requirements, anti-monopoly, priority, and procedure could be addressed accordingly in this regard.

8 Conclusion

The attitudes and rules toward cross shareholding vary in accordance with each country's specific conditions, for example, how the country's economy has developed, the maturity of its capital market, the degree of governmental interference, and the history of corporate governance. In order to discuss how cross shareholding should be regulated in China, further studies should be conducted on various factors such as its cultural background, the degree of development, the role of banks, how corporate governance works, and so on.

Among other things, China is now facing the similar situation which confronted Japan years ago, such as the endogenic and outsides pressures for

currency appreciation, the changed accounting rules, the increasing portion of stock exchange tradable shares, and the looming threat of more hostile takeovers, due to the reasons alike or not. Cross shareholding is predictably to become more common. It is vitally important to recognize that cross shareholding has both positive and negative effects. This paper suggests a possible framework for the regulation of cross shareholding in China, by mainly applying the lessons and implications from the experiences of Japan. Targeting at different situation, a spectrum of rules has been proposed, from permission, to restriction on exercising shareholder's right, to restriction on possession, and finally to prohibition.

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