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Corporate Governance: A Legal Study on the Reform of State-Owned Enterprises in China

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Abstract

Corporate governance (CG) has been introduced to China as central to establishing the modern company system. The current Chinese CG principles and legal framework are the results of China having absorbed lessons and copied advanced and matured CG models from other countries. This thesis evaluates the process of CG practice by Chinese State-owned enterprises (SOEs), and concludes that the main issue for Chinese SOEs is not to adopt a fixed model of CG to copy, but to develop a complete and continuous set of institutions that lead to effective CG in the context of China's economic and social environment.

At this transitional stage, what are the significance and the functions of CG in China? And how do these functions applied in reality? During the last decade of practice, what are the achievements and problems of CG in the reform of SOEs in China? What are the future perspectives of Chinese SOEs' reform? The series of questions above describe the dynamic of this thesis. In discussing the phenomenon of CG in the reform of SOEs, this thesis reviews the debates about the role of CG in China's SOEs reform. Furthermore, this thesis will analyze the tensions concerning CG in the process of SOEs reform, in relation to ownership, boards of directors, shareholders and boards of supervisors. Moreover, explorations taking a legal approach are made in this thesis in order to find and fill the gap between theory and practice about CG of SOEs in China.

The research into the CG of Chinese SOEs is a challenging and stimulating field. The

aim of this thesis is to provide an analysis of the CG of Chinese SOEs and offer some suggestions for improvement to make the development of CG of Chinese SOEs more attractive to experts and scholars, so as to better guide the practice.

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Chinese Terms

baozhuang shangshi (包装上市) going public through the packaging less rotten assets

chengbao jingying zerenzhi (承包经营责任制) responsibility contract system

faren gu (法人股) legal-person shares

geren gu (个人股) individual shares

guanxi (关系) social connections, social relations

gugai (股改) shareholding structure reform

guojia gu (国家股) state shares

guojiutiao (国九条) nine-point policy guideline released by the State Council on Developing China's capital markets

jianjinshi minyinghua (渐进式民营化) gradual, step-by-step privatization

minyinghua (民营化) privatization

minying qiye (民营企业) private enterprise

shuanggui zhi (双轨制) dual-track system; dual-track approach

wei guoqi jiekun (为国企解困) save state-owned enterprises from financial difficulties

yigu dada (一股独大) dictatorship of one shareholder

zhuada fangxiao (抓大放小) grasp the large, release the small

Abbreviations

BOC	Bank of China
CCT	China Cheng Tong
CG	Corporate governance
CIRC	China Insurance Regulatory Commission
CNPC	China National Petroleum Corporation
CPC	Communist Party of China
CPPCC	Chinese People's Political Consultative Conference
CSRC	China Securities Regulatory Commission
ESOP	Employee Stock Ownership Plan
FDI	Foreign Direct Investment
FSA	Financial Services Authority
GNP	Gross National Product
ICLCG	Institute of Corporate Law and Corporate Governance
ICRA	Information and Credit Rating Agency
LP	Legal Person
LR	Listing Rules
M&A	Merger and Acquisition
MES	Modern Enterprises System
MoC	Ministry of Commerce
NDRC	National Development and Reform Commission
NPC	National People's Congress
OECD	Organization for Economic Co-operation and Development
PRC	People's Republic of China
SASAC	State-owned Assets Supervision and Administration Commission
SCRES	State Commission on the Reform of the Economic System
SCSC	State Council Securities Commission
SDIC	State Development & Investment Corporate
SEC	Securities and Exchange Commission
SHSE	Shanghai Stock Exchange
SMLR	Stock Market Listing Rules
SOE	State-owned Enterprises
TVE	Township and Village Enterprises
WTO	World Trade Organization

List of Legislation and International Agreements

People's Republic of China

The National People's Congress and its Standing Committee

1982 中华人民共和国宪法 Constitution Law of the People's Republic of China
(adopted by the Fifth Session of the Fifth National People's Congress and came into force on 4 December 1982, then amended in 1988, 1993, 1999 and 2004; amendment came into force on 14 March 2004)

1985 中华人民共和国会计法 Accounting Law of the People's Republic of China
(adopted by the Ninth Session of the Standing Committee of the Sixth National People's Congress on 21 January 1985, and amended in 1993 and 1999 respectively; amendment came into force on 1 July 2000)

1988 中华人民共和国全民所有制工业企业法 Law on Industrial Enterprises Owned by the Whole People of the People's Republic of China
(adopted by the First Session of the Seventh National People's Congress on 13 April 1988 and came into force on 1 August 1988, then amended by the Decision of the Standing Committee of the National People's Congress on Amending Some Laws on 27 August 2009; amendment came into force on 27 August 2009)

1989 中华人民共和国行政诉讼法 Administrative Procedure Law of the People's Republic of China
(adopted by the Second Session of the Seventh National People's Congress on 4 April 1989 and came into force on 1 October 1990)

1991 中华人民共和国民事诉讼法 Civil Procedure Law of the People's Republic of China
(adopted by the Fourth Session of the Seventh National People's Congress on 9 April 1991 and came into force on 28 October 2007)

1993 中华人民共和国公司法 Company Law of the People's Republic of China
(adopted by the Fifth Session of the Standing Committee of the Eighth National People's Congress on 29 December 1993, amended 25 December 1999 and further amended on 28 August 2004; amendment came into force on 1 January 2006)

1993 中华人民共和国宪法修正案 Constitution of the People's Republic of China
(adopted at the First Session of the Eighth National People's Congress and promulgated for implementation by the Announcement of the National People's Congress on March 29, 1993)

1994 中华人民共和国仲裁法 Arbitration Law of the People's Republic of China
(adopted by the Ninth Session of the Standing Committee of the Eighth National People's Congress on 31 August 1994, and came into force on 1 September 1995, amended and amendment came into force on 27 August 2009)

1997 中华人民共和国刑法 Criminal Law of the People's Republic of China
(adopted by the Fifth National People's Congress on 1 July 1979, then was amended on 14 March 1997 ; amendment came into force on 1 October 1997)

1998 中华人民共和国证券法 Securities Law of the People's Republic of China
(adopted by the Sixth Session of the Standing Committee of the Ninth National People's Congress on 29 December 1998, amended 27 October 2005; amendment came into force on 1 January 2006)

1999 中华人民共和国会计法 Accounting Law of the People's Republic of China
(adopted by the Ninth Session of the Standing Committee of the Sixth National People's Congress on 21 January 1985, amended in 1993, 1999; amendment came into force on 1 July 2000)

2003 中华人民共和国证券投资基金法 Securities Investment Fund Law of the People's Republic of China
(adopted by the Fifth Session of the Standing Committee of the Tenth National People's Congress on 28 October 2003, and came into force on 1 June 2004, replacing 1997 *Tentative Rules of Securities Investment Fund*)

2005 中华人民共和国公务员法 Civil Servant Law of the People's Republic of China
(adopted by the Standing Committee of the National People's Congress on 27 April 2005)

The State Council and its Ministries and Commissions

1979 关于扩大国营工业企业经营管理自主权的若干规定 several Provisions on the Expanding the Autonomy in Operation of the State-owned Industrial Enterprises
(issued by the State Council on 13 July 1979)

1983 关于国有企业利改税试行办法 (Tentative) Procedures for State enterprises pay taxes instead of turning over their profit to the state (ligaishui)
(issued by Ministry of Finance was forwarded by the State Council)

1986 关于深化改革增强企业活力的若干规定 the Provision on the Deepening Enterprises Reform and Enhancing the Vitality of Enterprises
(issued by the State Council on 5th December 1986)

1992 全民所有制工业企业转换经营机制条例 Regulation on the Transformation of Operational Mechanism of the Industrial Enterprises Owned by the Whole People

(adopted at the 106th executive meeting of the State Council on June 30, 1992, and promulgated by Order No.103 of the State Council on July 23,1992)

1992 股份制企业试点办法 the Pilot Measures for Joint-Stock Enterprises
(No. 30 [1992] Order of the State Commission for Restructuring the Economic System (SCRES) 1992)

1992股份有限公司规范意见Opinion Standards for the Companies Limited by Shares
(promulgated by No. 31 [1992] Order of the State Commission for Restructuring the Economic System (SCRES) on May 15,1992)

1992 有限责任公司规范意见 Opinions on Standards for Limited Liability Companies
(promulgated by the State Commission for Restructuring the Economic System (SCRES) on May 15,1992)

1992 国家科学技术委员会，国家经济体制改革委员会关于在国家高新技术产业开发区创办高新技术股份有限公司若干问题的暂行规定 Interim Provisions of the State Commission of Science and Technology and the State Economic Restructuring Commission on Several Issues Concerning the Establishment of High and New Technology Incorporated Companies within National High and New Technology Industry Development Zones (Expired)
(issued by State Science and Technology Commission (repealed) on 19th, Nov, 1992)

1992 股份制试点企业国有资产管理暂行规定Interim Provisions on the Ownership of State-owned Shares of the Pilot Enterprises of the Stock Ownership
(adopted by State-owned Assets Administration Bureau on July 27 1992)

1992 海南经济特区股份有限公司条例 Provisions on Hainan Special Economic Zone Concerning Joint Stock Limited Companies
(adopted by Twenty-third Meeting of the Standing Committee of the People's Congress of Hainan Province on July 11 1992)

1993 股票发行与交易管理暂行条例 Interim Provisions on the Management of the Issuing and Trading of Stocks
(promulgated by the State Council and came into force on 22 April 1993)

1993 中共中央关于建立社会主义市场经济体制若干问题的决定 Decisions of the Communist Party Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economy System
(adopted by the Third Plenary Session of the CPC Fourteenth National Congress on 14 Nov. 1993)

1994 国务院对《外经贸股份有限公司内部职工持股试点暂行办法》的批复Reply of the State Council on the Provisional Measures for Experiments of Employee Stock

Option Plans in Joint-Stock Limited Companies of Foreign Trade and Economic Cooperation

[Letter No. 54(1994) of the State Council]

1994 关于股份有限公司境外募集股份及上市的特别规定 Special Provisions on Joint Stock Limited Companies Issuing Shares and Listing Overseas (promulgated by the State Council and came into force on 4 August 1994)

1994 到境外上市公司章程必备条款 Mandatory Provisions for the Articles of Association of Companies Listed Overseas (promulgated by the State Council and the State Commission for Restructuring the Economic System and came into force on 27 August 1994)

1994 财政部，国家体改委，国家经贸委，国家税务总局，国务院法制局关于停止执行企业以留利再投资退 40% 所得税规定的通知 Notice of the Ministry of Finance, the State Commission for Restructuring the Economic System, the State Economic and Trade Commission, the State Administration of Taxation and the Bureau of the Legislative Affairs under the State Council on Stopping the Implementation of the Provisions that 40% of Income Tax will be Refunded if an Enterprise Makes Reinvestment by Using the Retained Profits

1995 国务院关于深化企业职工养老保险制度改革的通知 Circular of the State Council on Deepening the Reform of the Pension System for Staff and Workers of Enterprises

1995 国务院关于原有有限责任公司和股份有限公司依照《中华人民共和国公司法》进行规范的通知 Notice of the State Council to Standardize Original Limited Liability Companies and Joint Stock Limited Companies in Accordance with the Company Law of the People's Republic of China (issued by the State Council on 3rd July 1995)

1995 中央关于指导国民经济和社会发展“九五计划”和 2012 年远景目标的建议 Zhonggong Zhongyang Guanyu Zhiding Guomin Jingji he Shehui Fazhan Jiuwu Jihua he Er ling yi er Nian Yuanjing Mubiao de Jianyi (promulgated officially at the Fifth Plenum of the CCP's 14th Central Committee on 28 September 1995)

1997 国务院关于在若干城市试行国有企业兼并破产和职工再就业有关问题的补充通知 Supplementary Notice of the State Council on the Relevant Issues about the Pilot Implementation of the Merger and Bankruptcy of State-owned Enterprises in Some Cities and the Reemployment of Workers

1997 国务院转批国家计委，国家经贸委，国家体改委关于深化大型企业集团试点工作意见的通知 Circular of the State Council on the Approval and Transmission of the Suggestions of the State Planning Commission, the State Economic and Trade

Commission and the State Restructuring Commission on the Work of Deepening the Expe
(issued by the State Council on 29th April, 1997)

1997 国务院关于进一步加强对境外发行股票和上市管理的通知 Circular of the State Council on Further Strengthening the Administration of Overseas Stock Offering and Listing
(promulgated by the State Council 8 December 1998 and came into force on 20 June 1997)

1997 财政部关于外商投资企业依据何种标准编制会计报表问题的复函 Letter of the Ministry of Finance Concerning the Issue on the Standard with which the Enterprises with Foreign Investment Work out the Accountant Report Forms

1998 对外贸易经济合作部，国家发展计划委员会，国家经济贸易委员会关于赋予试点企业集团进出口经营权和对外承包劳务经济权有关事项的通知 Circular on the Related Issues of Granting Import and Export Operation Right and Foreign Contracted Project and Labour Service Cooperation Right to the Trying out Enterprises Group

1999 关于加强技术创新，发展高科技，实现产业化的决定 Decision of Strengthening Technological Innovation, Developing Advanced Science and Technology and Realizing Industrialization
(promulgated by the State Council and came into force on 20 August 1999)

1999 关于境外上市公司进一步做好信息披露工作的若干意见 Several Opinions on Further Enhancing the information Disclosure by Overseas Listed Companies
(promulgated by the CSRC and came into force on 26 March 1999)

2000 国有企业监事会暂行条例 Interim Regulations on the Board of Supervisors in State-owned Enterprises
((promulgated by the State Council on 15 March 2000)

2000 证券公司会计制度 Accounting System for Securities Companies
((promulgated by the Ministry of Finance on 26 November 1999 and came into force on 1 January 2000)

2001 国务院办公厅关于外经贸企业内部职工持股会法律地位问题的复函 Letter Reply by the General Office of the State Council on the Legal Status of the Meeting of Employee Stock Ownership in Enterprises of Foreign Trade and Economic Relations
(issued by General Office of the State Council on 28th April, 2001)

2002 企业会计制度 Accounting System for Business Enterprises
(applicable to Joint Stock Limited Enterprises effective 1 January 2001 and applicable

to Foreign Investment Enterprises effective 1 January 2002).

2003 中共中央关于完善社会主义市场经济体制若干问题的决定 Decision of the Central Committee of the Communist Party of China on Some Issues concerning the Improvement of the Socialist Market Economy
(adopted by the Communist Party of China through the Third Plenary Sessions of the Sixteenth Central Committee on October 14, 2003)

2004 关于推进资本市场改革开放和稳定发展的若干意见 Several Opinions on Promoting the Reform and Opening-up and the Stable Development of the Capital Market
(promulgated by the State Council and came into force on 31 January 2004)

2006 关于国外投资者并购境内企业的规定 Rules on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors
(promulgated jointly by the Ministry of Commerce, the State Asset Supervision and Administration Commission, the CSRC, the State Admission of Taxation, the State Administration for Industry and Commerce, the State Administration of Foreign Exchange on 8 August 2006, amended and amendment came into force on 22 June 2009)

2006 外国投资者对上市公司战略投资管理办法 Measures for the Administrative of Strategic Investment in Listed Companies by Foreign Investors
(promulgated jointly by the Ministry of Commerce and the CSRC on 31 December on 2005, effective 30 January 2006)

2009 国务院国有资产监督管理委员会关于印发《董事会试点中央企业董事会规范运作暂行办法》的通知 The Notice of the State-owned Assets Supervision and Administration Commission of the State Council on Issuing the Interim Measures for the Standard Operation of the Board of Directors of a Central Enterprises in the Pilot Program on Board of Directors
(promulgated by the State-owned Assets Supervision and Administration Commission of the State Council on 20 March 2009)

Supreme People's Court Interpretation

2006 最高人民法院关于适用《中华人民共和国公司法》若干问题的规定（1） Provisions of the Supreme People's Court on Several Issues concerning the Application of the PRC Company Law (1)
(promulgated by the Supreme People's Court on 28 April 2006 and came into force on 9 May 2006)

2006 最高人民法院关于适用《中华人民共和国公司法》若干问题的规定（2） Provisions of the Supreme People's Court on Several Issues concerning the Application

of the PRC Company Law (2)
(promulgated by the Supreme People's Court on 12 May 2008 and came into force on 19 May 2008)

Securities Regulatory Authorities

1999 关于企业申请境外上市有关问题的通知 Circular on the Issue Concerning the Companies Applying for Overseas Listings
(promulgated by the CSRC and came into force on 14 July 1999)

1999 中共中央关于国有企业改革和发展若干重大问题的决定 The Decision of the Central Committee of The Communist Party of China on Major Issues Concerning The Reform and Development of State-Owned Enterprises
(promulgated by the Central Committee of the Chinese Communist Party and came into force on 22 September 1999)

2001 关于在上市公司建立独立董事制度的指导意见 Guiding Opinion about Establishing Independent Director System in Listed Companies
(promulgated by the CSRC and came into force on 26 August 2001)

2002 上市公司治理准则 Corporate Governance Code for Listed Companies
(issued and promulgated by the CSRC and State Economic and Trade Commission in 2001 and came into force on 20 January 2002)

2004 关于高新技术中央企业开展股权激励试点工作的通知 A document on High-tech Central Enterprises to carry out the Work of Stock Option Incentive Pilot
(promulgated by the Ministry of Science and Technology and came into force 2004)

2005 上市公司股份分置改革管理办法 Measures on Administration of Split Share Structure Reform of Listed Companies
(promulgated by the CSRC and came into force on 4 September 2005)

2005 上市公司回购社会公众股份管理办法 (试行) Administration of Repurchase of Public Shares by Listed Companies Procedures (Trial Implementation)

2006 首次公开发行股票并上市管理办法 Measures on Administration of the Initial Public Offering and Listing of Shares
(promulgated by the CSRC on 17 May 2006 and came into force on 18 May 2006)

2006 上市公司收购管理办法 Measures on Administration of the Takeover of Listing of Shares
(promulgated by the CSRC on 31 July 2006 and came into force on 1 September 2006; amended and amendments came into force on 27 August 2008)

2006 上市公司章程指引 Guidelines for the Articles of Association of Listed

Companies

(promulgated by the CSRC and came into force on 16 March 2006, replacing the 1997 Guidelines for the Articles of Association of Listed Companies)

2006 上市公司证券发行管理办法 Measures on Administration of the Offering of Securities by Listed Companies

(promulgated by the CSRC on 6 May 2006 and came into force on 8 May 2006)

2006 中国证券监督管理委员会发行审核委员会办法 Measures on the Public Offering Review Committee (POR Measures)

(promulgated by the CSRC on 9 May 2006, amended on 13 May 2009; and amendment came into force on 14 June 2009)

2006 公开发行证券的公司信息披露内容与格式准则第1号-招股说明书 Criteria No.1 on the Content and Format of Information Disclosure by Companies Conducting Public Offer of Securities—Prospectus

(promulgated by the CSRC and came into force on 18 May 2006)

2007 上市公司信息披露管理办法 Measures on Administration of the Information on Disclosure of Listed Companies

(promulgated by the CSRC and came into force on 30 January 2007)

2007 财政部关于印发《金融企业财务规则—实施指南》的通知 Notice of the Ministry of Finance on Issuing the Financial Rules for Financial Enterprises-Implementation Guide

(promulgated by the Ministry of Finance and came into force on 30 March 2007)

2008 关于上市公司以集中竞价方式回购股份的补充说明 Supplementary Provisions on the Share Repurchase by Listed Companies by Means of Centralised Bidding.

2009 首次公开发行股票并在创业板上市管理暂行办法 Tentative Measures for the Administration of the Initial Public Offering of Shares and the Listing thereof on the Growth Enterprises Board

(promulgated by the CSRC on 31 March 2009 and came into force on 1 May 2009)

Local Authorities

2001 上海证券交易所股票上市规则 Shanghai Stock Exchange Listing Rules

(promulgated by the SHSE on 8 June 2001, amended on 25 February 2002; and further amended on 29 November 2004, amendment came into force on 10 December 2004)

2001 深圳证券交易所股票上市规则 Shenzhen Stock Exchange Listing Rules
(promulgated by the SZSE on 7 June 2001, amended on 24 February 2002; and further amended on 29 November 2004, amendment came into force on 10 December 2004)

2009 上海市推进国际金融中心建设条例 Regulations of Shanghai Municipality on Promoting the Building of International Financial Centre
(adopted by the 12th Session of the Standing Committee of the 13th Shanghai People's Congress on 25 June 2009 and came into force on 1 August 2009)

Documents about OECD

OECD 2004, Principles of Corporate Governance

OECD 2004, The State-Owned Enterprises' Corporate Governance Guidelines

OECD 2005, OECD Guidelines on Corporate Governance of State-owned Enterprises, OECD Publishing

OECD 2005, Governance in China

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OECD (2009) Working Group on Privatization and Corporate Governance of state Owned Assets, State Owned Enterprises in China: Reviewing the Evidence, 26 January 2009

OECD 2010, Accountability and Transparency: A Guide for State Ownership
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http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12

Chapter 1: Introduction

The reforms of SOEs reforms in China are extensive and profound.¹ After over thirty five years of SOEs reform,² having experienced different periods of reform including the early period of reform and opening-up policy, the establishment of modern enterprises system,³ and the reform of small and medium SOEs,⁴ the composition of Chinese SOEs has hugely changed. Now, most Chinese SOEs are large-sized. Some SOEs continue to be wholly owned by the state; by contrast, the state has reduced its stake in others to a majority or become a non-controlling shareholder.⁵ The transformation of the SOEs' system and their structures has reached a crucial stage,⁶ with some deep-rooted contradictions and problems having emerged.⁷

Corporate governance (CG) has become the core of the reform of state-owned enterprises (SOEs) among various contradictions or problems summarized above in

¹ The terms “extensive” and “profound” will be illustrated from two aspects: span of time and social influence about Chinese SOEs reform. On the one hand, SOEs reform in China started 1978 and lasted over 35 years. It experienced different periods with different targets. The reform is the core and challenge for Chinese SOEs which they must face up to and solve from the beginning till now. On the other hand, the success or failure of SOE reform has a vital bearing on the success or failure of the overall economic restructuring. The transformation of the SOEs' system and their structural readjustments has reached a crucial stage, with some deep-rooted contradictions and problems having emerged.

² In this thesis, the starting point of Chinese SOEs reform is the Third Plenum of the 11th CPC Central Committee in 1978. More details can be seen in the Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of SOEs, which issued by Central Committee of the Communist Party of China on 09-22-1999.

³ Establishment of modern enterprises system (MES) of SOEs, as a new strategy, started to play a key role because SOEs were one of new targets for this stage of economic reform. For more details and analysis see Chapter 2, 2.1.2 Different phases with different targets of SOEs reform.

⁴ This essay divided the whole SOEs reform process into four periods, the reform of small and medium-sized SOEs is the third phase, and the concept, target, process, methods and influence of the reform small and medium-sized SOEs can be seen in Chapter 2, 2.1.2 Small-medium SOEs reform.

⁵ Wang Z, 2014: 487-502.

⁶ See footnotes 1 about social influence, and see footnotes 7, the list of tensions for SOEs reform, the SOEs reform shall take practical and effective measures to solve problems above. It is long way and protracted work.

⁷ A considerable number of SOEs have not yet adapted to the demands of a market economy due to the long-term influence of the traditional system, with many problems left over from history, the redundant construction over the past years and the drastic changes of market environment. For example, some SOEs can not be flexible in terms of operations, weak in technical innovation, heavily in debt and social burdens, and have too many surplus workers and difficulties in production and business operations. Their economic returns are dropping and some employees lose their work.

China, particularly since 2003.⁸ The CG of those companies which transferred from traditional SOEs is totally different in development methods and characteristics from the CG of a capitalist system's company, because under the capitalist system they are based on private ownership. However, in China, especially at this transition stage, the governmental agencies are extensively involved in the CG of the SOEs as controlling shareholders.⁹

This thesis provides an overview of the background and development of the CG of SOEs in China. It discusses the ownership and control of SOEs in this transformational period, analyses the problems of internal governance for Chinese state-owned listed companies, and suggests the ways in which the problems can be solved. A central argument is that although the CG of Chinese SOEs has come a long way since it was transplanted from the west and introduced into China, the CG of SOEs cannot be acclimatized. The CG of SOEs formed its own features with Chinese characteristics in the process of development following a large-scale SOEs' restructuring, and with inheriting features from the original and chaotic legal system. Therefore, this thesis suggests methods from a legal perspective to further develop CG in Chinese SOEs.

⁸ The way CG become the core of the reform: Experienced the Reform and Opening up Policy, establishment of MES established the position of CG of SOEs, the main method of MES is ownership restructuring. The form of MES for SOEs had been completed when the traditional SOEs restructured followed Company Law. Then, CG as the key target regarding internal reform became to the core for SOEs, because the development of CG is restructuring SOEs in essence. This is also the reason why CG is so important for SOEs, especially for the SOEs to develop into international enterprises under WTO. The significance of the year 2003 is that SASAC had been established, and SASAC pushed CG to a higher level and offered a clearer standard.

⁹ CG of capitalist system's company developed from continuous evolution of company or corporate; the legal system and market environment had already matured. However, the CG of Chinese companies which transferred from traditional SOEs is from transplantation, which included the relevant codes, laws, modes and market rules, with inconsistent background, corporate culture and legal system and its own experience. Therefore, the CG of Chinese SOEs developed in China with strong Chinese characteristics. The nature of the characteristics of CG will be discussed in Chapter 6.

This thesis is divided into six chapters. Chapter 1 introduces basic concepts and definitions, research questions, methodology, theoretical approaches and literature review. It provides an outline and overview of chapters and contributions of this research. Chapter 2 examines the history of different development periods and the current situation of CG of SOEs in China. The examination shows a combination of political elements from the past together with the modern enterprise system China has been pursuing. Chapter 3 discusses the transformation of the ownership and control of SOEs. Chapter 4 focuses on internal governance of Chinese state-owned listed companies. Chapter 5 analyses the tension arising in the internal governance of Chinese state-owned listed companies. Chapter 6 proposes the ways and measures that can improve the CG of Chinese state-owned listed companies.

1.1 Definition

1.1.1 The Concept of Corporate Governance

The term ‘corporate governance’ first appeared in the 1970s in the United States.¹⁰ With a rise in takeover activities in 1980s, this concept had been applied more broadly in the field of corporation law and practice.¹¹ Then, gradually, the term as a subject gained more attention from economists, social scientists, corporate managers, investors, policy-makers and lawyers. Since the 1990’s, corporate governance as a policy issue in the developed countries, had attracted greater attention from scholars, managers, and

¹⁰ Zhao Yuan, 2009. “Dongshihui Zhongxinshuo Yu Gudong Zhongxinshuo: Xiandai Meiguo Gongsì Zhili Xueshuo zhi Bian”, *Journal of Comparative Law*. 04 2009. Pp. 93-99.

¹¹ Veasey E 1993. the Emergence of Corporate Governance as a New Legal Discipline the Business Lawyer. P 1267.

directors. CG became an important factor for a nation's companies to make use of the capital market to attract foreign capital investment. A good CG structure can obtain the trust and recognition of other countries' investors. Although there are differences among different countries in political systems, company culture, company organization and business culture leading to a diversification of CG modes, the universal principles of CG still get maximum recognition. At least, across a certain geographic range, uniform principles of CG can be recognized.¹²

What, then, is corporate governance? The concept of CG is defined differently in various fields, as the following selection of definitions demonstrates:

·For business management, CG refers to those procedures established within a company's organization that allow directors to oversee the decisions of key officers, provide disclosure of material facts to investors and other stakeholders, and allow for efficient and accurate decision making within the organization.¹³

·From the finance perspective, CG deals with the ways in which suppliers of finance to corporations can assure themselves of getting a return on their investment.¹⁴ The

¹² It can be proven by the legislative and regulatory philosophy, and the importance of regulation in some countries and regions, such as Principle of Corporate Governance: Analysis and Recommendations, published by American Law Institute in 1994; and according to the Committee on the Financial Aspects of Corporate Governance (the London Stock Exchange intends to require all listed companies registered in the United Kingdom, as a continuing obligation for listing, to state whether they are complying with the code and to give reasons for any areas of non-compliance. See the part of the setting for the report on page 10) where CG refers to the system by which companies are directed and controlled: 'The board of directors is responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting are subject to laws, regulations and the shareholders in general meeting.' This can be seen as a summary of the general principles for modern corporate governance. It can also be seen that the particular geographic range is the element which can influence the form of CG.

¹³ Vanderloo J 2004-2005. "Encouraging Corporate Governance for the Closely Held", *Business Mississippi College Law Review*, Vol 24, p. 39.

¹⁴ Shleifer, Andrei, and Robert W. Vishny 1997. A Survey of Corporate Governance, *Journal of Finance*. 52

purpose of corporate governance is to minimize the total cost in aligning managers' and shareholders' incentives, and in unavoidable self-interested managerial behaviours.¹⁵

After the 1997 Asian Financial Crisis, CG attracted more attention around the world. The Organisation for Economic Co-operation and Development (OECD) called the governments, relevant international organizations and non-governmental organizations to establish a set of CG standards and guidelines.¹⁶ The OECD Principles of Corporate Governance was the first international CG standard established by inter-governmental international organizations.¹⁷ In 2000, the OECD Principles of Corporate Governance was adopted as a major criterion to measure whether a financial system is sound or not by the Financial Stability Forum.¹⁸ At present, the OECD Principles of Corporate Governance have helped members and non-members to carry out the reform of CG in their own countries, to establish their own code of CG, and to develop their new legislative and regulatory measures.

Revised in 2004, the OECD Principles of Corporate Governance started focusing on other issues and changed key points to cover the tensions caused by separation of ownership and control. It made the following changes. Firstly, it focused on the

1997. Pp. 737-783.

¹⁵ Nabavi Chashmi S. A. , Matan M. , Nasrollahi M. 2012. "The Relation Between Institutional Shareholders and Earnings Management in Companies Accepted in Tehran Stock Exchange", *Pajouheshgar (Journal of Management)* Spring 2012, Volume 9, Number 25; P. 65-74.

¹⁶ Includes the following the OECD Steering Group Corporate Governance and includes regular observers from the World Bank, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS).

¹⁷ The Principles of Corporate Governance purposed by the OECD in 1999. Although there is no legal effect, this Principle has become the basis of legislation for the countries of the world, and also is the action guidance for various countries' securities trading markets, investors and enterprises' Corporate Governance. More discussion can see Si Yuan, 2004. "OECD Caoni Gongsi Zhili Xinfangan", *the Chinese Certified Public Accountant*. 04 2004. The Principles mainly include: rights and equitable treatment of shareholders, interests of other stakeholders, role and responsibilities of the board, integrity and ethical behavior and disclosure and transparency.

¹⁸ Tan Jingyu, 2011. "Ouyuan yu Guoji Huobi Jinrong Tixi de Wanshan", *Huoli*, (11) 2011.

coordination of related interests of internal and external elements instead of internal managers about distribution and monitoring. Secondly, it paid more attention to employees and creditors who had been neglected before. Finally, it set out that a sound CG must meet the following six principles: I. Ensuring the basis for an effective corporate governance framework, II. The rights of shareholders and key ownership functions, III. The equitable treatment of shareholders, IV. The role of stakeholders in corporate governance, V. Disclosure transparency, and VI. the responsibilities of the board.¹⁹

‘corporate governance is the system or process by which companies are directed and controlled’.²⁰ And on the basis of this approach, the OECD further developed the definition of CG: ‘...the CG structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance’.²¹

The definitions of CG from the views above suggest that CG is a system which can realize control and balance the relationship of a corporation’s structure between owner, directors and managers. However, most views above define the CG from a financial or economic perspective, and establish the theory of the modern corporation on the issues

¹⁹ OECD Principles of Corporate Governance 2004 see part one, p17-24.

²⁰ Ibid.

²¹ Ibid.

of why and how to separate ownership and control. Some scholars have debated the concept of CG from a legal angle. There are several typical views as follow:

Oliver Hart in his article named “Corporate Governance: Some Theory and Implications Provided a Theoretical Framework for Corporate Governance” discussed legal concerns about CG. In his opinion, corporate governance would become an issue in an organisation if the following two conditions are present. On the one hand, if there is an agency problem, or conflict of interest, involving all the members of the organisation including owners, managers, workers or consumers. On the other hand, if a contract cannot solve all the agency problems because the transaction costs are so big.²²

Concerning the first condition, Oliver believes that all individuals associated with an organisation can be instructed to maximise profit or net market value or minimise costs without agency problems. Oliver explained that because individuals do not care about the outcome for the organisation, they just follow their own instructions.²³ The result of above situation is that all the costs of individuals can be reimbursed by the organisation. In another words, the organisation pays the costs for activities even the effort of individuals. If so, it is hard to find a position for corporate governance because there are no disagreements needing to be resolved through corporate governance. For the second condition, the optimal principal-agent contracts do not need any costs or take any risks, and the contracts should be comprehensive. However, the costs might be huge during

²² Hart O, 1995, “Corporate Governance: some Theory and Implications”, *The Economic Journal*. Pp.678-689.

²³ Ibid.

the transaction process, and the risks-bearing cannot be zero for clients. It is the reason why principal- agent contracts cannot be comprehensive. His opinion was popular for some years because the root of legal nature of CG was found, and the bridge between legal considerations and financial considerations was established through defining CG. His idea about CG was later absorbed into many researchers' thinking, even in some important theories of organizations; the incompleteness of contracts was the fundamental theory.

The definition of CG world-wide was gradually completed as the requirements of corporation affairs became more complex and across industries. There is a classic, complete definition on corporate governance, such as Blair's belief that 'the phrase CG is often applied narrowly to questions about the structure and function of boards of directors to the rights and prerogatives of shareholders in boardroom decision-making. Now this definition has been broadened to refer to the whole set of legal, cultural, and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated'.²⁴ In Blair's opinion, CG was not only a system for decision-making to adjust and manage the position and relationship between directors and shareholders, but also involved the nature of relevant parties of the corporation: rights, prerogative of shareholders, and risks and returns. Although the description of CG in Blair's article was vague, it should be noted that the legal factor was closely linked with management and financial factors. In addition, the combination

²⁴ Yang Hua, 2011. *Reconstruction: New Path for Corporate Governance*, Beijing: China CITIC Press. P4.

of these two factors is a breakthrough for the development of CG in Modern Corporation's level.²⁵

- *The Definition of CG in China*

On the basis of the views above, the concept of CG has been further developed through years of practice in China. In accordance with the basic principles of the Company Law, the Securities Law and other relevant laws and regulations, as well as the commonly accepted standards in international corporate governance, the Code of Corporate Governance for Listed Companies (hereinafter referred to as "the Code") is formulated to promote the establishment and improvement of the modern enterprise system by listed companies, to standardize the operation of listed companies and to bring forward the healthy development of the securities market of our country.²⁶ The Code is the major measuring standard for evaluating whether a listed company has a good corporate governance structure. The Code states the basic principles for corporate governance of listed companies in our country, the means for the protection of investors' interests and rights, the basic rules of behaviour and moral standards for directors, supervisors, managers and other senior management members of listed companies.²⁷ There are different views about CG theory in China as follows.

²⁵ In the framework of modern corporation, the combination of financial, management factors and legal factor was the basic theory for agency problem. Here the factors mean separation of ownership and control, and the incompleteness of contract. The agency problem is not the core issue in this study, so here this study just simple introduces but not further and detail; it means the agents of the shareholders of corporation may pursue private interests that conflict with some or all shareholders. Most research on modern corporation believe that a sound CG will offer a good check and balance between managers and shareholders to induce the conflict and make sure maximization of interests for all the parties in the corporation.

²⁶ Code of Corporate Governance For Listed Companies in Chin, issued by CSRC and State Economic and Trade Commission on January 7, 2001.

²⁷ Ibid.

The first opinion focuses on the internal governance in a company. According to Wu Jinglian, CG refers to an organization structure which includes owner, board of directors and senior executives.²⁸ Wu points out that a restricted and balanced relationship should be established among owner, board of directors and senior executives, ‘through which the owner entrusts its capital to the board of directors. The board of directors is the highest level of decision making of the company and has the power to appoint, reward and penalise, and dismiss senior managers.’²⁹

The definition of CG from Wu was published in 1990s. It can be seen that Wu’s opinion emphasized the function and importance of the board of directors. In addition, it also can be inferred from his view that CG has been established in China since the 1990s. A legal bailment has been created between the owner and the board of directors; secondly, the board of directors is the highest decision-making body in the corporation, with the power of hiring, reward, punishment and firing for senior executives; last but not least, senior executives are employed by the board of directors, and run enterprises within the scope authorized by board of directors.³⁰ Although the concept of CG was officially introduced only in 2000, the practice had begun long before that.

In contrast, the second view supports the idea that corporate governance is equivalent to corporate ownership arrangements; Zhang Weiyong believes CG is a system about the function and structure of the board of directors and the power of shareholders.³¹ From a

²⁸ Wu Jinglian, 2004. “the Functions of Chinese Government in Transition Stage”, *Journal of Hebeip*. Pp. 39-46.

²⁹ Ibid.

³⁰ Ibid. P. 39.

³¹ Zhang Weiyong, 2005. “Wealth Distribution of Corporate Governance”, *China High Technology Enterprises*, Pp.80-82.

wider perspective, CG refers to arrangements connected to law, culture and institution.³² Specifically, the arrangements can solve problems during the operation of enterprises, such as deciding corporate goals, who controls the enterprises and how, distribution of income, and risk assessment.³³ Another scholar Li Wei'an holds a similar view. According to Li, the nature of CG is the check and balance between owner and operator.³⁴ Internal governance refers to shareholders, the board of directors, the board of supervisors and managers.³⁵ Another important point made by Li is that CG deals with the relationship between enterprises and all stakeholders, including government, shareholders, creditors, employees and suppliers.³⁶

The third opinion stresses external governance in a company. According to Lin Yifu; corporate governance is a complete set of institutional arrangements for the owner of supervision and performance. The most basic component of the CG is indirect control through the competitive market or external governance. However, although internal governance is necessary and important, compared with a market competition mechanism, the internal governance is just an institutional arrangement whose purpose is to use the system arrangement and organization form to achieve the goal of minimizing the possibility of asymmetric information in order to protect the interests of the owner.³⁷

³² Ibid.

³³ Ibid. P. 80.

³⁴ Li Weian, 2001, 'Summarization of Workshop on WTO, Corporation Development and Corporate Governance Principles', *Nankai Business Research Vol. 4. Issue 01*. P. 40.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Lin Yifu, 1997. "Xiandai Qiye Zhidu de Neihan yu Guoyou Qiye Gaige Fangxiang", *Economic Research*, 03 1997.

Chinese researchers particularly emphasized the management and financial functions of CG in a corporation, and compared with foreign researchers, their opinion combined the Chinese actual situation seems to be more specific. Compared with Wu and Zhang, Qian Yingyi's opinion was similar to Oliver's in that Qian agreed with Oliver that, as a system for the corporation, the core constituents of CG were investors, managers, workers and other important parties, and there should be checks and balances among them.³⁸ To sum up, Qian's opinion can be regarded in the light of several questions: firstly, how to separate ownership and control and how to exercise their power; secondly, how to supervise and evaluate the board of directors, managers and employees; finally, how to design and implement incentive mechanisms to promote the optimal use of resources.³⁹

Based on the analysis and comparison of different views above, the following consensus can be reached about CG: firstly, CG is playing a contractual role in a corporation, and this nature of CG is determined by an incomplete contract. The incomplete contract means a contract in a corporation that cannot anticipate every possible situation in advance, and a contract that cannot make all the rules clear for the interests of parties and loss to various situations.⁴⁰ To reduce the transaction costs, the parties to contracts may focus on fixed objects including the target of the contract, the general rules, decision rules, share decision-making and solve possible dispute mechanisms in order to have an agreement. Therefore, the incomplete contract saves

³⁸ Qian Yingyi, 2006. "Enterprises Reform in China: Agency Problems and Political Control", *Economics of Transition*, 4 (2) Pp. 422-447.

³⁹ Ibid.

⁴⁰ Yang Ruilong, Nie Huihua, 2006. "Bu Wanquan Qiyue Lilun: Yige Zongshu", *Economic Research Journal*. 02 2006. Pp. 104-115.

the costs of constantly negotiating.⁴¹ As we know, the incomplete contract should be based on company law and articles of association; the incomplete contract specifications offer a standard for all the parties and regulate the trading among them to realize the comparative advantage of transaction cost.

Secondly, the core issue and main functions of CG is about an allocation of ownership, power, rights, responsibility and interests in a corporation. On the one hand, the different styles of ownership determine the style of CG, for example, debt and equity. The centralized or decentralized equity are all factors that can impact on CG.⁴² Generally speaking, the answer to ‘who control the corporation?’ is the foundation for CG; and ‘how to control the corporation’ and ‘how the risks and returns from activities the parties undertake are allocated’ are the main tasks for CG.

1.1.2 The Concept of SOEs

The term “SOEs” refers to “enterprises where the state has significant control, through full, majority, or significant minority ownership”⁴³. As in the OECD Guidelines, the

⁴¹ Yu Huihui, Jia Jie, 2002. “Qiyе de Buwanquan Qiyue Lilun Pingshu”, *Zhejiang Social Sciences*. 06 2002. Pp.184-188.

⁴²Ownership structure is the foundation of the corporate governance mechanism. Different ownership structure determines the shareholders’ equity concentration, composition of the shareholders, and the identity of majority shareholders, which leads to differences in the methods shareholders use to exercise their rights. From another perspective, different ownership structure determines different enterprise organization structure, so as to determine the different corporate governance structure, ultimately affecting the enterprise behavior and performance. Decentralized ownership structure needs a sound legal system for the protection of investors as strong support. As a company in the United States is the typical representative for decentralized equity structure, the one of reason why its capital markets can operate so well is that the United States a country where protection for investors is strong through the legal system, while China is a country which protects investors is weaker through civil-law. In addition, excessive decentralized ownership structure easily leads to another kind of agency problems, namely the internal conflict between managers and external shareholders. More discussion of the ownership structure: see Hu Xucheng, 2015. “Qianyi Guquan You Fensan Xiang Jizhong Zhuanbian de Zhanlue Xuanze- Guanliceng Guquan Shougou”, *China Economist*. (5) 2015. and see Sun Wenbo, 2005. “Guquan Jizhong yu Gongsi Zhili Xiaolv de Lilun Fenxi”, *Social Science Front bimonthly*. 06 2005. Pp. 267-271.

⁴³ OECD2005:11.

concept of “SOEs” covers commercial enterprises under central government ownership and federal ownership. In addition, this concept also applies to non-commercial SOEs for public policy purposes.⁴⁴

In the Chinese law context,⁴⁵ the term SOEs refers to ‘exclusively state-owned companies established in accordance with the Company Law of the People’s Republic of China; and limited liability companies and joint-stock limited companies funded by two or more exclusively state-owned companies, the people’s governments or the departments or institutions thereof, or other state-owned entities.’⁴⁶ In the process of the reform of SOEs in China, different classification methods of SOEs were involved in practice.

Firstly, according to the Company Law of the People’s Republic of China, Chinese SOEs can be divided into exclusively state-owned enterprises, limited liability enterprises and joint-stock limited enterprises. The term ‘exclusively state-owned enterprises or wholly state-owned company’ refers to ‘a limited liability company invested wholly by the state, for which the State Council or the local people’s government authorizes the state-owned assets supervision and administration institution of the people’s government at the same level to perform the functions of the capital contributor’.⁴⁷ Secondly, Chinese SOEs are divided in accordance with a supervision system of the state-owned assets of enterprises, including central

⁴⁴ Ibid.

⁴⁵ Here mainly refers to 1988 Law on Wholly State-owned Industrial Enterprises and the Company Law.

⁴⁶ See Ministry of Finance 2007.

⁴⁷ Company Law 2014 Article 64.

enterprises which are supervised by the state-owned Assets Supervision and Administration Commission of the State Council (SASAC) and SOEs supervised by local government.⁴⁸ Finally, the terms “small, medium-sized SOEs” and “large-sized SOEs” are used by Chinese government in practice. Tracing the history of reform of SOEs in China, only the term “large-sized SOEs” was defined explicitly in Chinese law as “the State Council shall, on the behalf of the state, perform the contributor’s functions for the large-sized state-invested enterprises that have bearings on the national economic lifeline and state security determined by the State Council and the State-invested enterprises in such fields as important infrastructures and natural resources.”⁴⁹ These SOEs which are concerning with important infrastructures and natural resources are also considered to be central enterprises. More detail about classification methods of SOEs will be introduced in following chapter.

In this thesis, the term of ‘Chinese SOEs’ refers to large-sized SOEs in China; and the state-owned listed company means a wholly state-owned listed company and state holding listed company. These types of SOEs will be mainly discussed in relation to the CG of SOEs.

1.1.3 Corporate Governance of SOEs

In the OECD Guidelines on the CG of SOEs, the specific difficulties of the CG of SOEs are illustrated: “Corporate governance difficulties derive from the fact that

⁴⁸ Lu Fucui, 2011. *Report on Corporate Governance of Central State-owned Enterprises*, Beijing: China. Economic Publishing House. p17 according to the web of SASAC, there are 113 central enterprises. <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html> access on 11-11-2014.

⁴⁹ See Law of the People’s Republic of China on the State-owned Assets Enterprises 2009.

accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, and the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge.”⁵⁰

In the Chinese context, the term CG of SOEs refers to the corporate governance of state-owned enterprises in China needed to deal with a special relationship, namely the relationship among the shareholders’ meeting, board of directors and board of supervisors; the Party Committee, trade unions, commission for discipline inspection. The relationship between the *old Sanhui*-- shareholders meeting, board of directors and board of supervisors, and *XinSanHui* are all play an indispensable role in SOEs. But the relationship between them has not been regulated very well.⁵¹ The CG of SOEs includes the internal and external governance of SOEs. The SOEs’ internal governance is the board of directors, board of supervisors and operators’ incentive constraint mechanism and the new *Sanhui*’s problems. China’s external corporate governance system includes the securities market, legal system, institutional investors and other issues.⁵²

⁵⁰ OECD, supra note 16.

⁵¹ Cui Tao, 2008. “Some Special Issues Concerning the Corporate Management of State-owned Enterprises”, *Journal of South China University of Technology (social science edition)*, 10 (3) 2008.

⁵² Liu Yanling, 2005. “Woguo Guoyou Qiye Gongsi Zhili Yanjiu”. And see Chen Qingtai, 2009. “Guoyou Qiye Gaige yu Gongsi Zhili”, *Nankai Business Review*. 05 2005. Pp. 4-5. also can see Liu Yinguo, Wu Chengfeng, 2006. “Guoyou Qiye Gongsi Zhili yu Zhengfu de Jiaose”. *Economics Information*. 12 2006. Pp. 27-32.

1.2 Research Questions

As it is stated above, the reform of Chinese SOEs is extensive and profound. During the process of reform, some SOEs have not adapted to the demands of a market economy and have had to face up to some serious problems. For example, a loss of state-owned asset due to the long-term influence of the traditional system had led to difficulties in production and operations and falls in economic returns.⁵³ The Chinese Government has tried to find a practical and effective approach to solve those problems. CG as an expected solution was therefore introduced into the reform of Chinese SOEs. In the early stage of development of CG in China, CG had been thought of as an unsuitable approach for China, because Chinese CG was not developed from a privatised but from a public ownership economy. With the development of CG in China, some achievements as well as lessons have been gained in Chinese SOEs reform which is still facing some new challenges.

The central question of this research is: “How the law can make corporate governance more robust in further reform of SOEs in China?” In answering this question, the research will examine some relevant issues and questions which follow.

The first group of issues and questions should be considered firstly include: the definition of reform of SOEs; the definition of the CG of SOEs, the nature of central enterprise and state holding listed companies; the functions of CG for reform of SOEs; the operation CG of SOEs in reality; the practical difficulties of CG of SOEs in practice;

⁵³ See The Decision of the Central Committee of The Communist Party of China on Major Issues Concerning The Reform and Development of State-Owned Enterprises 1999.

the standard for a robust system of CG; and functions of CG as applied in China's reform of SOEs.

The second group of questions and issues which will be examined include: the significance of corporate governance in China at the transition stage, the relationship between theory and practice of CG and SOEs; the problems in China's reform of SOEs in the early period and the problems related to the CG of SOEs; the relationship between Chinese law and CG of SOEs; the importance of Chinese law for CG in the reform of Chinese SOEs; and the achievements and problems of CG of reform of SOE in the reform of SOEs in China.

The last group of problems and issues to be examined concerns Chinese law and the CG of SOEs' Chinese Law and CG of SOEs, including: discussions on whether current Chinese law and regulations are suitable for CG of SOEs; discussion from a legal perspective on the problems and development of separation of ownership and control in the CG of Chinese SOEs as there are some legal disputes can reflect the weakened part of the CG of SOEs; discussion on whether the current law can be helpful in solving the legal disputes related to CG of SOEs; discussion on the problems of internal governance of Chinese state-owned listed companies and suggestions for improvements; the characteristics and suggestions about CG of Chinese state-owned listed companies; and the discussion about how the legal measures could improve CG of SOEs to become a robust system.

1.3 Methodology

As mentioned above, the central question of this research is how the law can make CG more robust in the further reform of Chinese SOEs. In answering this question and those sub-questions and issues mentioned above, different methodological approaches have been applied in this research, including documentation analysis, fieldwork and case studies, qualitative perspectives.

1.3.1 Documentation Analysis

Documentation analysis can be divided into two parts, namely, legal and policy sources and secondary sources. Legal and policy sources analysis is a legal system research method which discusses the CG of Chinese SOEs issue from two perspectives. On the one hand, national laws and regulations, as a useful tool, reflect the will and intention of policy makers. Policy makers are more normative than positive, as they tend to simply consider how reliably the theory produces correct answers to a particular question.⁵⁴ There are many elements to be considered when policy makers make decisions, such as economic factors, historical factors, and social factors. In this research, the nature of the questions regarding CG call for legal and policy sources analysis, such as the concept, functions, and importance of CG. Legal and policy sources analysis, as an effective method, seeks for the best methods or course of action for reaching targets, a means-end way of thinking about government goals and

⁵⁴ Hovenkamp, 1990. Positivism in Laws and Economics, *California Law Review*, 78 CAL. L. REV. 78.

actions.⁵⁵ The background and definitions of CG and SOEs, historical reasons of CG of Chinese SOEs reform will be given an in-depth critical analysis. In addition, some sub-questions can be solved through this method, such as: the relationship between Chinese law and CG of SOEs; how and why the Chinese legal system offers legal security for CG of SOEs and whether and why Chinese law and regulations are suitable for the CG of SOEs

On the other hand, the term “documents” does not mean the laws and regulations in the legal framework. Most of documents, such as notices or decisions concerning the CG of SOEs, played the role of pushing the process of reform before the relevant laws and regulations were promulgated. However, the documents are important for the CG of SOEs in China, because they affect the development of CG. Some specific documents will be introduced in the following section.

Secondary sources will play an important role for this research when it comes to considering the background and history of the reform of SOEs, the relationship between CG and SOEs and achievements and lessons of CG of SOEs to date. For example, academic literature and newspapers offer various views for relevant topics and these views form a basis of this type of research.

Secondary sources will be examined in this research. Firstly, the definition of some key terms, such as CG and SOEs, are identified in academic literatures. Secondly, representative arguments on the CG of Chinese SOEs reform in the literature will be

⁵⁵ Jackson& Sorensen ,1999. *Introduction to International Relations: Theories and Approaches*. Oxford University Press. P. 241.

critically reviewed, for example, the relationship between CG and SOEs and the achievements and lessons of CG of SOEs to date. This research will start by reviewing the relevant literature for different views from previous studies on the topic of CG, and then develop its own opinion.

Through literature review, the following sub-questions will be answered. What is the definition of reform of SOEs? What are the functions of CG for reform of SOEs? What is the relationship between CG and SOEs? Why the law is important to CG of reform of Chinese SOEs? After almost ten years of practical operation, what are the achievements and problems of CG of reform of SOE in China? What kind of experiences, knowledge, and lessons about CG should be shared from other countries?

Finally, in the second year of this research, fieldwork was conducted in China, but the sources from books, journals, newspaper, internet, and documents from libraries are also helpful. In summary, secondary sources are an effective method because there is no physical distance limitation.

1.3.2 Fieldwork and Case Studies Methods

In the second year of this research, fieldwork had been carried out in China. The case tracking method was applied in the process of fieldwork. As John Gerring observed, the case study is as intensive study of a single unit for the purpose of understanding a large class of unities.⁵⁶ The case study method is a suitable way of understanding definitive

⁵⁶ Gerring & John, 2004. "What is a Case Study and What is it Good For?", *98 American Political Science Review*. 342.

cases.⁵⁷ Although case study method is not a way of analysing cases or a way of modelling causal relations, it will help one to peer into the box of causality and its purported effect if well-constructed.⁵⁸ The aim of fieldwork in this research is to find the answers to these sub-questions: the functions of CG for SOEs reform applied in reality; the sum total of experiences, knowledge, and lessons about CG.

In order to answer the above sub-questions, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), China National Petroleum Corporation (CNPC), the China Minmetals Corporation, and Rainbow Group (a subsidiary of CEC) were selected as cases. Almost six months' work would be shared by two different cities in China, namely, Beijing for SASAC, China Minmetals Corporation in Beijing, CNPC in Beijing and Rainbow Group in Beijing, and branch of CNPC in Jilin (a subsidiary of CNPC). These cases can be divided into different types from the perspectives of controlling shareholders, namely the subsidiaries of listed companies, affiliated companies, and the whole Group.

The reasons for choosing SASAC, China Minmetals Corporation, CNPC and Rainbow Group to be cases for research are discussed below. Firstly, SASAC is an important government department candidate for reform of Chinese SOEs. One of contributions of SASAC is that SASAC established State-Owned Assets Supervision. It is responsible for managing SOEs in China, including appointing top executives and

⁵⁷ Ibid, p341.

⁵⁸ Ibid, p341-348.

approving mergers or sales of assets, as well as drafting laws related to SOEs.⁵⁹ The data collected from SASAC helps this research to conduct in-depth discussion from a wider perspective. Specifically, the term “data” refers to notices, decisions, plans, and reports which can reflect the change of CG of SOEs in China. Through analysing the data from SASAC, further trends of CG of SOEs will be predicted. Secondly, CNPC and China Minmetals Corporation⁶⁰ are first generation SOEs in China with a long history. Both of them have experienced the whole reform process of SOEs, therefore, they are typical cases for this research. Thirdly, CNPC and China Minmetals Corporation are Chinese state-owned listed-enterprises, so from the CG perspective, the experience and lessons of CG will more standardized. Last but not least, Rainbow Group was one of the central enterprises operated by SASAC in Beijing, transferred from the state-run colour picture tube factory in Shanxi Province. It was a wholly state-owned enterprise and founded in 1977. Rainbow Group was approved by SASAC and merged into the China Electronic Information Industry Group. Co, LTD. It became a wholly-owned subsidiary, and was no longer supervised directly by SASAC.⁶¹

Through the fieldworks above, more details and differences about the CG of different SOEs were gained and analysed, including state-owned corporation, state-owned subsidiary, state-owned Group and state-owned listed company. The hardship, the gap and the conflicts between theory and practice of CG of SOEs, and the role of the Party Committee are the practical difficulties which have to be faced up to in developing CG

⁵⁹ Lu, *supra* note 48, at p8.

⁶⁰ More details see <http://www.minmetals.com.cn>.

⁶¹ More information can see <http://www.rainbow-china.com>. Rainbow was established as Xiangyang Color Picture Tube Factory in 1977, upon the ending of Cultural Revolution.

of Chinese SOEs. The fieldwork such as interviews was repeated over and over again during the period of research. The fieldwork of this thesis is a progressive and developmentally process. Although some arguments cannot be shown in this thesis because of the interviewers' position and background, the fieldwork is enormously significant for this thesis as it helps further understanding for CG of SOEs. For example, on the one hand, from the point of view of the management system, the mode of management system for state-owned Group is the factory director responsibility system; it is not the CG of MES, in general, and the state-owned Group is operated by non-CG. On the other hand, a Chinese state-owned listed company is in accordance with the Company Law, and all the forms of CG are very comprehensive. Therefore, the scope of CG of SOEs in this thesis has been defined, that is the CG of Chinese state-owned listed company and CG of wholly state-owned company.

1.3.3 Qualitative Research Strategy

The next goal of this chapter is to focus on the difference between theory and practice of CG of SOEs in China. The methods to be applied are qualitative research strategy and fieldworks. As mentioned above, in the second year of research, fieldwork was conducted in China. Qualitative research strategy is one of main methods used in the process of fieldwork. One of key aspects of fieldwork is the interview. The interviews had been carried out with managers and legal advicers, and employees of CNPC in Beijing and Jilin, Rainbow Group in Beijing, and China Menmetals Corporations in Beijing, government officers, lawyers.

Different answers were to be explored in the process of interviewing different groups. First of all, the interviews with managers of SOEs sought the difference between theory and practice of CG of SOEs. Because the managers of SOEs received the documents about CG of SOEs from central or local government which specify “what CG of SOEs should do”, while in practice, they may experience practical problems of CG and they may have their own understandings of “what SOEs are not able to do now and why”. Secondly, lawyers who deal with cases related to CG of SOEs and legal advisers of SOEs are the pioneers to get in touch with about the new situation for Chinese reform of SOEs. Their voices reflect the main debated points of CG of SOEs. Finally, employees are another important group who should not be ignored for CG of SOEs. The attitudes, feelings and suggestions of employees call for the practical change of CG of SOEs.

To summarise, the interviews try to adopt different positions to examine how functions of CG are applied in reality for SOEs reform. These following sub-questions would be solved through interviews: What is CG of SOEs in reality? What is the difference between theory and practice of CG of SOEs? Which part of CG of SOEs often appears legal disputes? For the legal disputes aspects of CG, is the current law able to solve, and if not, why not? What are the difficulties of CG of SOEs in practice? Which problems are caused by early reform of SOEs? Which problems are caused by CG of SOEs? What kind of difficulties would be solved through improving the CG of SOEs? How can laws improve CG of SOEs?

1.4 Theoretical Approaches and Literature Review

The theoretical approach in this thesis is based on the assumption that there is a gap between theory and practice in the CG of SOEs in. This section tries to answer whether Chinese law is an appropriate approach (suitable for Chinese social situation) for CG of Chinese SOEs in current situation, and how Chinese law makes CG of SOEs better.

Many scholars have studied the theory of CG from different angles, in particular, the theory on separation of property ownership and management, principal-agent theory and stakeholder theory, as represented by scholars as follows. They are the basis for the main theories about CG structure.

Separation of property ownership and management

The theory on separation of property ownership and management is developed with the emergence of the joint-stock company. The representatives are Adolf Berie and Gardiner Means, and Alfred D. Chandler. Jr. According to the report about 200 larger-sized companies in American conducted by Berie and Means, quite a proportion of these companies were controlled by the senior management who did not hold the shares of the companies.⁶² Thus it concluded that separation of ownership and control had taken place in the modern company, and the company had been controlled by professional managers. A similar argument was further analysed by Chandler who held that dispersed shareholding and professionalization of management led the

⁶² Berie, Adolf, and Means, Gardiner. 1932. *The Modern Corporation and Private Property*, Macmillan.

manager with a monopoly specialized business information and with professional management knowledge to grasp control of the enterprises, which then led to separation of ownership and control.⁶³

Principal-agent theory

There is a core problem caused by the separation of ownership and control which is how to supervise the operators and managers for the owner who lost control and how to protect the operator and manager to conduct business decisions aimed at maximizing the interests of the owner, rather than abuse of management decision-making. This problem is fundamental for the principal-agent theory to solve. The principal-agent theory is an important part of CG theory, which summaries the features of the owner (principal) and managers (agent) as follows: economic interests are not completely consistent, the risks for the company are not the same, and the information of operating and capital operation is asymmetric. The operator is responsible for the company's business operations, with absolute information superiority. Therefore, if the operators pursue self-interest maximization, their behaviour is likely to be inconsistent with the interests of the owner and the company, and even damage the interests of the owner and the company, and then induce risks.⁶⁴ In order to avoid this risk and ensure safety and the biggest return on investment, CG as a preventative mechanism which should be introduced into modern company, and realize the operator's incentive and supervision.

⁶³ Chandler, Alfred, D. 1977. *The Visible Hand: The Managerial Revolution in American Business*, Belknap Press. Cambridge, MA.

⁶⁴ Jensen M. and W. Meckling. (1976). Theory of the Firm : Managerial Behavior, Agency Costs, and Ownership Structure, *Journal of Financial Economics*, 3 1976. Pp. 305-360.

In summary, the company's shareholders are the owner, namely the principal, and the operator is the agent. The agent's behaviour is self-interested; their target concerning the business is different from the interest of owners, with a tendency towards opportunistic behaviour.⁶⁵ Therefore, the key problem of CG is to solve the agency risk, namely how to make the agent to perform the duty of loyalty, and how to establish an effective mechanism of incentive and constraint, in order to supervise the operator service for the owners (shareholders) with the target of maximizing the shareholders' interests.⁶⁶

Stakeholders' theory

Stakeholders' theory is a new concept of connotation for CG, which in a broad sense refers to anyone who has an interest or relationship with the company, and the natural person or legal person or institution which have a bidirectional influence on the company, such as shareholders, creditors, employees, customers, suppliers and retailers, the community and government, individuals and groups.⁶⁷ Stakeholders' theory developed principal-agent theory, believing that the purpose of company cannot be confined to maximizing shareholder profits, and should consider the other stakeholders mentioned above.⁶⁸ To maximize the interests of various stakeholders should be the

⁶⁵ Liu Yougui, Jiang Nianyun, 2006. "Weituo Daili Lilun Pingshu", *Academics*. 01 2006. and see He Yadong, Hu Tao, 2002. "Deputation Theory Review", *Journal of Shanxi Finance and Economics University*. 24(3) 2002.

⁶⁶ Ding Hongyan, 2000. "Daili Lilun yu Gongsu Zhili Jiegou yiji dui Woguo Guoyou Qiye Gaige de Qishi", *China Economist*. 03 2000.

⁶⁷ Li Weian, Tang Yuejun, 2005. "Shangshi Gongsu Liyi Xiangguangzhe, Zhili Jizhi, Zhishu Zhili yu Qiye Yeji", *Management World*. (9) 2005. Pp. 127-139.

⁶⁸ In 1963, a research team -SRI - from Stanford University, United States, proposed the concept of stakeholders, refers to the groups without whose support the companies cannot develop. However, the theory of stakeholders did not attract more attention from the management academia. See Freeman R. E., Reed D. L. 1983. "Stockholders and Stakeholders: A New Perspective in Corporate Governance", *California Management Review*. 25 (3) 1983. Pp. 88-105. Blair thinks that company is an organization with social responsibility, and the existence of the company is

modern company's business objective, and can be seen as the value of the company as an economic organization. Therefore, the effective CG should provide rights, responsibilities and obligations which match the stakeholders' interests.

Around the goal, structure and reform of CG, different theories have been introduced. Stakeholders' theory has gradually become the mainstream academic opinion. Furthermore, different academic theories have also developed in China. The main academic opinions from Chinese scholars will be presented in next section.

Relevant issues review

This section will review two main issues. The first main issue to be examined is the reform of SOEs in China. Firstly, background and origin of Chinese SOEs reform will be reviewed. Secondly, the importance and development of SOEs reform will be discussed, with reference to theories and schools of thought. Finally, the four stages of reform of SOEs will be highlighted to demonstrate different targets of development of Chinese SOEs.

The second issue to be examined is the SOEs reform on CG in China. First of all, the definition of CG will be reviewed, with reference to theories and schools of thought from Chinese scholars and foreign scholars. Secondly, the origin and development of CG of SOEs in China will be analysed. Last but not least, the issues in the debating of CG of Chinese SOEs will be critically examined, such as internal governance, external

to create wealth for the society. The key to CG reform is that should not give more rights and control to the shareholders. See Blair M.M. 1998. "For Whom should Corporate be Run? An Economic Rationale for Stakeholder Management", Long Range Planning, 31 1998. Pp. 195-200.

governance and other relevant issues which need to be solved by good governance.

1.4.1 Reform of SOEs in China

Since the economic reform which took place in the 1980s, the target of the reform of Chinese SOEs has been changing gradually. In 1999, the Decision of the Central Committee of the Communist Party of China on the reform of SOEs pointed out: “Advancing SOE reform and development is an important and urgent task.”⁶⁹ In order to achieve a comprehensive understanding on the reform of SOEs in China, the following part will discuss the reform of Chinese SOEs from different perspectives through a literature review and critical analysis, highlighting the importance and different four stages of the reform of Chinese SOEs.

- *Understanding the Reform of SOEs in China*

In understanding the reform of Chinese SOEs, there is no universal and certain definition across laws, regulations and academic literature. Scholars have tried to introduce the process of the reform of SOEs in China through defining the significance, targets and other relevant issues of the reform of Chinese SOEs.⁷⁰ This thesis adopts the view that the reform of SOEs in China is not a static concept. On the contrary, the

⁶⁹ See The Decision of the Central Committee of The Communist Party of China on Major Issues Concerning The Reform and Development of State-owned Enterprises, adopted on September 22 the Communist Party of China the 15 th, issued by the Cenral Committee of the Fourth Plenary Meeting 1999.

⁷⁰ Lang Xianping, Sun Jie, 2003. “Chanye Zhenghe Zhongguo Qiye de Qiantu Mingyun”, *Economy*, 10 2003. P. 30-33. and see Li Yining, 2000. “Guoqi Gaige Yaopo Liuda Sixiang Zhangai”, *China Reform*, 03 2000. P. 19 and see Li Zheng, Dai Shuanping, 2008. “Zhongguo Guoqi Gaige Sanshinian de Lilun Huigu Yu Zhanwang”, *Jiaoyubu Wenke Zhongdian Yanjiu Jidi Lianyihui 2008nian Nianhui Jiqingnian Jingjizhe Luntan Lunwenji*. <http://www.cmr.xum.edu.cn> (accessed on 21 September 22, 2015)Pp. 297-305. and see Zhang Wenkui, 2006. “Zhongguo Yinggai Tingzhi Guoyou Qiye Gaige Chanquan Gaige—Huiying Langxianping Xiansheng de Ruogan Guandian”, *Party Construction of Company*. 01 2006.

thesis believes the reform of SOEs in China is a dynamically moving process along with the development of Chinese economic reform. Therefore, the concept of SOEs reform in China cannot be defined fully until the Chinese reform of SOEs is complete in future. If so, when will the reform of SOEs in China are completed? What are the achievements and aims that Chinese SOEs ought to seek in the reform? Nobody can answer the question as to when the reform will be finished. However, the aim of Chinese SOEs reform was the hot topic for both public and scholars in the early years of the reform. The answer was hiding in a good summary: The reform of Chinese SOEs is related to the lay-out of state-economy, and tries to make considerable number of SOEs adapt to the demands of a market economy.⁷¹

There are various aspects of the reform of Chinese SOEs that scholars have summarized and discussed. From a prominent and mainstream perspective, the dynamic process of reform of SOEs includes a series of changes. Firstly, back in the times of the planned economy, Chinese SOEs were appendages of central or local governments, and were controlled through policy and administrative instructions by governments. This old fashioned framework was criticised by Lu Fucai who argued that Chinese SOEs should be independent market operators and competitors and should be firmly embodied into laws and regulations with the development of reform of SOEs.⁷² Considering the criticisms made by scholars about the old model of SOEs and government, this thesis holds the view that such debates about the old model were

⁷¹ See The Decision of the Central Committee of The Communist Party of China on Major Issues Concerning The Reform and Development of State-owned Enterprises, adopted on September 22 the Communist Party of China the 15 th, issued by the Cenral Committee of the Fourte Plenary Meeting 1999.

⁷² Lu, *supra* note 48, at p6.

helpful to develop SOEs in the early period of the reform. This was because the debates on the correct role for the government to play in the reform of SOEs in China attracted much attention from decision-makers. In 1980s and 1990s, the concept of CG was not officially introduced in China, but from a different perspective, the issue of how the state acts as an owner for SOEs in China forms a basic issue about CG of SOEs in theory today. To illustrate this point, the issue about how the states act as an owner of SOEs was discussed as a basic and important chapter in OECD Guidelines 2005.⁷³ Secondly, the SOEs under the traditional mode were formed with an all-inclusive organization structure.⁷⁴ Such a structure failed to focus efficiently on specialized production capacity and thus lacked market competitiveness. The reform in this aspect was to bring changes so that SOEs should be structured as specialized corporations. Previously, before the reform, the state was the only investor and operator. Scholars argued that sources of investment must be diversified after the reform.⁷⁵ Another opinion comes from Jiang Ping from the legal system to research. Jiang Ping believes that the issues on CG- the governance structure of listed companies should focus on three important legal problems. Firstly, what on earth is the range of autonomy of the parties in the CG structure? Secondly, how the legal systems deal with the same interests of shareholders and company? Thirdly, what is the role of the jurisdiction intervention in the CG structure?⁷⁶

⁷³ OECD, supra note 16.

⁷⁴ The term of all-inclusive refers to a package of management for the overall planning of management. For more details, see Wu Xiaomin, Wu Fangning, 2006. "Guoyou Qiye Jianchi Dangguan Ganbu Yuanze de Renshi yu Shijian", *Journal of Jiangxi Administration Institute*. 04 2006. Pp. 19-22.

⁷⁵ Qian Weiqing, 2006. 'From Legal Perspective, Analysis the Reform of Chinese SOEs', *Legal Report of SOEs' Reform*. Beijing: CITIC Publishing House. Pp.55.

⁷⁶ Jiang Ping, 2002. 'Wanshan Gongsi Zhili Jiegou de Jiben Falv Wenti', *Finance and Economics*, (11) 2002.

The various kinds of changes discussed above were taken as the goal for the reform of SOEs by policy makers in early period of Chinese reform of SOEs.⁷⁷ During the process of the reform of SOEs in China, some of those goals were achieved.⁷⁸ However, some problems were not solved and then became central points of the reform, such as the issue on the role of state and government for SOEs. Those problems pushed the reform of SOEs in China to new direction.

- *Background of Reform of SOEs in China*

Since the Third Plenum of the 11th Communist Party of China (CPC) Central Committee, China has embarked on a new way of building socialism with Chinese characteristics, guided by Deng Xiaoping's Theory. Against this the background, the reform of Chinese SOEs, as a part of economic reform in China, were advanced gradually to overcome the defects of the traditional planned economy. The term "defects" here refers to the problems and contradictions of SOEs which emerged during the transition stage, such as redundant construction of SOEs and lack of flexibility in terms of operations of SOEs.⁷⁹ Those defects could be seen as a result of some SOEs

⁷⁷ Different periods of reform have had different targets. According to decision of the Fifteenth Central Committee of the Communist Party of China, the reform of state-owned enterprises and the development goal is "to adapt to the economic system and economic growth way two fundamental shift and enlarge the demand of opening to the outside world, basically complete reorganization strategic adjustment, the state-owned economic layout and structure of reasonable, to establish a relatively perfect modern enterprise system, the economic benefit is improved obviously, science and technology development ability, market competition ability and the ability to resist the risk enhanced obviously, the state-owned economy better to play a leading role in the national economy." The task of the reform of state-owned enterprises is to make the state-owned enterprises become the basic modern enterprise, establish modern enterprise system in large SOEs; the second target is to adjust the structure of the state-owned economy, and establish dominant position in the national economy.

⁷⁸ After the experience of almost twenty years reform of SOEs in China, some goals had been achieved, such as establishing modern enterprise system in large SOEs and adjusting the structure of the state-owned economy, establishing a dominant position in the national economy; however, the result of reform should become deeper in future. More discussion can be seen in Xu Jingyong, Huang Huanwen, 2002. "We Are not Ready to Achieve the Goal of State-owned Enterprises Reform", *Economic Review*. (7) 2002.

⁷⁹ See The Decision 1999, *supra* note 9.

not having adapted to the demands of a market economy. In fact, those problems were not to be solved in the following decade.

- *The Importance of Reform of SOEs*

The public-ownership economy, which includes the state-owned economy, is the economic base of China's socialist system. The SOEs are a pillar of China's national economy. Reform of SOEs will enhance the vitality of the SOEs and the control of the state-owned economy in an overall way, and this is of great significance from the establishment of a socialist market economic structure, to the improvement of the people's living standards, as well as maintaining a good political situation of stability and unity.⁸⁰

- *The Four Stages of Reform of SOEs in China*

The development of the reform of Chinese SOEs was a part of the implementation of the Reform and Opening up Policy in China. It is widely accepted that the history of reform of SOEs can be divided into several periods. For example, according to Qian Weiqing, there are four stages of reform of SOEs. The first stage was from 1978 to 1983, when the Chinese government tried to expand enterprises' autonomy. The second stage was from 1983 to 1987. The focus of reform of SOEs in this period was on the issue of interest distribution between government and enterprises. In the period between 1987 and 1992, the SOEs contract responsibility system was enhanced by the Chinese

⁸⁰ Ibid.

government. From 1992 until to now, most SOEs are trying to establish a modern enterprises system.⁸¹In summary, Qian’s opinion on the four stages of SOEs shows that SOEs were reformed by means of administrative measures, policies and laws.

In this research, the history of reform of Chinese SOEs will be divided into four stages, namely, the first stage from 1978 to 1988, the second from 1988 to 2002, the third from 2002 to 2011, and the fourth from 2012 to present and future. The way in which these stages are divided is in accordance with the different focuses regarding state-owned asset as was administrated by the Chinese government in different stages.

- *The first stage: 1978 - 1988*

First of all, from 1978 to 1988, the main goal of reform of SOEs in China was to separate governments from SOEs. During this period, there were no relevant laws and regulations on SOEs, but some important policies and decisions about this issue were implemented which directed the reform in a better and clear way. As mentioned above, those policies and decisions will be described as “documents” in this research.

For example, The Third Plenary Session of the 11th CPC Central Committee was held in Beijing in 1978.⁸² It marked the beginning of the Reform and Opening Up policy. The

⁸¹ Qian, *supra* note 31, at p61.

⁸² The Third Plenary Session of the 11th CPC Central Committee correctly solved the key problem of the relationship between the reform and opening up, so as to find the correct way for Chinese modernization development, and greatly propelled the development of China's modernization process, firmly grasp the socialism direction of China, and establish the correct coordinates for the formation of the socialist modernization with Chinese characteristics, to ensure the steady development of China's modernization. See Du Yanhua, 2008. “Lundangde Shiyijie Sanzhongquanhui Zai Zhongguo Xiandaihua Shishang de Teshu Diwei”, *Academic Forum*. 10 2008. pp. 62-66. the meaning of the Third Plenary Session of the 11th CPC Central Committee can see Zhao Xianming, Feng Jing, 2010. “View on the Third Plenary Session of the Eleventh Central Committee Learning and Dealing with the Historical Problems—Postscript on Learning the Committee of the Third Plenary Session of the Eleventh Central Committee”, *Journal of Xichang College (Social Science Edition)*, 22 (4) 2010. Also see, Ning

policy offered a good condition and background for the reform of SOEs. In addition, in 1984, the Third Plenary Session of the 12th CPC Central Committee adopted the Decision of the Chinese Central Government on Economic Reform, particularly stressing the need to enhance the vitality of the state-owned large and medium-sized enterprises.⁸³ Moreover, in 1986, the State Council issued Provisions on Deepening Enterprises Reform to Enhance the Vitality of Enterprises, proposed the implementation of the various forms of management responsibility systems for large and medium-sized state-owned enterprises, such as the contract responsibility system.⁸⁴ In summary, the first stage of reform of SOEs was the reform in a superficial standard, policy and plans more than in specific actions. In relation to this research, it is worth noting that one of the main goals of this period of reform was to establish a concept of economic reform for the whole country.

- *The second stage: 1988 - 2002*

The second stage is from 1988 to 2002. Most scholars state that in this period the reform of SOEs focused on the establishment of a modern enterprises system.⁸⁵ This research agrees with this argument and holds the opinion that in this stage the Chinese government paid more attention to the definition and administration of state-owned assets. For example, in 1993 the CPC amended the Constitution of the PRC and

Nan, 2008. "Shiyijie Sanzhong Quanhui Lakai Zhongguo Gaige Damu", *Business Watch Magazine*, 14 2008. Pp. 58-59.

⁸³ Lu, *supra* note 48, at p5.

⁸⁴ *Ibid.*

⁸⁵ Zhou Guanqiang, 2007. "Guoqi Gaige yu Xiandai Qiye Zhidu Biange", *Modern Enterprises*. 11 2007. P. 14 and see Lin Yifu, Li Zhou, 1997. "Xiandai Qiye Zhidu de Neihan yu Guoyou Qiye Gaige Fangxiang", *Economic Research Journal*. 03 1997. Pp. 3-10.

established a socialist market economic system in this context, the concepts of “state-owned” and “state-operated” were separated in law.⁸⁶

- *The third stage: 2002 - 2011*

The year from 2002 to 2011 should be seen as the third stage of reform of SOEs, because in this period the reform of small and medium-sized SOEs was completed.⁸⁷ Also at this stage, the CG of SOEs in China had become the core of reform of SOEs, especially after 2003.⁸⁸ Therefore, from a perspective of the CG of SOEs, experiences and lessons from the reform of small and medium-sized SOEs should be applied to large-sized SOEs. The specific events which can show that the CG of SOEs had become central to the reform of SOEs will be discussed in the following section.

- *The fourth stage: 2012 - present and future*

The main goal of the reform of SOEs from 2012 onwards concerns the CG of large-sized SOEs.⁸⁹ This research will focus on a number of sub-questions including:

- What is the difference between the CG of small and medium-sized SOEs and CG of large-sized SOEs in the reform?

⁸⁶ Lu, supra note 48, at p5.

⁸⁷ Shao Ning, 2012, The Report from SASAC Boao Forum for Asia in Apr. 2012. http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12.

⁸⁸ For the reform of state-owned enterprises, 2003 was a milestone; the establishment of the SASAC indicated the reform of SOEs had entered a new stage. After the reform of state-owned enterprises, The kuoquan rangli, the implementation of contracted responsibility system of the SOEs gradually introduced SOEs into the market; pushed the establishment of MES in the large SOEs and Zhuada fangxiao, experienced the process of reorganization and joint, merging, leasing, contract operation, the joint stock cooperative system and sell or other forms to enliven the state-owned small and medium-sized enterprises; the establishment of SASAC means the reform of SOEs has made great progress in the exploration, and has entered a new historical stage. See Luo Zhirong, 2013. “Guoqi Gaige: Shinian Gongjian Tanchu Fazhan Xinluzi”. *Enterprises Civilization*. (3) 2013. and see Lin Yifu, 2003. “Guoziwei dui Guoqi Gaige Qi Shenme Zuoyong”, *China National Conditions and Strength*. 10 2003. P. 2.

⁸⁹ Ibid.

- What is the aim and target of the reform of large-sized SOEs in China?
- What is the target of the CG of large-sized SOEs?
- How will the large-sized SOEs achieve the target?

1.4.2 CG of SOEs

From both national and international perspectives, the definitions of CG and SOEs were discussed in the introduction part of this thesis. In order to avoid repetition, this section does not review each definition in detail. It mainly provides a brief account of the relationship between CG and SOEs in China, the background and development of CG of reform of Chinese SOEs and debated issues on the CG of Chinese SOEs.

- *The Understanding of CG of SOEs*

In OECD Guidelines on CG of SOEs, the specific difficulties of CG of SOEs are illustrated: “Corporate governance difficulties derive from the fact that accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, and the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge.”⁹⁰ The SOEs had to face up to those difficulties after a long time, and the OECD experience showed that good CG of SOEs is an important prerequisite for economically effective development.

⁹⁰ OECD, *supra* note 16.

In China, the concept of CG is officially introduced after 2000, but the practice has begun long before that. In fact, most problems mentioned in OECD Guidelines, such as management, ownership entities and the government, were handled by Chinese SOEs in the reform. However, because CG as a concept was introduced into Chinese SOEs later than practice, the uniform concept of CG of Chinese SOEs was not defined. A number of scholars believe that CG of SOEs in China is a complex and extensive system. A representative argument is from Qian Weiqing, who argues that the CG of SOEs in China is an adjustment system about government, SOEs, employee and other relevant parts.⁹¹

In this thesis, the CG of SOEs in China will be discussed based on Qian's opinion, but the scope of CG of SOEs will be defined clearly mainly from the perspectives of internal governance and external governance.

- *Background and Development of CG of Reform of Chinese SOEs*

The concept of CG of reform of SOEs in China has become a core focus especially after 2003. This section analyses the reasons why the CG of SOEs became so important to the reform of SOEs in China.

In the practice, the most debated issues of SOEs in the history of Chinese reform include the management, state acting as owner, government and ownership. In 2001, China accessed the World Trade Organization (WTO). To meet the international

⁹¹ Qian, *supra* note 84, at p 61.

standards, China had to solve weak points in all respects in a short time, included the CG of SOEs. This is to enable Chinese SOEs to face up to competition from the entire world. At the same time, in 2002, CG Guideline for Listed Companies was issued,⁹² and a normative standard was proposed for CG for Chinese SOEs, which was advantageous for improving CG of Chinese SOEs. Some Chinese SOEs were changed in the process of reform by taking the CG Guideline for Listed Companies as an important reference.

From a national perspective, in 2003 the reform of Chinese state-owned enterprises entered into a new era. The State-Owned Assets Supervision and Administration Commission (SASAC) were established in 2003. SASAC is a specialist commission, directly under the State Council. It is responsible for managing China's SOEs, including appointing top executives and approving any mergers, sales of stock or assets, as well as drafting laws related to state-owned enterprises.⁹³ It is the view of this thesis that the establishment of SASAC has significant implications in practice for the reform of SOEs in China. This is because it is the first opportunity for SASAC to clarify the issue of ownership of SOEs in practice and act as an investor and owner of SOEs. After the establishment of the SASAC, some attempts were made to establish a legal supervision system for state-owned assets in China. These attempts include the

⁹² Code of Corporate Governance for Listed Companies in China, issued by CSRC, and State Securities and Trade Commission on January 7, 2001. The Code combined with Chinese Company Law and Chinese Securities Law, CSRC Guidelines for Articles of Association of Chinese Listed Companies, established a corporate governance of Chinese listed company's evaluation system, for example, the Code influenced the Chinese Audit Committee System, according to the Article 52 of the Code, The board of directors of the listed company may set up the strategy, audit, remuneration and appraisal committee in accordance with the relevant resolutions of the shareholders' meeting, the audit committee under the authorization of the company, responsible for handling the company's financial and supervising internal control system, especially play an important role in the process of financial disclosure and prevent financial reporting fraud.

⁹³ Lu, *supra* note 48, at p8.

issuance of the Supervision and Administration of State-Owned Assets of Enterprises, the Interim Measures for Assessment of the Operational Performance of Persons in Charge of Central Enterprises, and a document on High-tech Central Enterprises to carry out the Work of Stock Option Incentive Pilot.⁹⁴

At the same time, four main points were proposed by the Resolution of Certain Issues from CPC Central Committee on Perfecting the Socialist Market Economic System:⁹⁵ first of all, establishment of state—owned capital management budget system and development performance evaluation system of business operators; secondly, improvement of the authorized management system; thirdly, establishment of property rights trading rules and regulatory measures; last but not least, establishment of regulation on the supervision and management for state-owned financial assets, non-operating assets and natural resources assets. These four main points reflected a positively good signal that policy from Chinese government had begun to develop CG of SOEs. After that, some attempts have been made in the Chinese legal system to promote the development of CG of SOEs. For example, the Law of the People's Republic of China on the State-Owned Assets of Enterprises, which was adopted upon deliberation at the 5th sessions of the Standing Committee of the 11th National People's Congress on October 28, 2008, came into force on May 1, 2009.⁹⁶ It has had a major impact on improving the state-owned assets' administration system and advancing the

⁹⁴ Ministry of Science and Technology in China, 2004.

⁹⁵ The Resolution of Certain Issues from CPC Central Committee on Perfecting System of Socialist Market Economy, adopted on October 14, 2003 by the Communist Party of China through the Third Plenary Sessions of the Sixteenth Central Committee.

⁹⁶ Lu, *supra* note 48, at p8.

reform and development of the state-owned enterprises.⁹⁷

In summary, the issue of the CG of Chinese SOEs has become a core agenda over time for the reform of Chinese SOEs. In the history of Chinese SOEs reform, many factors have encouraged the CG of SOEs to occupy a central place in the Chinese SOEs reform. Next, the following parts will analyse the experience and lessons of CG of Chinese SOEs between 2003 and 2011.

- *The Experience and Lessons of CG of Chinese SOEs*

In the process of the reform of SOEs in China, some of the most debated points have attracted scholars' attention. These points are mainly concentrated upon the issues of internal governance and external governance. From a legal perspective, the following part critically discusses arguments from scholars about these two issues.

Internal Governance of CG of SOEs

Firstly, the ownership of SOEs in China was not in the past clearly defined and clarified. As mentioned above, some scholars believe that the establishment of the SASAC is a big improvement for the CG of SOEs in China. But this thesis argues that the establishment of SASAC cannot make up for the lack of a completed legal system. According to Qian Weiqing, the ownership of SOEs under the traditional system was

⁹⁷ The Law of the People's Republic of China on the State-Owned Assets of Enterprises makes many issues clear, including ownership of state-owned assets, the duties of the investor, the selection of state-funded enterprises, management personnel, operation and management of state assets, state assets assessment and transfer of state-funded enterprise restructuring and restructuring of state-owned capital management budget management, state-owned assets supervision and operational auditing, and legal responsibilities of the state-owned asset management.

failing, because the owner and operator were not separated.⁹⁸ Qian argues that the decision-makers of SOEs were the owners who controlled SOEs. If they made wrong decisions, the loss made by the SOEs was accepted by the State.⁹⁹ Another scholar Li Baoyuan reveals a similar opinion that unclear ownership of SOEs will lead to insider-control.¹⁰⁰ This thesis agrees with their views. In fact, this thesis believes that the undeveloped and traditional ownership of SOEs is the source of loss of state-owned assets, because the traditional ownership of Chinese SOEs cannot be suitable for the development of a market economy. That is why the SOEs restructuring is necessary to meet the need of market economy.¹⁰¹ In addition, a lack of clear protection by legal system for the owner of SOEs is another main problem. According to Interim Provisions on the Ownership of State-owned Shares of the Pilot Enterprises of the Stock Ownership,¹⁰² Articles 2, 3, 13, 14, 15, 16, 25, the regulation only described the obligation of the equity for the state, but did not describe the interests of the equity for the state. It will discourage owners of SOEs to pursue improvement of SOEs due to lack of motivation.

Secondly, another weakness of CG of SOEs in China concerns the protection of small shareholders' rights and interests. According to OECD Guidelines 2005, the state and

⁹⁸ Qian, supra note 84, at p 66.

⁹⁹ Ibid.

¹⁰⁰ Li, Y, 2007. 'New Wave on Equity Incentive of Reform of State-owned Enterprises', *China Report*. Pp. 78-81

¹⁰¹ Loss of state-owned assets can be divided into two stages in the process of state-owned enterprises restructuring. The first one is that losses due to underestimated value of SOEs in the process of restructuring. The second one is the loss of interest of state-owned shares in the operation after the restructuring. The main reason is the supervisor system for state-owned assets is not sound, assets appraisal is not in accordance with the regulations, and circulation of state-owned shares cannot be listed. For more discussion, see Wang Zhenjiang, Li Jing, 2000. "Guoyou Qiye Gaizhi Zhong Guoyou Zichan Liushi de Yuanyin Fenxi ji Falv Duice", *Journal of Lanzhou University (Social Sciences)* 02 2002. Pp. 87-91. and see Yang Dan, 1999. "Guoyou Qiye Zichan Zhuanrang Dingjia Xingwei Fenxi—Jianping Guoyou Zichan Liushiguan", *Economic Research Journal*. 12 1999. Pp. 15-23.

¹⁰² Interim Provisions on the Ownership of State-owned Shares of the Pilot Enterprises of the Stock Ownership adopted by State-owned Assets Administration Bureau on July 27 1992.

SOEs should recognise the right of all shareholders and ensure their equitable treatment and equal access to corporate information.¹⁰³ However, these rights and equitable treatment are not stated in current Chinese law. Without clear provisions to define the specific rights and interests of shareholders, especially small shareholders, their rights and interests cannot be protected properly. Using a similar argument, Yao Yang points out that in Company Law of the PRC the protection of shareholders is only mentioned in some Articles.¹⁰⁴ For most Chinese SOEs, the state-owned equity stands at a high proportion; minority shareholders always lose interest in shareholders meeting and are then absent from shareholders meetings. This being so, the law on protecting the right of shareholders just exists in name only.

Thirdly, the board of directors is undeveloped for most Chinese SOEs. The board of directors of Chinese SOEs is established by reference to OECD Guidelines.¹⁰⁵ However, in practice, some scholars have pointed out several problems. For example, Lu Fucui pointed out that the board of directors of Chinese SOEs lacks independence, because the relationship between the state and SASAC is unclear.¹⁰⁶ Zhu Xiangyu concludes that the functions of decision-making and supervision of the board of directors of Chinese SOEs are underdeveloped.¹⁰⁷ The basic functions of a board of directors of Chinese SOEs cannot work well in practice, because the theory of CG was copied from western countries.¹⁰⁸ In China, the concept and mode of CG were

¹⁰³ OECD, supra note 16.

¹⁰⁴ Gu & Zhou, 2004. 'Breakthrough Corporate Governance Bottleneck, Deepen the Reform of SOEs', *Journal of Social Sciences*. Pp. 121-122.

¹⁰⁵ OECD the State-Owned Enterprises' Corporate Governance Guidelines 2004.

¹⁰⁶ Lu, supra note 48, at p152.

¹⁰⁷ Zhu, 2009. The Research of Low Efficiency on Management of Chinese SOEs, *Academic Research*. 1-4.

¹⁰⁸ More details about transplant of corporate governance will be discussed in Chapter 6, the characters of Chinese

established over a short period of time, therefore, in practice, the traditional mode has not changed completely.

Fourthly, the board of supervisors of SOEs in China is titular. The function of the board of supervisors of SOEs is only an ideal, but not a reality in practice.¹⁰⁹ Practical problems about the board of supervisors of SOEs in China can be summarised as following two points. On the one hand, there is no clear provision to define the authority of board of supervisors in Chinese Company Law.¹¹⁰ On the other hand, the function of supervision of the board of supervisors of Chinese SOEs is ex post facto.¹¹¹

1.5 Outline and Overview of Chapters

This thesis includes seven chapters as follows.

Chapter 1 offers an introduction of this research. It provides a background of the Chinese reform of state-owned enterprises over more than the last twenty years. Corporate governance, as a new solution to improve efficiency of Chinese SOEs, has been the focus of Chinese reform of SOEs since 2003. It is demonstrated in the first chapter that the concept of corporate governance in this research means ownership, shareholders, board of supervisors and board of director.¹¹² This thesis believes that the

CG of SOEs.

¹⁰⁹ More details will be discussed in Chapter 4.

¹¹⁰ See Chinese Corporation Law, Articles: 102 103 112 119 126 143 148 106 126 and more details will be discussed in Chapter 4.

¹¹¹ Ibid and more details will be discussed in Chapter 4.

¹¹² More information about CG can see Pp.16-20 this Chapter.

nature of CG is as a check and balance mechanism between owner and operator. CG is an institutional arrangement which includes formal and informal, internal or external systems to coordinate the interest relationship between company and all stakeholders (including government, shareholders, creditors, employees and suppliers), to ensure the correctness of decision-making, and eventually to guarantee the interest of the company in all aspects. Although the CG of SOEs includes internal governance and external governance, this thesis focuses on the internal governance of Chinese SOEs, including shareholders, board of directors, board of supervisors and managers. This chapter also introduces research questions, methodology, literature review, and the significance of this research.

Chapter 2 is a historical review of the four stages of reform of state-owned enterprises in China. The relationship between CG and the reform of SOEs will be discussed. This is followed by an introduction of the current situation of CG of Chinese SOEs. Firstly, the importance of CG will be discussed. Secondly, the experience and lessons through the reform of small and medium SOEs before 2011 will be summarised and analysed. Thirdly, the chapter also distinguishes between small and medium SOEs and large SOEs, and identifies good governance experience. Fourthly, the aims, characteristics, achievements and difficulties of the reform of large Chinese SOEs will be discussed. The international and national background of Chinese CG is demonstrated at the end of the chapter two.

Chapter 3 focuses on the transformation concerning the ownership and control of SOEs

in the reform period. The term Corporate Governance was introduced in China after 1990, but the adjustments involving the ownership and control of SOEs had already started before then. The transformation process experienced different periods, including an expansion of the SOEs' autonomy, payment of taxes by state enterprises replacing turning over their profit to the state, the reform of shareholding system in Chinese SOEs, a move to grasp the large and let it go the small, the debt-into-equity reform, and the ownership and control of SOEs under the SASAC. The difficulties and breakthroughs of CG of SOEs in the transformation period will be summarized in this chapter.

Chapter 4 discusses the main problems of CG of Chinese SOEs, including internal governance, external governance and related issues. The specific problems related to CG are in the areas of ownership, board of directors, shareholder, and board of supervisors, market control and financial supervision. This Chapter focuses on the current situation and problems of internal governance (the shareholder meeting and the rights of shareholders, the board of directors, the board of supervisors, the managers, information disclosure and the stakeholders) of Chinese state-owned listed companies. National laws and regulations addressing the problems mentioned above will be introduced, and in this context some existing loopholes will be discussed.

Chapter 5 further discusses the issues about internal governance of Chinese state-owned listed companies, including the problems about ownership structure and controlling shareholder's behaviour, the problems about related party transactions and

information disclosure, and the defects of *Sanhui* and stakeholders.

Chapter 6 starts with a discussion on the characteristics of CG of Chinese SOEs in the transition period, followed by an exploration on the solutions for the problems in the CG of Chinese SOEs reform through a legal approach to be taken in the future.

The last chapter is a summary and conclusion of the research.

1.6 Contributions made by this Thesis

The development of CG of reform of Chinese SOEs has entered a new stage. The focus of reform has transferred from small and medium-sized SOEs to large-sized SOEs. However, current literature has not offered much in-depth research for the understanding of this new stage. Therefore, the CG of large-sized SOEs is my focus and the first contribution of this research to the body of knowledge. Secondly, the features of CG of SOEs at the transition time have been summarized as follows: strong intervention by the government, transplantation of Chinese CG into state-owned listed companies and wholly state-owned enterprises, insider control and formalized *Sanhui*. Thirdly, my research will discuss main practical problems of CG, they are also can be seen as the characteristics of the CG of Chinese State-owned listed companies, namely, strong government intervention and the government-led driving force, transplantation of Chinese CG; and this thesis helps to fill in the gap between theory and practice related to the CG of Chinese SOEs reform. The suggestions include fundamentally solve the problem of related party transactions; perfect the management system of

the state-owned equity, standardize the scope and procedure of government intervention. Improve the efficiency of CG of state-owned holding listed companies; strengthen the supervision of insider information sources; improve the state-owned equity transfer system. Finally, my first hand documents from cases studies will fill in the gap for English language literature in the field.

Chapter 2: The Development of Corporate Governance of State-Owned Enterprises in China

In 1978, China embarked on a path of economic reform. Over more than 30 years, this economic reform brought significant changes for China. For example, from 1978 to 2008, China's per capita GDP doubled every ten years; China's economic aggregate world ranking rose from 13th in 1978 to 4th in 2007; China's import and export as a proportion of world trade rose to third place in 2007 from 23rd 30 years previously.¹¹³ Indeed, the past three decades of economic reform have shown the world an economic miracle and delivered contribution to the world. At the same time, it has brought about new issues and challenges. As a big contributor to China's flourishing economy, the development of Chinese SOEs will largely influence the sustainability of economic booms. However, corporate governance of SOEs has lagged behind, and it has become an essential and critical link which needs to be improved.

As an important component of the economic reform, the reform of Chinese State-Owned Enterprises has been continuously discussed by scholars.¹¹⁴ The debates

¹¹³ In early of 1980s, Deng Xiaoping set a goal for Chinese economy, which was that the Chinese national income would be doubled by 2000. But lots of people doubted it and considered it was an impossible task. In Zhang's article, he took these cases and examples to support Chinese economy increasing so fast, even beyond the early goal. For detail discussions of the contribution of Chinese economy reform see Zhang, Weiying, "Zhongguo Gaige Sanshinian" (*The 30 Years of Chinese Economic Reform*)2009: 10.

¹¹⁴ Here are some important and representative scholars and their work: Li Yining, Chinese famous economist and doctoral supervisor of Chinese Prime Minister Li Keqiang, thinks there are two levels for Chinese SOEs reforma higher level is the capital system reform of SOEs which means SASAC does not control SOEs directly, but consists of the SOEs and manages the SOEs' capital configuration. And the lower reform is reform of SOEs system which includes establishing and perfecting the corporate governance structure. For more details, see Li Yining, 2013, *Chinese Economy in Dual Transition*, Beijing: China Renming University Press. And the former books can refer to Li, Yining, 1994. *Gufen Zhi Yu Xiandai Shichang Jingji*. Jiangsu, Jiangsu Renmin Press. Another scholar is Li Weian, he thinks actively developing the state-owned capital, collective capital, non-public capital and other cross-shareholding; mutual integration of the mixed ownership economy is a key to promoting the reform of state-owned enterprises. The reform of state-owned enterprises has gone through three stages, the first: set up corporate governance structure; the second is the perfect governance mechanism; the third one is how to improve the

include the effectiveness of the reform of SOEs in China, the changes to SOEs caused by the reform, and the evaluation of SOEs reform measures in the early days.

¹¹⁵Moreover, with further expansion of the process of reform of SOEs, corporate governance of SOEs has become a heatedly discussed issue.¹¹⁶

This chapter will first review the background of reform of SOEs in China. It will then examine the relationship between the reform of SOEs and corporate governance of SOEs. Finally, it will explore the features of corporate governance of SOEs in a transition stage.¹¹⁷ The chapter aims to expound, through explaining these three

effectiveness of governance. How to improve the effectiveness of corporate governance is the current plight of the reform of state-owned enterprises. Mixed ownership must be introduced to solve the dilemma. For example, a lot of SOEs have been established with the governance structure and mechanism of state-owned enterprises, but the serious problem is corporate governance behavior of the security administration. Some issues should be determined by the internal governance functions, such as the executive to appoint or remove, salary, equity incentive, but have been determined by the external governance. And many of the external management functions, such as the social functions of the enterprise, have been determined by the degree of internal governance. These problems seriously affect the effectiveness of the state-owned enterprises, hindering the reform process. Therefore, introducing the mixed ownership to reform of state-owned enterprises, implementation of cross-shareholding to state-owned capital and private capital and other non-public sectors capital, state-owned capital advantage can be merged with the private capital advantage of flexible market mechanism, in order to improve the governance effect. for more opinions about Chinese SOEs reform of Li Weian see Li Weian, 2009. *Corporate Governance Study*. China Economy Press. And Li, Weian, 2013, *Chinese Corporate Governance: Road to Transition and Perfection*. China Machine Press.

¹¹⁵ Ibid. See the books and articles above. And some more articles which engaged with these debates including: Keister, L. A. 1998. 'Engineering Growth: Business Group Structure and Firm Performance in China's Transition Economy', *American Journal of Sociology*, 104: 404-440. ; Liu, G.S AND Sun, P., 'the Class of Shareholdings and Corporate Performance- A Case of State Shareholding Composition in Chinese Publicly Listed Companies', *Corporate Governance: An International Review*, forthcoming. ; Liu, G. S., Sun, P and Woo, W. T., 'Triggering the Chinese -style Privatization: Motives and Constraints', in Green, S. and Liu, G. S. (eds), *Exit the Dragon ? Privatization and State Ownership in China*, Blackwell, forthcoming.; Qi, D. Wu, W and Zhan, H 2000. 'shareholding Structure and Corporate Performance of Partially Privatized Firms: Evidence from Listed Chinese Companies', *Pacific- Basin Finance Journal*, 8: 587-610.; Sun, Q., and Tong, W.H,S,2003. 'China Share Issue Privatization: the Extent of its Success', *Journal of Financial Economics*, 60: 183-222.

¹¹⁶ See the second footnote in this Chapter. Li, Yining and Li, Weian can be seen as the famous scholars who have researched Chinese corporate governance of SOEs, and their opinions and books are typical. The same issue had been discussed by many scholars, such as Wu, Jiong, 2014. *Corporate Governance*. Beijing. Beijing University Press; and Yue Wu, 2006. *Corporate Governance: Ownership and Goals in SOEs*, Law Press.

¹¹⁷ Mainly refers to the economic transition period. Now China is in economic transition period, from single to complex, planned economic develop towards the market economic, and eventually to integration with the world. Monomer to the development of the complex is embodied in the connection degree between the departments, such as the change of penetration. As before the Tax and Customs are two independent departments, the link between each other is weak, but now the contact between them is more and more close. The tax bureau has a record of the customs information, and the customs, tax related records also can be checked. The embodiment of the planned economy developing into a market economy in the transition of the economic development mode, uch as the economic marketization and interest rate marketization. The ultimate goal of these changes is reach the target with the international community.

aspects, how the Chinese SOEs have improved CG and distanced themselves from the states, and how CG has played a key role for the development of SOEs in future.

2.1 The Background of Corporate Governance of State-Owned Enterprise in China

After the founding of the People's Republic of China in 1949, the main economic goal of the country was to establish a centrally planned economy. China established a state-owned assets management system to adapt to a planned economy at the same time. The Cultural Revolution (1966-76) left China in chaos. Over these ten years, China dismantled the formal legal system which it had begun to create in the early 20th century and continued under Soviet influence in the 1950s. One of the impacts on the Chinese state-owned enterprises was a highly centralized management.¹¹⁸ As a result, when China started its economic reform and tried to re-build the legal system in the late 1970s, the management of state-owned enterprises was involved.¹¹⁹ The so-called 'Chinese reform of state-owned enterprises' was closely bound up with the economic reform. Therefore, a short review of the relevant economic and political environment will provide essential information to understanding the Significance of this history.

¹¹⁸ The term of highly centralized management refers to: firstly, the management right of State-owned assets had been controlled by central government, and the investment plan had been led by government, and the money can be use by government for free, without interest. Secondly, the main measure for the State controlled State-owned assets was material object magnitude pattern, and carried out planned transfer for production and uniform distribution. And finally, the central government controlled too much of the SOEs, the ownership and the rights of management and the rights of operation overlapped.

¹¹⁹ Lu, C *Zhongyang Qiye Gongsi Zhili Baogao, (Report on Corporate Governance of Central State-owned Enterprises)* 2011:5 More traditional way in which the management of SOEs was involved as can be seen in last footnote, because the traditional methods cannot be suitable for the development of Chinese SOEs.

2.1.1 Economic Reform and its Impacts on State-owned Enterprises Reform

There are two terms frequently used in relation to the rise of economic reform, namely ‘socialist market economy’ and ‘socialist economy with Chinese characteristics’. These two concepts were first proposed by Deng Xiaoping in order to incorporate the market into the planned economy in China at that time.¹²⁰

As discussed in Chapter One, corporate governance was introduced into China in 1990s. However, the activities of SOEs existed before then. What then was the focus of SOEs before 1990? What was the difference between traditional SOEs and SOEs after the reform? What was the background for CG development? In order to answer these questions, two concepts should be introduced as fundamental for further research into the relationship between SOEs and economic reform, namely state-owned assets management and state-owned assets management system.¹²¹ In the Chinese context, “state-owned assets management” refers to the way in which the state representing common wealth manages the state-owned assets.¹²² “State-owned assets management system” refers to the ways and forms of management of state-owned assets, including how to deal with the relationship between owner and operators of state-owners assets, and how to choose relevant incentive and restraint measures.¹²³ Indeed, these two

¹²⁰ Following Deng Xiaoping’s speech of inspecting the south, in 1993 the Communist Party Committee amended the Constitution of China, to establish a socialist market economic system, and to change state enterprises to state-owned enterprises, and to separate the concepts “state-owned” and “state-operated” in law. More details see *Zhonggong Zhongyang Guanyu Jianshe Shehui Zhuyi Shichang Jijing Tizhi Ruogan Wenti de Guiding* (Decisions of the Communist Party Central Committee on Some Issues Concerning the Establishment of a Socialist Market Economy System), adopted by the Third Plenary Session of the CPC Fourteenth National Congress on 14 Nov. 1993.

¹²¹ These two concepts are popular phrases in the Chinese Report on the Work of the Government and rules, laws of Chinese SOEs.

¹²² Lu, *supra* note 48, at p4.

¹²³ *Ibid*, P4.

concepts were frequently mentioned during the early time of SOEs reform.¹²⁴ Even in the reform period, the traditional SOEs management system was still playing an important role in practice for some SOEs in China.

- *The Traditional SOEs Management System*

As already discussed in Chapter 1, after the nation was established, SOEs in China were the principal producers of energy, transportation, telecommunications, semi-finished materials and technical equipment. The dominant feature of economic entities in China was SOEs as a representative of ‘the whole people’ or ‘commonwealths’. The highly centralized SOEs management system pushed SOEs development in the early era of the establishment of the PRC. The features of this system can be summarized in the following three points. Firstly, the central government controlled the state-owned assets, decided the investment plan and free utilization without paying money. Moreover, the asset management mode of SOEs was the material object magnitude pattern in time of the planned economy.¹²⁵ The main production material was planned and centrally distributed by government. Finally, a great number of SOEs were managed by central government; therefore, central government had the ownership and operation of SOEs at the same time.¹²⁶

¹²⁴ Ibid, P4. The same opinion can see Liu, Z. 2002 *Zhongguo Guoyou Zichan Guanli Tizhi Gaige Yu Chuangxin*. Beijing. Economic Science Publish.

¹²⁵ Relevant information see footnotes 6 this Chapter. And see Lu, supra note 48, at p4.

¹²⁶ Ibid, P4.

The features above are the reasons why Chinese SOEs were in a non-competitive environment in the period of planned economy. When the Opening Up policy was proposed in the late of 1970s, subsequent changes pushed Chinese SOEs to compete with every single rural enterprises, joint venture and foreign enterprise.¹²⁷ SOEs struggled with serious problems such as financial losses, and high cost but low efficiency. Chinese government statistics showed that about one third of SOEs were losing money, and even in debt, in the 1990s.¹²⁸

According to Sun, there were about 380,000 SOEs in China in 1997.¹²⁹ Most of these enterprises were organized between the 1950s and the 1970s by different levels of governments. As discussed in Chapter 1, large-sized SOEs refers to those large-sized state-invested enterprises that the State Council shall, on behalf of the state, perform the contributor's functions and that have bearings on the national economic lifeline and state security as determined by the State Council in such fields as important infrastructures and natural resources, and so on. In contrast, SOEs which are established by local governments are normally small and medium sized. The employees of these¹³⁰ SOEs have reached about one hundred million, and directly affect the lives of more than three million Chinese people.¹³¹ Hence, the importance of SOEs in China not only relates to the Chinese economy, but also to the lives of people.

¹²⁷ Ibid, P4.

¹²⁸ Sun, X 1999:21 Sun believed that under the centrally planned economy, the noncompetitive environment lead to lack the efficiency of SOEs.

¹²⁹ supra note 136, at p21.

¹³⁰ The term of these means small/ medium sized.

¹³¹ Ibid, P21.

Scholars conducted researches from various perspectives, trying to explain experiences of Chinese SOEs. Some scholars concluded that the SOEs were lacking autonomy, initiative and adequate incentive for efficiency and productivity.¹³² By contrast, others offered more specific reasons: the Chinese Communist Party was not separated from the government; SOEs relied on the government heavily and the government was intertwined with SOEs.¹³³

It is the view of this thesis; these different arguments can be summarized in terms of relationships among owner, manager and operator.¹³⁴ How to deal with the relationship among those three is a key and central point in the process of reform, contributing to the reform activities and helping economic reform achieve a better result.¹³⁵ The contribution of the traditional SOEs management system for the development of SOEs was undeniable in a historical perspective. However, the highly centralized management system could not adapt to a changing environment and an immediate consequence was that some SOEs lost money and even shut down, and became burden to Chinese economy.¹³⁶ The social responsibility of SOEs was non-existent at that time.¹³⁷ Influenced by these circumstances, CG of SOEs was slowly emerging. The reason can be shown and explained by the attempts below, some of them achieving,

¹³² Art, R and Gu, Minkang, 1995. 'China Incorporated: The First Corporation Law of the People's Republic of China', 20 *Yale Journal of International Law*, P. 277.

¹³³ *Ibid*, P277.

¹³⁴ Under the traditional mode, the owner, manager and operator were all the State, but under the management of SASAC, the owner is the State, manager is SASAC and the operator is SOEs.

¹³⁵ In China now, these three refer to government, SOEs, and SASAC. Find a method to keep balance to make the government just play the owner's role, and not to control the SOEs too much.

¹³⁶ see Lu, *supra* note 48, at p4.

¹³⁷ Social responsibilities of enterprises refer to enterprises obligations to maintain and improve social interests in addition to their pursuits of shareholder maximal profits. For China at that time, SOEs without profits even in debt, cannot take on their own social responsibilities.

but some of them failing. The main issues of CG of SOEs, as the key factors after the attempts, became the new issues for SOEs.

In general, the attempts of Chinese government and SOEs to change the situation of the traditional management system of SOEs can be divided into two steps in early period of the reform. The first step of SOEs reform was converting SOEs operational management mechanisms while leaving their basic ownership and organizational structure unaltered in the period between 1978 and 1988.¹³⁸ The activities of this period focused on improving the efficiency and productivity of SOEs. Indeed, the first step accorded with the goal of economic reform at that time.¹³⁹ Over those ten years, China replaced profit-retention systems with a taxation system.¹⁴⁰ Moreover, the pricing system was relaxed to encourage market transaction.¹⁴¹ Finally, China started to incorporate SOEs and give more power to their decision-makers.¹⁴²

The second step was the corporatization of SOEs. In the Chinese context corporatization refers specifically to the transformation of SOEs into joint-stock

¹³⁸ Under the traditional operational management mechanisms, each right of SOEs had been controlled by government at each level. SOEs are the appendages for the governments. It was not good for the enthusiasm of employees of SOEs. After 1978, some new attempts for SOEs had been completed, such as Kuoda Qiye Zizhu Quan, Li gai Shui, and some others to reduce the intervention from the government, and give more autonomous rights to SOEs. In the Chapter 3, more reasons, methods and results about those attempts will be discussed.

¹³⁹ Chinese economic reform was aimed at: firstly, moving the economy toward greater decentralization of decision-making; secondly, increasing reliance on market forces and on material incentives for motivating desired economic behavior and resource allocation; finally, opening the economy to external competition through foreign investment. See Xia, Mei, 1992: 22.

¹⁴⁰ More details about this system can see Chapter 3.

¹⁴¹ The new pricing system made more profit for the SOEs themselves; the SOEs had more motivation to create more and more profit through transactions.

¹⁴² See 1984 May issued by the State Council Guanyu Jinyibu Kuoda Guoying Qiye Zizhuquan de Zanzheng Guiding, ten aspects had been given more power to SOEs' decision-makers, namely, operation, sales, the production, price of production, choosing the material, using money, using assets, setting the departments, personnel management, salary, and joint-operation.

companies, in which the state, or its agents, continues to hold the controlling interest.¹⁴³

With an experience of almost ten years' reform, China realized that SOEs reform needed fundamental legal and institutional changes.¹⁴⁴ Corporatization of SOEs was a key solution at that time.

Jonathan and Laurent identified a clear line between Chinese corporatization and privatization; they thought the corporatization of Chinese SOEs was not a true privatization.¹⁴⁵ Privatization means 'transfer of ownership or control of assets from the public to the private sector'.¹⁴⁶ They thought the SOEs reform in China would fail because the so-called 'corporatization' was a fake privatization, and was not thorough.¹⁴⁷ By contrast, Chinese scholars in the fields of law or economics argued that corporatization was a correct solution because it applied to the Chinese situation.¹⁴⁸ They believed that the privatization of European or Russia style was not suitable for a country with a big population, such as China.¹⁴⁹ This thesis agrees partially with the

¹⁴³ Ocko, J and Campo, L 1994-1995. 'Focus on the Corporatization Process in China', *Vol. 5:145 Duke Journal of Comparative & International Law*, p. 145.

¹⁴⁴ Sun, *supra* note 136 at 21.

¹⁴⁵ Ocko, J and Campo, *supra* note 151, at p145.

¹⁴⁶ Amy L, Chua, 'The Privatization-Nationalization Cycle: The Link Between Market and Ethnicity in Developing Countries', *95 Colum.L.Rev.*1995:223-226.

¹⁴⁷ Zhang, W, *supra* note 5 at 145 When Chinese economic reform started, there were some economists who thought China should follow 'shock therapy', because the countries which followed shock therapy would experience a short financial crisis, but would welcome sustained increase in the economy. They took Russia and Eastern Europe as examples. In Zhang's article, he did not agree this argument, because after the shock therapy period, Russia experienced protracted inflation and then got a chain reaction in economy. Poland was the most successful country that experienced shock therapy reform in Eastern Europe; however, the SOEs of Poland were not privatized. Russia followed shock therapy, but got the bad result. It is cannot be say Poland enforced strict shock therapy. This thesis agrees with Zhang's argument, and will do the further research based on his view.

¹⁴⁸ *Ibid*, P146 The state and social institution of China are different from Russia and other countries of Eastern Europe, especially the population problem, so that China should adopt different strategies. That is also another reason why Zhang cannot agree with the argument about shock therapy.

¹⁴⁹ Chinese scholars in the fields of law or economics thought the style of privatization of Europe or Russia cannot be implemented in China, there are two reasons, first of all, bankruptcy of SOEs is the common method for privatization of Europe; however, for SOEs in China, such a SOEs with a huge population, bankruptcy will make lots of people lose their jobs and lead to storm and stress in one night. Moreover, China is in transition, and most SOEs were advanced at that time. It is necessary to continue to have and develop SOEs.

argument of Jonathan and Laurent; Chinese corporatization was not a typical western privatization. In fact, as an important component of SOEs reform, the corporatization is just a reflection of Chinese characteristics.¹⁵⁰ Chinese corporatization should not have been considered halfway.¹⁵¹ As it is not privatization, the application of the standards of privatization as the criteria would be appropriate in judging Chinese corporatization of SOEs.

It is the view of this thesis that the corporatization of Chinese SOEs contributed to some breakthroughs, although there were negative evaluations of such corporatization. On the one hand, huge numbers of workers were laid off in the process of corporatization and became a big burden for society.¹⁵² In addition, the incomplete legal system leads to a drain of state-owned assets of every steps of corporatization, such as evaluation, liquidation, mergers and acquisition.¹⁵³ Last but not the least, the bad debts of SOEs became an impossible task to recover in the process of corporatization. Most of the bad debts were from policy loans before SOEs reform from commercial banks or other

¹⁵⁰ Because Chinese SOEs developed in their own style, it is different from the normal and standard company. Therefore, when Chinese SOEs need to develop towards a standard and international company, the first thing that must be done is setting the basic mode of modern enterprises. Corporatization is the process of setting the basic framework and mode of modern enterprise for Chinese SOEs. This process is particular for China. The companies developed in other countries without- corporatization. That means Chinese characteristics.

¹⁵¹ Compared with the privatization in the Western countries, the result of Chinese corporatization is not the same. The standards and the aims for privatization and Chinese corporatization are not the same. The functions for Chinese corporatization just reached the goal for standards of modern enterprises. Therefore, from this point of view, corporatization had some achievements.

¹⁵² The issues of laid-off workers of Chinese SOEs in 1990s are the main social topic. Because laid-off workers were the main measure to reduce the burden for SOEs, also the key way to improve the effectiveness for SOEs at that period, so the laid-off workers became a label of Zhu Rongji's time (Zhu's planning policies). Zhu thinks for some SOEs, too many workers means a loss-making enterprise. And this it conducted from Zhu's advice for a Chinese SOE in 1993. For more information, see Gao Yangwen. 1999. "Jianyuan Zengxiao Xiangang Fenliu-Zhumei Gongsi Zongjingli Lidong Tan Shenhua Qiye Neibu Gaige Fanglue." *Meitan Jingji Yanjiu*.

¹⁵³ This argument has been conducted from interviews with a legal advice of a Chinese SOE and a senior manager of another Chinese SOE, and the record of the interviews had been kept by the author. For example, the agency or institutions which can be selected to do evaluate, liquidate and mergers for SOEs, most of the time did not rely on rigorous procedures because the rules or laws in legal system were not perfect. Therefore, some agency or institutions, which have some related transaction with SOEs, may be selected. During the process to evaluate, liquidate and mergers, it is possible to reduce the value of SOEs intentional.

financial institutions or were in the form of ‘triangular debts’.¹⁵⁴ Undoubtedly, bad debts were a historical problem, but which also became an obstacle and hardship for SOEs reform. And a chain reaction of bad debts exploded during the corporatization of SOEs.¹⁵⁵

On the other hand, the corporatization process brought about some breakthroughs for Chinese economy. Firstly, as it was described by Lan Cao, corporatization was a means by which the transition from a planned economy to a market economy could effectively take place.¹⁵⁶ Secondly, corporatization created a good environment for the development of CG of SOEs. The modern enterprises system, as a new concept and solution of corporatization, was built for improving the efficiency of SOEs in 1990s in China.¹⁵⁷ A core element of modern enterprises system was identified by the Chinese government to be CG.¹⁵⁸ This identification led to the policy being focused on CG and related reform. Finally, another component of the economic reform was the establishment of shareholding companies.¹⁵⁹ At that time, conversion of SOEs into shareholding companies was taken as a fundamental activity for the listing of some

¹⁵⁴ In the context of Chinese research, triangular debt means the linked debts relationship among three or more business enterprises. The triangular debts problem had been a main hard task for Chinese economic reform. In the practice, there are many causes of the triangular debts in the process of transaction. Most reasons can be attributed to the weakness of traditional SOEs, and the conflicts between the free market and the old management system.

¹⁵⁵ The chain reactions include: firstly, SOEs finds it hard to obtain new loans from banks, or high interest rates for new loans. Secondly, bad debts hurt tax revenue and the profit of Chinese economy. Finally, bad debts of SOEs made heavy burdens for employees, such as low salaries, cheap social benefits including pensions, free medical care and monetary support for low-income families. For more specific information about bad debts see Kai C, 1997:433-436.

¹⁵⁶ Lan Cao, 1995. ‘The Cat That Catches Mice: China’s Challenge to the Dominant Privatization Model’. *Brook Journal of International Law*. P.97 Lan Cao means privatization, but the in Chinese context, here it means corporatization. According to Lan, in the view that is now dominant, privatization debates center around the transformation of an economy from centralized to more decentralized arrangements, its subtext is on political liberalization. For China, corporatization is always linked with transformation time.

¹⁵⁷ Tenev, S and Zhang, C, 2002. ‘*Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets*’, Washington, D.C.: World Bank and the International Finance Corporation 1.

¹⁵⁸ see Lu, supra note 48, at p 23-25.

¹⁵⁹ Xi, Chao, 2009 *Corporate Governance and Legal Reform in China*, London: Wildy, Simmonds& Hill Publishing. 7-14.

SOEs in the following years.¹⁶⁰

2.1.2 Different Targets of SOEs Reform

Target I: Reform and Opening up Policy

‘The policy of opening up domestically and internationally means domestic reform and opening-up to the world. Opening-up to the world is important for China. It is impossible that a country will be better in a closed environment... opening up, from the domestic perspective, was reform. And reform needs to be a comprehensive reform, including economic, political, science, technology, education and other industries’.¹⁶¹

This paragraph can be read as the definition of the policy of opening up from Deng Xiaoping, former Chinese leader and the founder of this policy. Included in the proposed comprehensive reform was the SOEs reform which should be viewed as a part of the strategy of the economic reform anticipated by Chinese leaders at that time, except that the result and length of the reform were probably beyond their expectations.

As discussed, the goal of Chinese economic reform aimed at establishing a socialist market economy.¹⁶² However, the establishment of this goal lasted more than twenty years. The earliest attempt at economic reform could be traced back to the mid-1950s.

¹⁶⁰ After the establishment of shareholding companies, Chinese SOEs reached the basic goal of modern enterprises; this is first to convert into the shareholding company before they could be listed. Form 1994, the State Council determined 100 SOEs to be the pilots as modern enterprises, and the governments in different levels also determined 2600 pilots, and transferred them to be wholly SOEs, State-owned holding enterprises and the State-owned shares (limited liability companies and joint stock limited companies) through the reform. See Lu, *supra* note 48, at p25

¹⁶¹ Speech made by Deng Xiaoping on meeting with Vice-President Ali Hassan Mwinyi of the United Republic of Tanzania in 1985.

¹⁶² See 2.1.1.

The centralization of power and interest had been identified as the main problem of the underdeveloped economy at that time; and also true for SOEs.¹⁶³ Consequently, the Chinese government copied the model of the planned economy of Russia, and tried to balance the power and interest of SOEs between central government and local government, between enterprises and employees in the following twenty years. During the development period, the case Rainbow is the good evidence to support. According to the case study and the interviews, Rainbow was established as Xiangyang Color Picture Tube Factory in 1977, upon the ending of Cultural Revolution. The opening up started before 1977, as this was the part of the plan and target of the opening up.

A breakthrough came at the Communist Party Thirteenth National Congress in 1987.¹⁶⁴ With a view to opening up to the world, Deng Xiaoping supported some economists' opinion that some capitalist methods could be employed to build socialism.¹⁶⁵ As for domestic reform, a strategy of economic reform was to give priority to the development of non-public sectors of the economy, specifically, the establishment of market-orientated non-state-owned enterprises (including foreign trade enterprises and joint venture enterprises) to develop the economy.¹⁶⁶ Until 1987, the theory of public and non-public sectors of the economy was encouraged by Chinese policy.¹⁶⁷ It was

¹⁶³ Mainstream view (such as Li Yining and Wu Jinglian) in the period between 1950 and 1970 believed that over-centralized power and interest damaged the producing zeal of employee and enterprises. Therefore, the Chinese government tried to incorporate SOEs and gave more power to their decision-makers.

¹⁶⁴ The Communist Party Thirteenth National Congress on 25 Oct. 1987.

¹⁶⁵ As Deng Xiaoping said, it does not matter if the cat is black or white, so long as it can catch mice. That some capitalist methods could be employed to build socialism is inference of the theory about 'black cat white cat'. This is a pragmatic economic policy which was appointed by Chinese leader Deng Xiaoping. Forore discussions of this theory see Wu, J *Rushi Yu Jingji Gaige De Mubiao He Quanchihua*, (*WTO, the Targets of Economic Reform in China and Globalization*), No.6 *Jounral of Shanghai Institute of Foreign* 2001:1.

¹⁶⁶ *Ibid.*

¹⁶⁷ See policy of Communist Party Thirteenth National Congress in 1987.

stated that China, as a socialist country, was still in the primary stage of socialism.¹⁶⁸ It was also stated that public ownership must continue to predominate; however, non-public sectors may contribute to production and employment alongside of public sectors.¹⁶⁹ The changes of the government policy showed that any solution of developing Chinese economy should confirm a leading role for public ownership.

According to Wu, some economists believed that the reform in this period was unsuccessful, because the Chinese government did not carry out any fundamental transformation for SOEs.¹⁷⁰ Wu also pointed out that SOEs had taken two thirds of Chinese economic resources but just contributed one third of GNP (gross national product).¹⁷¹ By contrast, others argued that the strategy of economic reform reduced obstacles and gained experiences for further reform.¹⁷² The achievements and drawbacks of economic reform during early periods were learned and adopted by policymakers who, following the view of Deng Xiaoping, put forward that ‘making foreign things serve China and achieve greater, faster, better and more economical results in building socialism’.¹⁷³

This thesis considers that both Wu and Meryer’s views focused on the result of SOEs reform during a short time. The attempts made and their influence in the SOEs reform

¹⁶⁸ Ibid.

¹⁶⁹ Ibid.

¹⁷⁰ Wu, supra note 28 at 1 Here economists mean the state sectors just completed shift superficial.

¹⁷¹ Ibid.

¹⁷² Ibid.

¹⁷³ Meyer, Jennifer, ‘Let the Buyer Beware: Economic Modernisation, Insurance Reform, and Consumer Protection in China’, 62 *Fordham Law Review*, 1994: 2131-2132.

in the period between 1978 and 1988 deserve more attention.¹⁷⁴ Chinese public ownership was a core policy and was stressed repeatedly through several policy documents, rules and laws.¹⁷⁵ It is the view of this thesis that a clear position of public ownership was the most helpful direction for SOEs reform. Although for a long time after 1988 SOEs reform was dealing with the ownership of SOEs as a main issue, the Chinese leaders at that time were concerned about the methods of the reform and social responses caused by the reform.

Target II: Establishment of Modern Enterprises System

In 1992, the speech of Deng Xiaoping made during his tour of south China brought another breakthrough for the theory of Reform and Opening up policy. Following Deng's south China tour, in October 1992, the socialist market economy was defined as a clear goal by the Communist Party Committee.¹⁷⁶ The shift of policy showed that Chinese economic reform had moved from a partial ground to a comprehensive ground leading to a socialist market economy. In November 1993, the establishment of modern enterprises system (MES) of SOEs, as a new strategy, started to play a key role and SOEs reform became one of new targets for this stage of economic reform.¹⁷⁷ The

¹⁷⁴ The Chapter 3 will discuss the attempts and their influence. Here some relevant policy can be listed: expansion of the enterprises' decision-making powers, economic responsibility system, Li Gai Shui, and contracted managerial responsibility system for enterprises.

¹⁷⁵ Third Plenary Session of the Eleventh Central Committee of the Communist Party of China in 1978; several Provisions on the Expanding the Autonomy in Operation of the State-owned Industrial Enterprises issued by the State Council in 1979, Procedures for State enterprises to pay taxes instead of turning over their profit to the state (ligaishui), issued by Ministry of Finance was forwarded by the State Council in 1983, the provision on the Deepening Enterprises Reform and Enhance the Vitality of Enterprises, issued by the State Council on 5 th December 1986. And so on.

¹⁷⁶ The 14 th National Congress of the Communist Party of China on 12-18 October 1992.

¹⁷⁷ See the documents about MES of SOEs on the Third Plenary Session of the Communist Party of China 14 in

same strategy was reiterated and further developed at the 15th CCP Congress in 1997.¹⁷⁸

In the history of Chinese SOEs Reform, MES has been an effective way to combine public ownership with the market economy, and is the direction of the reform of SOEs.

The main task of MES can be summarized as: (1) Continue to push forward the task of separating administrative and enterprise functions. (2) Actively explore effective ways for management of state assets. (3) Introduce the standardized corporate system into large and medium-sized SOEs. (4) Concentrate efforts to gear enterprises operation mechanisms to the market.¹⁷⁹

Traditional SOEs generally had the following features: firstly, the state owns the assets; secondly, the SOEs control the production and sales of goods; finally, sale revenues of SOEs bear a relationship to cost because if there are too many policies, rules could lead high cost but low benefit.¹⁸⁰ Until 1990s, the tension between the first and second features had existed for a long time.¹⁸¹ It was also a root of obstacles for the modern enterprises system.¹⁸² Therefore, some scholars thought MES was an attempt at

1993.

¹⁷⁸ See the documents about MES of SOEs on the 15 th Chinese Communist Party Congress in 1997.

¹⁷⁹ See The Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of State-Owned Enterprises 1999.

¹⁸⁰ Sun, *supra* note 136 at 21.

¹⁸¹ The tension means the State owns the assets of SOEs, the State played the owned, operator and sales at the same time. The requirement of market had been ignored in the early time. And the State did not care requirement of market, the State decided how many to produce and sell. After the Opening Up Policy, the requirement of market had been increased in valued gradually. The State was not the decider for market supply and demand, but the market was.

¹⁸² As stated in the last footnote, the market mechanism did not develop in China, but the development of MES needed a market mechanism as a basic requirement. That is the reason why it is said that the congenital condition of MES is missing.

reform for state-enterprise property relationship.¹⁸³

It is easy to understand the reason why so many scholars had doubts about the establishment of MES.¹⁸⁴ A main method for establishing a MES of SOEs is through ownership restructuring, characterized by the incorporation of SOEs with the state as the sole or majority shareholder and as the owner of the state-owned assets.¹⁸⁵ However, the conditions for establishing MES were premature in China at that time.¹⁸⁶ For most SOEs, CG is the first and main task of internal reform. Clarke pointed out that external reform aims to change the environment in which SOEs operate, for example, the reform of the pricing mechanism, crucial to determining whether an enterprise is actually making a profit.¹⁸⁷ Baev further claimed that the external reform can be divided into ‘demonopolization’ (‘the liquidation of privileges and peculiar advantages vested in one or more state enterprises’) and ‘deintegration’ (‘the management reform of the national economy by means of reorganizing Ministries and Government Departments, and abolishing the system of control over the distribution and consumption of commodities’).¹⁸⁸ This thesis prefers Baev’s arguments rather than Clark’s. For China at that time, the first core task of MES was ownership restructuring,

¹⁸³ The reform of SOEs can be divided into two broad categories. The reform of the state-enterprises property relationship falls most nearly into the category of internal reforms. According to Clarke, these reforms seek to restructure SOEs to Change the way that SOEs respond to environment. Clarke, 1991:8.

¹⁸⁴ See Li Bingyan, Niu Zhengke 2007. “Chongxin Shenshi Woguo Xiandai Qiye Zhidu: Zhiyi yu Chonggou”, *Journal of Jiangsu University of Science and Technology* 01 . Li thinks MES is a regimen which is transplanted from developed countries, and the MES was not suitable for Chinese society. The same opinion can be seen from Hou Ruoshi, 2004. “Zhiyi Xiandai Qiye Zhidu”, *Zhongguo Dangdai Sichao*. June. No. 3. China Opening Herald. According to Hou, the opinion from Zhang Weiyong, Li Yining and Wu Jinglian, who carried out the MES in China is a one sided theory, Hou thinks the MES was not the only one measure for modern production organization.

¹⁸⁵ Clarke, 1991:8.

¹⁸⁶ The conditions for establishing MES was not perfect at the beginning of 1990s. The main problem if the role of the State for the SOEs was not clear.

¹⁸⁷ Ibid.

¹⁸⁸ Andrei Baev (1993) ‘Alternatives to Privatization: Civil Law and the Transformation of State Property in Post-Socialist Economies’, *12 Pac. Basin L. J.* Pp.131-137.

more specifically, a task of clearing the relationship between SOEs and governments, and of distinguishing the power of SOEs and government. This strategy was similar in some way to Baev's arguments.

There were different views about the specific strategy and principle of establishing MES. According to Robert, some Chinese economists believed that establishing MES should hold the principle of successfully managing large enterprises while invigorating small ones and readjusting the lay-out of state economy.¹⁸⁹ The economists' opinion that the State economy was over-distributed, with its overall quality remaining low, and the distribution of resources unreasonable, was adopted by policymakers, and the Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of SOEs was adopted at the Four Plenum of the 15th CPC Central Committee on September 22, 1999. To sum up, the Chinese government made changes in the following four areas. Firstly, the Chinese government defined industries and sectors that needed to be controlled by the national economy, including industries that are related to national security; industries that are naturally a monopoly; industries that supply major products and services for the public; and pillar industries and backbone enterprises in high and new technology sectors.¹⁹⁰ Secondly, with the exception that some enterprises must be controlled by the state, most

¹⁸⁹ For China at time, the state economy was over-distributed, and the distribution of resources was not reasonable. For example, the ownership of Chinese firms falls into state, collective, and private. The nature and composition of these three has fluctuated prior to the readjusting lay-out of state economy during the reform period. For more details see Robert, F. Dodds, JR (1995-1996). 'State Enterprise Reform in China: Managing the Transition to a Market Economy', *Law & Policy in International Business*, 699-707.

¹⁹⁰ The Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of SOEs was adopted at the Four Plenum of the 15th CPC Central Committee on September 22, 1999.

enterprises should be realizing a diversity of equities.¹⁹¹ Thirdly, the invigorating range should be extended to medium sized enterprises. Finally, the standardized corporate system should be introduced into large and medium-sized SOEs.

It is clear that the Chinese government tried to establish a relative balance of power between the owner and senior managers of SOEs and aimed to establish a fair market environment.¹⁹² This goal was achieved over different periods and faced up to and solved many challenges.¹⁹³

In summary, the SOEs' reform during this period of time attempted to make ownership of SOEs better arranged through a series of experiments, including establishing MES and managing large enterprises while invigorating small ones. As a result, the power of government become narrower, and the scopes of state-owned assets and public ownership were defined. Concurrently, the issue of ownership is a main component of CG. It could be said that as a result the CG of SOEs were pushed to a higher level of development. In another words, corporate governance as a new concept was introduced into China through Chinese reform of SOEs in the 1990s.¹⁹⁴

¹⁹¹ Ibid. Some industries such as national defense installations and hydraulic engineering must be controlled by the State. These kinds of SOEs are endowed with a mandatory social public goal, without economic targets. The functions of this kind of SOE is to provide public services directly.

¹⁹² Wu, *supra* note 28, at 2.

¹⁹³ A fair market environment includes many factors. Here for China it mainly refers to the information disclosure system which is not perfect, the relevant appraisal institutional selection system which is not sound, laws for selection agency which is not sound, and punishment implementation is not strict. These above are the challenges which SOEs need to face up to and solve.

¹⁹⁴ Tan, L and Wang, J (2007) 'Modeling an Effective Corporate Governance System for China's Listed State-Owned Enterprises: Issues and Challenges in a Transitional Economy', *Journal of Corporate Law Studies*, P. 143.

Target III: Reform of Small and Medium- Sized SOEs

In practice, compared with the reform of large sized SOEs, the small and medium-sized SOEs were the pioneer of reform. With further reforming and opening up to the world, the development of small and medium-sized enterprises became a heated issue. In the context of Chinese research, “small and medium-sized SOEs” refers to the enterprises which were established in the 1970s and operated by state, including small coal mines, refineries, cement works, glass factories and small thermal power plants.¹⁹⁵ Conducted from Tan and Wang, these enterprises had been wasting resources or were technologically lagging behind. Some were manufacturing poor-quality products or polluting the environment.¹⁹⁶ The issue of small and medium-sized enterprises was debated by economists and legal scholars mainly about the following aspects: the administration of small and medium-sized SOEs; the changes and development of small and medium-sized SOEs; the external environment of small and medium-sized SOEs.¹⁹⁷ According to Shao Ning, by 2011, the reform of small and medium-sized SOEs had almost been completed.¹⁹⁸ It is the view of this thesis that as a key part of the SOE reform, the experiences of the small and medium SOEs reform provide valuable lessons.¹⁹⁹ As some obstacles were removed in the process of reform of small and

¹⁹⁵ Ibid.

¹⁹⁶ Supra note 202.

¹⁹⁷ Shen, J 2000:1 The issued summarized by author Shen J.

¹⁹⁸ Shao Ning 2012, The Report From SASAC BOAO Form for ASIA in Apr., http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12 According to Shao Ning, in fact, after completing the small and medium-sized SOEs’ reform, the state economy had been narrowed. Narrowing the range of the state economy step by step is the main intention for SOEs’ reform. The next project of Chinese SOEs reform is the large-sized SOEs.

¹⁹⁹ The methods, steps, aims and time duration of reform of small and medium SOEs cannot be the same with the large sized SOEs.

medium-sized SOEs, it cleared the way for further reform of large SOEs. For the next stage of reform, the large SOEs are the clearer target.

The measures for the reform of small and medium-sized SOEs can be divided into two steps. Firstly, small and medium-sized SOEs were deregulated and revitalized through various means such as reorganization, combination, merger, leasing, contracted management, joint venture, transfer of state-owned property rights, the joint-stock system, and the joint-stock cooperative system.²⁰⁰ For those small and medium SOEs that had been losing money for a long time, or had been insolvent and could not pay due debts, a policy-oriented shut-down and bankruptcy should be conducted in strict accordance with relevant provisions if certain conditions were met.²⁰¹ After the reform, small and medium-sized enterprises of various ownerships played an important role in China, including private enterprises, township enterprises, individually owned enterprises, foreign-funded enterprises and private science and technology enterprises.²⁰² According to the Chinese economist Shen's study, the proportion of small and medium-sized enterprises was reaching ninety percent of all enterprises in

²⁰⁰ Supra note 202.

²⁰¹ Supra note 202 For those small and medium SOEs that had been losing money for a long time, before reform, the Chinese government gave a lot of subsidies. Here an example can demonstrate (in this case, the SOEs which complained including small/ medium and large SOEs): Trade was a main focus of the U.S.-China dialogue, with each side seeking assurances that the other's market would remain open. The U.S. always made complaints about Chinese trade and human rights practices in some dialogues, although they tried to focus on the need for better communication and trust. The U. S. thought Chinese SOEs were subsidized by Chinese government, and restricted competition, because subsidies to SOEs may be specific and actionable, and will cause potential effect on international trade. Shao did not agree with the U.S.'s argument; he said Chinese subsidies to SOEs are very small; in fact, the target of roll-back of subsidies was completed in Zhu Rongji's time. There are mainly four types about SOEs subsidies in China, including tax preference, policy-related subsidies to cover enterprises losses, preferential loans and funds for special purposes. For more debates on Chinese subsidies see Ding Yan 2008, *WTO Kuangjia Xia Zhongguo Guoyou Qiye Butie Falv Wenti Yanjiu*, (*The Legal Research on Chinese SOEs Subsidies and WTO*). Xiamen: Xiamen Da Xue. And see Michael Daly 1998 Special Problems Concerning the Measurement of Subsidies, Annex to Investment Incentives and the Multilateral Agreement on Investment, 5, *Journal of World Trade*. And see Julia Ya Qin, 2004, Regulation of Subsidies to State-owned Enterprises (SOEs)—A Critical Appraisal of China Accession Protocol, 12, *Journal of International Economic Law*.

²⁰² Supra note 205, at 1.

China. Moreover, the Gross National Product of small and medium-sized enterprises increased to almost sixty percent. In addition, it was claimed that most of the small and medium-sized enterprises were the major payers of local taxes.²⁰³ Finally, small and medium-sized enterprises offered more jobs for the people who were laid-off in the reform of SOEs.²⁰⁴

As a result, the adjustment of state-owned capital and reorganization of SOEs to some extent achieved the initial expectations of the reform of SOE. Up to 2008, those SOEs that were insolvent and had no prospect to eliminate losses had completed the policy-oriented shut-down and bankruptcy proceedings; and up to 2010, enterprises which were managed by the SASAC started perform the contributor's responsibility.²⁰⁵

It was thought that both the MES and the reform of small and medium-sized enterprises presented different perspectives of a constantly deepening reform of SOEs and the whole economic system.²⁰⁶ This thesis considers that the core of the reform of small and medium-sized enterprises was about ownership restructuring. That is because when the reform of all the small and medium-sized enterprises had been completed, the

²⁰³ Here the data still comes from Shen's study.

²⁰⁴ Ibid. In Zhu Rongji's time, tens of millions of skilled but mid-aged workers were laid off from SOEs and remained unemployed in the process of SOEs reform. How to create jobs for workers laid off because of economic transformation or because of enterprises reorganization, restructuring, closure or bankruptcy was a big challenge for China. There were many methods vigorously promoted by the Chinese government to help laid-off workers become re-employed. The one of methods was that laid-off workers would be re-employed by small or medium-sized enterprises. Small or medium-sized enterprises contributed more opportunities and jobs for Chinese laid-off workers.

²⁰⁵ Shao, N 2012, The Report From SASAC BOAO Form for ASIA in Apr. http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12.

²⁰⁶ Ibid. Shao, N 2012, The Report From SASAC BOAO Form for ASIA in Apr. http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12 According to Shao Ning, review the history of the Chinese SOEs reform, small and medium SOEs' reform was the key connecting link between the preceding and the following.

SOEs' range became clear, leaving just large SOEs. Before the formal reform, the definition, size, models and fields of small and medium-sized enterprises was confirmed by laws. This reform, as an attempt for large SOEs reform, gained lessons and experience under the preparation period. At the same time, it is also won more time for large SOEs reform to improve laws, rules and market environment.

Target IV: Reform of Large Sized SOEs

After many years of attempts and accumulation of reform, the Chinese government created a relatively mature plan for large SOEs reform.²⁰⁷ In a standard way, the definition, size, models and fields were firstly confirmed by rules or laws. 'Large-sized SOEs' were defined in Chinese law as those for which "the State Council shall, on the behalf of the state, perform the contributor's functions for the large-sized state-invested enterprises that have bearings on the national economic lifeline and state security determined by the State Council and the State-invested enterprises in such fields as important infrastructures and natural resources."²⁰⁸ Large SOEs have played an important role in China for more than fifty years; the 2009 Law of the PRC on the State-owned Assets of Enterprises and its confirmation regarding the large SOEs marked a step forward for large SOEs reform.

In addition, the target of large SOEs reform was not just focused on the ownership issue.

²⁰⁷ Shao Ning, 2012, The Report From SASAC BOAO Form for ASIA in Apr. http://news.chengdu.cn/content/2012-04/03/content_926063.htm?node=1880 Last accessed, 17/06/12.

²⁰⁸ See Law of the People's Republic of China on the State-owned Assets of Enterprises 2009.

SASAC held up a clear target for reform of large-sized SOEs, with the aim that most large-sized SOEs should have completed a transformation to listed companies and become main market players, able to assume civil liabilities independently.²⁰⁹ In other words, the core issue for reform of large-sized SOEs is to find a method for adaptation to the demands of a market economy. Therefore, in order to find the correct method, it is better to know the current situation of large-sized SOEs in order to understand the importance, strengths, weaknesses, responsibilities, and achievements up to that point, and the obstacles to face up to and solve.

Furthermore, the concept of CG of SOEs became a profound and more formal focus of the SOEs reform, and the internal and external governance of SOEs were borrowed and introduced for large SOEs. The CG of SOEs was improved to an international level. A far-reaching breakthrough for large-sized SOEs happened in 1999, when the Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of SOEs was adopted. The Decision specified that the goal of the first step of large-sized SOEs reform was: by the end of the 20th century, most large and medium-sized SOEs with financial losses should emerge from their difficulties, and majority of backbone large and medium-sized SOEs should try to set up a modern corporate system.²¹⁰ The second step targets of SOEs reform would be basically completing strategic readjustment and restructuring, creating a more rational layout and structure for the State-owned economy, and establishing a fairly

²⁰⁹ See the interview of Shao Ning for SOEs reform in Apr. 2012 <http://business.sohu.com/20120402/n339668260.shtml> Last accessed, 13/11/12.

²¹⁰ Ibid.

complete modern corporate system.²¹¹ It is the view of this thesis that this Decision, as the first government document, actually positioned the tasks and targets of large-sized SOEs reform and one of the achievements of this Decision was to divide the targets of SOEs reform into a partial task and a comprehensive task, because of the influence of the traditional system and the many problems left over from the past. The strategy of making different steps is also in evidence for supporting a long and protracted nature of SOEs reform.

Coincidentally, the same strategy was applied to the reform of large-sized SOEs in practice. At the initial stage of the reform of large-sized SOEs, the Chinese government followed the principle that ‘large and medium-sized SOEs, especially superior ones and those suited to the shareholding system, should be turned into shareholding enterprises, in the form of a standardized listing, Sino-foreign joint ventures and inter-enterprise equity participation.’²¹² By means of this method, the mixed ownership economy of China was developed, and the State controls the most stakes in major enterprises; specifically, sixty percent of net worth of the central enterprises listed.²¹³ The overall conclusion is that the partial strategy made a significant contribution to the SOEs reform.

²¹¹ Ibid.

²¹² Ibid.

²¹³ Before the establishment of SASAC, most SOEs separated the good assets from bad assets and liabilities, then followed the principle of fine listed assets first, completed partial listing on the stock market. This method was common for SOEs at the initial stage of reform of large-sized SOEs. After the establishments of SASAC, there were 117 central enterprises managed by SASAC, 43 of them completed the main business listed. More details see the interview of Shao Ning for SOEs reform in Apr. 2011. <http://opinion.hexun.com/2011-04-21/128941997.html> Last accessed, 13/11/12.

Based upon the result of the partial strategy, the goal of reform of large-sized SOEs becomes more ambitious for an overall listing.²¹⁴ Since 2011, the overall listing has led to an unprecedented boom for large-sized SOEs.²¹⁵ As an institutional reform, overall listing of SOEs has been the most popular feature in Chinese SOEs. However, at present, the domestic mainland market for overall listing research is still in its early stages, and there lacks mature theoretical system for large-sized SOEs.²¹⁶ Because it is an absolutely new attempt²¹⁷ for China, there is no previous experience which can be referred to for overall listing of large-sized SOEs. For the CG of large SOEs, overall listing as a new goal will impel and improve the CG in large SOEs and achieve international standards.

When it comes to the solutions of overall listing of large-sized SOEs, Shao Ning thought that the experience of reform of small and medium-sized SOEs could not be

²¹⁴ There is some accounting data that must be reached if shares-listed tries to be a listed company. In order to achieve this goal, shareholders generally will spin-off a large business into two parts: joint-stock company and the parent company, the good quality assets will spin-off into the joint-stock company, some others businesses and bad quality assets being left in the parent company, such as canteens, kindergartens, and loss of assets. It is the spin-off listing. After being listed successfully, the joint-stock company uses the money gained through listing, and buys their parent company, called the overall listing. More information can be seen in articles as follow: Huang Qing, 2004. "Guoyou Qiye Zhengti Shangshi Yanjiu- Guoyou Qiye Fenchai Shangshi he Zhengti Shangshi Moshi de Anli Fenxi", *Management World*. Qian, Qidong, Wu Qingsheng, and Wang Guojin, 2004. "Guanyu Zhengti Shangshi de Yanjiu", *Shanghai Economic Forum*. Deng Xiaozhuo, 2004. "Zhengti Shangshi de Fangshi Bijiao", *Financial theory and practice*.

²¹⁵ Overall listing of SOEs played a role to unique advantages in key sectors, and employs the market resources to optimize configuration. The SOEs' overall listing also has an exceptionally big meaning for the long-term development of the capital market. Overall listing of SOEs appears on the market not only to expand the scale of the capital market, but also improve the rate of asset securitization in our country, more effectively improve the size of its market value, improve the overall quality of assets. From the point of the view of the listed company having completed overall listing, SOEs after the overall listing had greatly increased the company's profitability, and improved the fundamentals. Overall listing has the following advantages for their own development: firstly, it is conducive to making better use of and giving full play to the advantages of group resources, management, optimizing the structure of the company's products and improving the level of profit; Secondly, it helps reduce the connection transaction and competition, and can make some hidden profits.

²¹⁶ Overall listing of SOEs in China has just started. The long-term result of overall listing SOEs needs more time to be examined. The method of overall listing may not suitable for every SOE. There are no useful lessons which can be learnt before the overall listing. The research followed the cases.

²¹⁷ Ibid.

applied.²¹⁸ SASAC illustrated that the reform of small and medium-sized SOEs were completed through reorganization, combination, merger, leasing, contracted management, joint venture, and transfer of state-owned property rights, joint-stock system, and joint-stock cooperative system, but those methods cannot be used for large-sized SOEs; SASAC showed the reasons through explaining the types, responsibility and importance of large-sized SOEs for China.²¹⁹ This thesis agrees with the arguments of SASAC and Shao that the lessons and experience of reform of small and medium-sized enterprises cannot be copied for large SOEs. Because the nature, size and responsibility of enterprises are completely different, the methods of reforms, especially CG of SOEs, cannot be the same. The biggest contribution of small and medium enterprises was that they tested the market reaction, eliminated obstacles and won more time for larger SOEs reform.

Another indication of China's readiness to start large SOEs reform was the way in which different SOEs were distinguished by different natures. It is the view of this thesis that the CG of SOEs would be improved by applying different plans and strategies for SOEs different in nature. According to different natures, the large-sized SOEs are divided into two types according to their different main tasks and responsibilities in China. On the one hand, some large-sized SOEs can offer protection for economic development and Chinese people's lives. These large-sized SOEs spread throughout all the country and different industries. Some industries supply

²¹⁸ See the interview of Shao Ning for SOEs reform in Apr. 2011. <http://opinion.hexun.com/2011-04-21/128941997.html> Last accessed, 13/11/12.

²¹⁹ Ibid.

infrastructures and public goods such as water supply, petrol supply, gas supply and public transportation. Some industries are related to the exploitation of natural resources, coal mines being a good example. The reason why such large –sized SOEs are so important for those industries is because one of their main tasks and responsibilities is to serve social benefits. So sometimes the large-sized SOEs must continue supplying although they are losing money, which cannot be accepted by non-SOE enterprises. In addition, large-sized SOEs can offer the supply of gas, petrol and electricity to cover most parts of China.²²⁰

On the other hand, some large-sized SOEs can improve China’s comprehensive national strength, including economic strength, defence capability and so on, such as the military industry, aerospace, petroleum exploration and communication. Those industries require high technical inputs, more investments, and undertake higher risks in competing with international enterprises. For China at present, only large-sized SOEs or state holding enterprises can carry out activities involving high costs but negative profits in order to support social stability.²²¹ The following programs are the best evidence: SOEs made huge contributions to such programs as the Three Gorges construction, the Qinghai-Tibet Railway, west-east gas transmission, the south-to-north

²²⁰ There is a case referred to by Shao Ning to support the importance of large-sized SOEs. There are five central enterprises of electric power which took up 66% share of the market. And at one time, the Chinese the electricity price was lower than cost. Nevertheless, those five central enterprises kept supplying electricity for China. However, it would be impossible for non-SOEs to do the same things.

²²¹ Some examples about SOEs or central enterprises’ contribution are: the selling prices drop away from the state purchasing pricing in China in a certain period, such as China Minmetals Corp. Sinochem, and China Petroleum Corp. Social responsibility, and supporting social stability are the main reason why they do like this. Only large SOEs can offer this kind of business loss.

water diversion project, and the launch of the Shenzhou series of spacecraft.²²²

Therefore, the large-sized SOEs are very important for China. Because of their size and characteristics, they cannot copy the methods of reform for the small and medium-sized SOEs. What is then the solution for large-sized SOEs reform? How could the CG of large SOEs be improved? In Feb 2012, representatives of SASAC at a conference of State Council information office, announced following five tasks: (1) concentrate resources on crucial industries and pivotal fields, further develop large-sized SOEs, (2) make the distribution of resources appropriate through regrouping and structure readjustment, (3) improve CG of large-sized SOEs, (4) further improve the state-owned assets supervision system, guarantee transparency, more efficiency and more scientific assessment and evaluation, and (5) further promote the internal reform, make the internal mechanism more market-oriented, and reduce various burdens of SOEs.²²³

It is the view of this thesis that the five tasks above are based upon the initial achievements of SOEs reform.²²⁴ The completion of the five tasks requires higher standards of CG of SOEs, and the tasks themselves are specific descriptions for internal governance, external governance and sound market environments for SOEs. In fact, the Chinese government has prepared for a long time and the achievements made in the

²²² The same considerations apply to the Three Gorges Project. Projects like this, and the projects mentioned in the thesis, can only be done by only large-sized SOEs.

²²³ Supra note 48.

²²⁴ The initial achievements of SOEs reform means former steps are already completed, such as reform of small and medium-sized SOEs, and establishment of MES. The basic conditions of CG for large SOEs have been established.

past lay down a basis for further reform. Next section will illustrate the initial results, changes, direction, and evaluation of SOEs reform.

2.2 CG at the Transition Stage

The following results had been achieved at the initial stage of the Chinese economic reform. First of all, with the deepening of reform and opening up, China's foreign trade rocketed. In 1999 it was 367 hundred million dollars, compared with 20.6 hundred million in 1978, which increased almost 17.5 times.²²⁵ Furthermore, various regions were opened up and established in coastal areas, inland and western regions. Last but not the least, absorption of foreign capital was expanded, which enriched the form and use of foreign capital, including Sino-foreign joint ventures, Sino-foreign cooperative ventures, foreign owned enterprises, BOT investment, and securities finance.²²⁶ Li Yining argued that the largest achievement of economic reform was the corporatization in the process of reform of SOEs through the establishment of shareholding companies in the late 1980s.²²⁷ China then established the securities market and pushed the SOEs reform to a higher and international standard.²²⁸ For the reform of SOEs, according to Li, the economists thought monopolistic behaviours of the SOEs was the most significant problem which needed to be solved at the same

²²⁵ Wu, *supra* note 28, at 2 According to Wu, SOEs were the big contributors to the Chinese economy, but undeveloped CG of SOEs was still limiting the development of the economy. He believed this problem should be solved by domestic reform, such as Chinese legal construction, and fair market environment.

²²⁶ *Ibid.*

²²⁷ Li, Y, in “*Zhongguo Gaige Sanshinian*” (*The 30 Years of Chinese Economic Reform*) 2009: 125.

²²⁸ *Ibid.*

time.²²⁹

China adopted a gradual path of reform, both for the economic reform and SOEs reform, and in every stage of practice to evaluate the effectiveness of reform measures. According to a report of SASAC in 2012, the different approaches and targets were designed for SOEs reform.²³⁰ The first concern was about the financial relationship between government and SOEs. According to Deng Yan, some American scholars suggested that the Chinese government should cut the subsidies to SOEs.²³¹ However, SASAC argued that cutting subsidies for SOEs had been done at Zhu Rongji's time. In support of this argument, SASAC showed that there were 5000 SOEs with financial difficulties who had to file for bankruptcy, and if government still provided subsidy for SOEs, those SOEs would have grabbed the opportunity rather than become bankrupt.²³² The other approaches were about SOEs reform through market-based measures, including deregulating the small and medium-sized SOEs, making large SOEs with financial difficulties bankrupted, and taking on management of normal SOEs by SASAC after 2003.²³³

In the process of reform some progress and achievements have been made and there came to be some formalization, such as CG of SOEs. Under the social and economic

²²⁹ Ibid.

²³⁰ See supra note 55.

²³¹ Ding Yan 2008, *WTO Kuangjia Xia Zhongguo Guoyou Qiye Butie Falv Wenti Yanjiu*, (*The Legal Research on Chinese SOEs Subsidies and WTO*). Xiamen: Xiamen Da Xue. And see Michael Daly 1998 Special Problems Concerning the Measurement of Subsidies, Annex to Investment Incentives and the Multilateral Agreement on Investment, 5, *Journal of World Trade*. And see Julia Ya Qin, 2004, Regulation of Subsidies to State-owned Enterprises (SOEs)—A Critical Appraisal of China Accession Protocol, 12, *Journal of International Economic Law*

²³² Ibid. Zhu Rongji's time is from 1993 to 2002.

²³³ About in which way deregulated small and medium SOEs can see Chapter 3.

conditions in old China and the planning economic, new concepts and systems such as CG of SOEs were unable to exist; in China now, these new concepts and systems need time to be adopted. However, China is trying to solve some problems through the mode of ‘Chinese characteristics’. Hence, the same words have the same connotations but may have different extensions and meanings between what they are in their own original country and in China. The concepts of CG, internal and external governance are representative examples. In addition, there are some concepts and modes of management that were unfamiliar for western scholars, such as the way in which the factory director (manager) assumed overall responsibly and the importance attached to the Party Committee of CG in China.²³⁴ More details about Chinese characteristics in the reform of SOEs will be discussed in the next chapter.

To sum up, Chinese characteristics are a typical consequence of transition. This thesis tries to conduct an objective evaluation for SOEs reform in China. The general trend of Chinese reform of SOEs is long, arduous, and irreversible.

²³⁴ The Chinese SOEs tried to achieve international standards and according to the urban situation of China, companies regarding chairman of the board under the leadership of manager, factory manager responsibility system, has formed a specialization standardization and modernization of the production system.

Chapter 3: Transformation of the Owner and Control of SOEs in the State-Owned Enterprise Reform

As mentioned in chapter 1, the traditional main participants of Corporate Governance include the owner (shareholder/s), decision makers (board of directors), executives (management), employees and other stakeholders.²³⁵ The term “Corporate Governance” was not used in official documents before it made its first appearance in the articles about Chinese SOEs in 1992.²³⁶

The absence of the term was misleading because the practice of CG had in fact been carried out for some time. There were examples of the theory and practice of CG of SOEs, including practices such as defining and simplifying the ownership and solving the problem of excessive state control over SOEs.²³⁷ Placing limits over excessive state control involved two elements. As the discussed in this Chapter, the first was defining

²³⁵ See Chapter 1 Pp. 16-20.

²³⁶ In 1992, the 14th NPC had a clear goal about the building of the socialist market economic system reform. In order to seek effective integration of state-owned economy and market economy, China's reform measures were mainly divided into two aspects: one is the reform of state-owned assets management system, the other one is to establish a modern enterprise system in China. The legal meaning of modern enterprise system is to draw lessons from western enterprise's effective legal system, establishing system of Chinese enterprises to adapt to the market economy, namely no longer traditionally divided enterprises system according to the ownership of enterprise's nature, but according to the investors in the risk of its portfolio companies and the rights and interests enjoyed characteristically to differentiate in the form of enterprise – in other words to enable China's enterprise system to connect with enterprise system of the world.

²³⁷ The reform of state-owned enterprises before 1992, mainly resulted in expanding the autonomy of state-owned enterprises. Starting in 1992 is the reform of state-owned enterprises towards a new way of ownership reform, shareholding system reform started, namely implementing diversification of state-owned enterprises, equity diversification, diversified ownership problem, which is bound to be involved in the diversity of members of the board of directors and management personnel. Corporate governance had been introduced into China in 1992. Beginning in 1979, the Chinese legal academics and economists began to seriously study western companies' system (in 1981 version of the American standard company law), the direct purpose being to draw lessons from western experience and solve the problem of independent legal entity of SOEs. The next step is put forward to solve the ownership of the state-owned enterprises and the management of separate issues, put forward against the background of the two rights separation in the United States and other western countries is the inevitable production by the company for the equity too scattered surface phenomenon; but this measure in China is to take the state-owned enterprises out of the control of the State (nearly all the stake controlled by in the state administrative organs), in order to enable the enterprise operation and management to get rid of the administrative organs of the direct intervention.

the owner and manager of Chinese SOEs, their respective responsibilities, rights and positions. The second element consisted of establishing the scope of the SOEs.²³⁸ When these reforms had taken place, some traditional SOEs developed into modern enterprises with the essential features of international enterprises.²³⁹ This was the most significant step in SOE reforms.

The changes to and improvements of Chinese SOEs mentioned above have brought changes to CG of SOEs. This chapter will focus on the changes of owner (shareholder/s) and control in the reform, and discuss the inevitability, strengths and weaknesses of the changes for Chinese SOEs. The other participants – decision makers (board of directors), and executives (management) of Chinese SOEs will be discussed in subsequent chapters.

3.1 Expanding the SOEs' Autonomy (*Kuoda Qiye Zizhuquan*)

Chinese SOEs are officially 'under the ownership of the whole people'.²⁴⁰ As discussed in the preceding chapter, in the period after 1949, the ownership structure of Chinese SOEs was highly concentrated. The central government gradually liberalized

²³⁸ In order to enable the enterprise operation and management to get rid of the administrative organs of the direct intervention, Fangquan Rangli and the system for contracted responsibility had been tried during that period.

²³⁹ After the periods about independent legal personality of SOEs and the separation of ownership and management of SOEs, Chinese SOEs gradually got rid of the mode about traditional management under the planned economy. The separation of owner and managers of SOEs was a good achievement in order to face up to the market economy. Here the international enterprises refer to enterprises under the market economy.

²⁴⁰ More discussions of this term can see the articles below: Tong Rou, Shi Jichun. 1990 "Wo Guo Quanmin Suoyouzhi Liangquan Fenli de Caichanquan Jiegou", *Social Sciences In China*; Wang Lanping, 1994. "Lun Woguo Quanmin Suoyouzhi Qiye Chanquan Zhidu Gaige de Falv Shixian Fangshi", *Journal of Shandong*. Wang Wei, Li Yunfeng, 2012, "Cong Quanmin Suoyouzhi Kan Guoyou Qiye de Chanquan Guishu" *University; Legal System and Society*.

the relevant provisions of autonomy and decision-making of SOEs because of the negative effect of the traditional ownership structure. The administration system was faced with a new dilemma.²⁴¹ For Chinese SOEs reform, expanding the SOEs' autonomy was the first step in the modification of the relationship between ownership and control of SOEs. Autonomy, according to the official documents of the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party, was defined in relation to SOEs decision-making, operation and management.²⁴²

Expansion of SOEs' autonomy gained great economic benefits; both the number of experimental enterprises and their profits saw significant growth.²⁴³ While this was occurring, the limits to the expansion of SOEs autonomy became exposed. On the one hand, the relationship between the state and SOEs was put into question: the degree or level of expansion of SOEs autonomy had been not defined very clearly. With a rapid development of the SOEs' autonomy and a lack of related law, the managers of SOEs required more decision-making powers in order to obtain more profit for the SOE. A search of all relevant laws at the time showed that while there were some provisions,

²⁴¹ In order to help the economy recover, the State accelerated the pace of the construction of state-owned economy. According to Su's 'the Report for Thirty Years of Chinese SOEs' Shareholding Reform' (*guoqi gufenzhi gaige :sanshi nian*), by around 1980, compared with the gross output value of industry and agriculture, the public sector of economy accounted for 95.3%, occupied the absolutely superior position in the national economy. In addition, the shortcomings of planned economy management system were exposed, and restricted the development of the Chinese economy. High-investing, low-output, and low efficiency were the main characteristics of State enterprise. In the past, the dilemma for the government was whether to liberalize the autonomy and decision-making of SOEs, the new dilemma means the degree and level of expansion of SOEs autonomy.

²⁴² In the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party, the problems about SOEs subordinated to the State were pointed out. It was the first time that owner, control and management of SOEs were discussed by the government. The reform of expanding the SOEs' autonomy, *Chengbao Zhi Gaige*, and the reform of State enterprises pay taxes instead of turning over their profit to the state were originated from this Plenary Session.

²⁴³ Su. 2012: 3.

rules and regulations, they focused on the provincial or city levels.²⁴⁴ It can thus be said that SOEs' autonomy as defined in laws and regulations at national level in China was vague. First, there were few laws, provisions, rules or regulations which elaborated upon the key points of the reform; for example, how and when to distribute profits between the State and SOEs and the specific limits of autonomy were not included in the subjects of regulations. Secondly, the rules and regulations were limited at regional level or within an industry and were thus not universally applicable to SOEs across China. Finally, legislation lagged behind economic developments.²⁴⁵ The Amendment to the Constitution in 1993, which was relevant to SOEs autonomy, made revisions so that it read as follows:

‘State-owned enterprises have decision-making power with regard to their operation within the limits prescribed by law. State-owned enterprise practice democratic management through congresses of workers and staff and in other ways in accordance with law’.²⁴⁶

This amendment used the term ‘state-owned enterprise’ instead of the term ‘state enterprise’ that had been used in the 1982 Constitution. While the Amendment changed the tone of a planned economy, it did not answer vital questions about how and when SOEs could be expanded and what limits there were on such expansion. Moreover,

²⁴⁴ According to the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party, the policies for the city and the country were different. For the country, the policy was to push the household contract responsibility system on the basis of the public sector (see the sixth part of the tasks), for the city, the policy was to separate the ownership and management, and expand enterprises' autonomy.

²⁴⁵ In China, the SOEs and company system were transferred from planned economy. Legal certainty is behind the transaction phenomenon. When the enterprise is moving from the planned economy to the market economy, social phenomena underwent new changes, but the law was not updated it still suffers the problems resulting from the planned economy period. So, to a certain extent, the lagging behind of the law influence the healthy development of the economy

²⁴⁶ See Constitution of the People's Republic of China 1982,, and Amendment to the Constitution of the People's Republic of China 1993 (1993) .

there were few rules, regulations and laws which defined the proportion of tax payable when the State enterprises made a loss. Obviously, the lack of such a law was a latent risk for the SOEs reform. Even in the special law for SOEs enterprises -- Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People 1988 -- most of the provisions described the nature of enterprise without addressing the issues of ownership and managerial authority.²⁴⁷ The Articles on expanding SOEs autonomy provided only a framework of SOEs' rights without providing sufficiently detailed rights and how they should be exercised.²⁴⁸ Instead, Article 67 stated that 'The State Council shall, in accordance with this Law, formulate rules for implementation.'²⁴⁹ It was not until 1992 that the State Council issued the Regulation on the Transformation of Operational Mechanism of the Industrial Enterprises Owned by the Whole People.²⁵⁰ This Regulation identified fourteen rights in SOEs autonomy.²⁵¹ It may thus be said that between 1988 and 1992 SOEs autonomy existed more in theory than in practice.

²⁴⁷ See the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People 1988 Article 2. 'An industrial enterprises owned by the whole people (hereinafter referred to as the enterprise) shall be a socialist commodity production and operation unit which shall, in accordance with law, make its own managerial decisions, take full responsibility for profits and losses and practices independent accounting. The property of the enterprise shall be owned by the whole people, and shall be operated and managed by the enterprise with the authorization of the state in line with the principle of the separation of ownership and managerial authority. The enterprise shall enjoy the rights to possess, utilize and dispose of, according to law, the property which the state has authorized it to operate and manage'.

²⁴⁸ Ibid. Article 2.

²⁴⁹ Ibid. Article 67.

²⁵⁰ See Regulation on the Transformation of Operational Mechanism of the Industrial Enterprises Owned by the Whole People 1992 issued by the State Council.

²⁵¹ Ibid, See Regulation on the Transformation of Operational Mechanism of the Industrial Enterprises Owned by the Whole People 1992 issued by the State Council. The fourteen rights were: an enterprises shall enjoy the 1 production and management decision-making right, 2 the right to fix price of its products and labor services, 3 the product selling right, 4 the material purchasing right, 5 the import and export right, 6 the investment decision-making right, 7 the right to dominate the retained capital, 8 the asset disposing right, 9 the right of joint venture and merger, 10 the right of labor employment, 11 the personnel management right, 12 the wage and bonus distributing right, 13 the internal structural establishment right, 14 the right to reject inappropriate apportionment.

On the other hand, the limits to the expansion of SOEs autonomy existed in that the State was the owner of SOEs, and at the same time it controlled the SOEs. The ‘autonomy’ was explained and defined by the State, and the fact that the SOEs were an appurtenance (*fushuwu*) of government remained.

3.2 State Enterprises²⁵² Pay Taxes Instead of Turning over their Profit to the State (*Ligaishui*)

The case about the reform of expanding the SOEs autonomy showed a beneficial distribution mechanism which was important for the SOEs reform, especially for the relationship between the owner and manager. When the state enterprises suddenly obtained more decision-making rights, their initiative in production was encouraged. However, the problem of unfair and vague distribution of profits was the reason for many disputes between State enterprises and the state or departments responsible for finance.²⁵³ Finally, a policy named ‘State enterprises pay taxes instead of turning over their profit to the state (*ligaishui*)’ which was launched in 1983 helped improve the relationships.²⁵⁴ According to Su, the old distribution solution made the State

²⁵² In this thesis, the term of state enterprise refers to “Guoying Qiye”. The state enterprise is the predecessor of SOEs in China. After the period of separation of ownership and management, when the state enterprise became an independent enterprise legal person, the term of state enterprises became to the term of SOEs in Chinese legal system.

²⁵³ After the period of separation of ownership and management, under the market economy, the state enterprises gained more profit than before, but because of the vague distribution of profits, the state enterprise left less profit when they handed over profits to the government. By then enthusiasm of for the state enterprise had been reduced, and disputes about distribution of profits arose more and more.

²⁵⁴ (Tentative) Procedures for State enterprises pay taxes instead of turning over their profit to the state (*ligaishui*) issued by Ministry of Finance was forwarded by the State Council. And in 1994, the Second Step of Reform for State enterprises pay taxes instead of turning over their profit to the state (*ligaishui*) had been issued by the Ministry of Finance was forwarded by the State Council. As discussed in last footnote, after the method of distribution of profits between SOEs and the State had been changed, the enthusiasm of SOEs had been improved, because SOEs would gain more profits after taxed.

enterprises hand over profits to the government, while the new fixed proportion of tax system defused tension between enterprises and government, and mobilized the enthusiasm of enterprises for profits.²⁵⁵

The reform for the state enterprises paying taxes instead of turning over their profits to the state was the first important measure towards modernizing the system of state enterprises. The tax system stabilised the relationship between State enterprises and government. State enterprises owned the rights of decision-making and management, and the government just focused on tax system of collection and thus played the role of a more remote enterprise owner. However, after around four years' effort in reforming the tax system, this system collapsed when some State enterprises found that they were unable to pay taxes to the government and the government found that their revenues had diminished drastically. There are a number of elements that made the reform unsuccessful, such as social background, economic environment and problems left over by history in terms of law.²⁵⁶ However, the reform of State enterprises paying taxes instead of turning over profits to government achieved more than the reform of expanding the SOEs' autonomy. Both these two reforms were completed under the planned economy framework, but these two reforms were a progressive process, and step by step. Li Gai Shui left more money for the state enterprises on the basis of expanding the autonomy.

The drawbacks of these two reforms were the same, which was that there were no rules,

²⁵⁵ Su, *supra* note 251, at 3.

²⁵⁶ For example, whether social background is planned economy or market economy, economic environment is fair or unfair, the legal system is sound or not.

regulations or laws for defining the proportion of tax when the State enterprises made losses.²⁵⁷

3.3 The Reform of Shareholding System (*Gufenzhi Gaige*) in Chinese State-Owned Enterprises Reform

Where the reform of the shareholding system is concerned, there is a popular view that ‘shareholding reform is one of the key elements of the corporatization reform, with corporatization itself as one of the key measures in the larger policy of the MES (Modern Enterprises System)’.²⁵⁸ Due to the fact that shareholding was seen only as a part of corporatization rather than as part of SOEs reform, many scholars neglected the significance of the reform of shareholding system for SOEs reform.²⁵⁹ In addition, this classification method also might explain the reason why there was not same amount of research about Chinese shareholding reform in the legal field. Most research considered shareholding reform to be a part of corporatization reform, and considered shareholding reform to have lasted a short time only.²⁶⁰ This focus on corporatization meant that the thirty five years of Chinese SOEs reform was overlooked in this context.

²⁵⁷ These two reforms did not distinguish the double identities for the State – social and economic management and the owner of state-owned assets. Professional management and supervision of the state-owned assets department had not been built. On the division of state-owned assets management’s function, the reforms did not point out the functions about asset’s owners of the State or SOEs’ property rights.

²⁵⁸ Zhang Y, 2008. *Large Chinese-State-Owned Enterprise*, New York: PALGRAVE MACMILLAN. P. 39.

²⁵⁹ Ibid. More scholars neglected the significance of the reform of shareholding system for SOEs reform can see: Li Ji, Sun Jianmin, Liu Xiangyang, and Ba Shusong, 2005. “Guanyu Guoyou Qiye Gufenzhi Gaige de Shizheng Yanjiu”, *Management World*, 01 2005. Xu Ying, 2013. “Guoyou Yinhang Gufenzhi Gaige Libi Fenxi”, *New Finance Economics*, (2) 2013. Duan Zhongpeng, Duan Baida, 1997. “Guanyu Gufenzhi Gaige de Jige Wenti”, *Economic Reformation and Development*, 08 1997.

²⁶⁰ Ibid.

There is of course consensus that corporatization reform shares the same objectives compared with shareholding reform (the objectives of corporatization reform will be discussed in the next chapter), and in this sense it is impossible to talk about shareholding reform without mentioning corporatization reform, because these two terms always appeared together after 1992.²⁶¹ However, it should be noted that in China the shareholding reform started earlier than corporatization reform,²⁶² and that these two reforms are independent processes, not as a part of each other. This is because the shareholding reform is a radical reform which had an effect of modification of property rights system of SOEs (the other main function of shareholding reform is relocating capital resources through M&A effectively, but we just focus on property right system of SOEs here). In contrast, the corporatization reform, as a core step of MES, is trying to change the SOEs towards modern enterprises.

As discussed above, it can be seen clearly that the reform of expanding the SOEs' autonomy (kuoda qiye zizhuquan) and the reform for taxation to replace profit transfer (ligaishui) failed. Yet, Chinese SOEs reform accumulated much experience through these two reforms. It was against these two failed reforms that SOEs shareholding

²⁶¹ The terms of 'corporatization' and 'shareholding reform', as two independent reforms, are the main different reforms for Chinese SOEs reform. Their common points can be summarized as follows: first of all, they focus on the relationship between the owner and manager of SOEs, secondly, they push the Chinese SOEs towards an international and modern direction. However, shareholding reform was proposed earlier than corporatization in China by the documents of central government. In fact, the result of shareholding reform of SOEs was not very good in the period between 1980 and 1997, but the failed experiences showed the importance of ownership issue and those experiences prepared for corporatization. Therefore, the first difference between corporatization and shareholding reform is that shareholding reform started earlier and served to prepare for corporatization reform, and corporatization reform started after 1992; the second difference is that shareholding reform focused on ownership and property rights of SOEs while corporatization reform paid more attention to the board of directors, shareholders and board of supervisors, and that helped SOEs to transform to international and listed enterprises.

²⁶² Shareholding reform was proposed in 1980s, and the central government paid great attention to developing SOEs shareholding reform in 1992. After 1997 the shareholding reform developed very well. Corporatization reform was proposed in 1992 as a core of MES, and started after 1992.

reform attracted more attention from the government.

According to Huang, shareholding reform in China started around 1978, the prototype of shareholding system of SOEs was the rural joint-stock system enterprises.²⁶³ It was considered by Li, a distinguished scholar in this field, that a core problem of SOEs was excessive concentration of property ownership, so the reform of the shareholding system was the best solution.²⁶⁴ Before 1992, Li held his opinion and developed a series of methods for SOEs, included the structure of the ownership, the structure of the SOEs after the reform, and the solutions of transition from the original contracting system enterprise to joint-stock enterprise.²⁶⁵ But some scholars argued for several opposite points. First, some believed that the shareholding system of SOEs was the product of the development of modern capitalist society and for that reason had to be rejected by a socialist society.²⁶⁶ Another main point they argued was that shareholding reform was not the objective of SOEs reform.²⁶⁷ They thus urged the Chinese

²⁶³ After the Third Plenary Session of the Communist Party of China in 1978, some of China's rural 'Sheban' enterprises for expanding production capacity, spontaneously adopted financing investment, cooperation, share dividends, a series of new solutions which made the scale of enterprises larger than before. Farmers through a variety of factors of production became a shareholder, formed the rural joint-stock system enterprise, which is the prototype of the shareholding system.

²⁶⁴ Su, *supra* note 251, at 3 Li Yining, Vice Commissioner, Economic Policy Committee, National People's Political Consultative, PRC; Dean, Division of Social Sciences, Peking University. Li compared China and many other countries on the practice of economic operation. On the basis of his comparative study; he developed a theory to explain China's economic operation. At the beginning of the Chinese reform, Li proposed shareholding system of SOEs should be used for China's economy, so in China, many people called him Li Gufen.

²⁶⁵ The specific methods: employees to buy shares in order to make the factory become an internal shareholding enterprises; establishing new shares through enterprise merger; enterprises shares or stock exchange each other, form the compact enterprises group; Sino-foreign joint venture and foreign joint venture, establishing joint-stock system; issue B shares, the enterprises change to be a sino-foreign joint venture; become to be a joint-stock enterprises through using of bank loans for enterprise; several companies joint investment, establish an investment company, the latter will be participation in the former enterprises, and transform them by instalments for a stake in enterprise and so on.

²⁶⁶ According to Huang Zehua, the economists such as Lang Xianping, criticized sharply for SOEs reform-shareholding reform. See Huang Zehua, 2008. "Zhongguo Gufenzhi Gaige Sanshinian Huimou", *China Report*. 07 2008.

²⁶⁷ *Ibid.*

government and SOEs not to pay attention to it.²⁶⁸

When looking at the initial reforms today, it is easy to find that in the early time of 1980, the argument of shareholding reform of SOEs from Li was so new, strange and difficult for Chinese government, scholars, and managers of SOEs. We have traced the roots of this phenomenon and believe that a lack of the economic theory, a lack of resources allocation theory and the problems left over by history are the main reasons.²⁶⁹ Indeed most scholars thought the reform of shareholding of SOEs was a temporary relief method for solving the problem of huge labour employment ²⁷⁰(170,000,000 youths from the cities were sent to the countryside between ... and ... in the 'shangshan xiexiang' campaign²⁷¹ and they were starting at that time to return to the cities. During

²⁶⁸ Su, *supra* note 251, at 4.

²⁶⁹ The Cultural Revolution (1966-1976) was a historical event prior to China's economic reform in late 1970s. The official line on the Cultural Revolution is that it was a time of 'chaos' that was bad for the country. In the early years of the PRC after a long civil war, China went into a historical stage of socialism too quickly, and the central leaders, the public and the government were lacking adequate preparation and scientific understanding of 'how to build China in a backward economy and culture and in the construction of socialism'. In the 'Cultural Revolution', the heads of the democratic parties, celebrities from all walks of life and the masses had been framed and persecuted. The Party and the government institutions at all levels, people's congress and people's political consultative conference organization were paralyzed and in an abnormal state for a long time. The public security organs, judicial and procurator organs, and other authority organs were in a chaotic period. Academia was a dealt blow by the Cultural Revolution, when the Red Guards shut down all institutions of higher education and persecuted thousands of teachers and administrators. During such a long period of social unrest, the development of national economy was slow, and economic management system was affected. So when the reform came to China, it broke the traditional order and mode about lacking economy theory and resources allocation theory, according to Yang Ruilong, the significance of the economics of innovation about State-owned enterprises and state-owned enterprise shareholding system reform is: China's reform is the transition from the planned system to market system. From the perspective of transformation, it is mainly changing the method of allocation of resources, meaning the rule of resource allocation is changing from equivalent rules to property rights, right of resource allocation from the government to the micro main body essentially. More details see Yang Ruilong, 2010. "Guoyou Qiye Gufenzhi Gaige Lilun de Jingjixue Chuangxin Yiyi", *Contemporary Finance & Economics*, 02 2010.

²⁷⁰ This opinion can see Wang Jiaoliu, 1998. "Dangqian Guoyou Qiye Gaige yu Zaijiuye Wenti Qianxi", *Qian Dongnan Minzu Shifan Gaodeng Zhuanke Xuexiao Xuebao*. S1 1998. and see Bai Jinfu, 1998. "Fuyou Renyuan—Guoyou Qiye Gaige Bijie de Nanti", *Theory Front*, 06 1998.

²⁷¹ The term "Shangshan Xiexiang campaign" originates from January 1956 when the political bureau of the CPC central committee proposed the 1956-1956 national agricultural development outlines (draft). According to Zhang Zemin, Mai Wenlan, began in 1955 and ended in 1980, experiencing two periods. The first period, 1955-1968, it is a normal social and economic measure to solve the lack of knowledge in the development of agricultural productivity and urban employment problem; the second period 1969-1980, it is a political education movement, in order to solve "against revisionism proofing" and upbringing of successor. The first period meets the need of the state and society; knowledgeable youth also basically played their part and should be given the basic affirmation; the second period damaged national vigour and did more harm than good, should be denied. More details see Zhang Zemin, Mai Wenlan, 1998. "Zhishi Qingnian Shangshan Xiexiang de Lishi Kaocha yu Sikao", *Journal of Henan Normal*

the same period, some 32,000,000 youths were not sent to the countryside but allowed to stay in the cities, including those who were an only child or a child whose siblings had all been sent to the countryside).²⁷² The overwhelming impact of the social problems made most scholars overlook the importance of the shareholding reform of SOEs and its important position in overall Chinese economic reform. A superficial and shallow question ‘whether the shareholding system of SOEs belongs to modern capitalist society or socialist society’ had been argued against a background of reform. From the point of view of the scholars who argued against Li Yining’s argument, the shareholding reform of SOEs was judged not by the standards of development, performance or strategy of SOEs, but by prevailing ideologies.²⁷³

The reform of SOE shareholding was also disturbed by political factors. In fact, the experience of the reform started in 1986 and during a chaotic time of discussion on reform theories. It began with the Provision on the Deepening of Enterprises Reform and Enhancement of the Vitality of Enterprises issued by the State Council on 5th December. This policy document indicated a possibility that some medium or large-sized enterprises could be chosen as the experimental SOEs for the purposes of shareholding reform.²⁷⁴ It would have been a good start for the shareholding reform of

University (Philosophy and Social Sciences Edition). 05 1998. and see Mi Hedu, 1999. “Xi Shangshan Xiaxiang Yundong de Qiyuan”, *Contemporary China History Studies*, 02 1999. see Ye Xin, 2006 “Discussing about the Movement of Educated Youth Went to and Worked in Countryside and Mountain Areas in China”, *Journal of Social Sciences*. 05 2006.

²⁷² Liu Xiaomeng, 1995. “Xuetong Lun yu Zhiqing Shangshan Xiaxiang Yundong”, *Youth Studies*. 02 1995.

²⁷³ The opinion can see Daiyi. 2000. “Guoqi Gufenzhi Gaige Silu de Zaisikao”, *On Economic Problems*. 06 2000. And see Shi Haixia, Wang Yu, 2005. “Makesi Gufen Jingji Lilun yu Guoqi Gufenzhi Gaige Shijian”, *Commercial Research*. 06 2005.

²⁷⁴ See the Provision on the Deepening Enterprises Reform and Enhance the Vitality of Enterprises which issued by the State Council on 5th December 1986.

SOEs if Hu Yaobang, who supported the shareholding reform, had stepped down as the General Secretary of the CPC.²⁷⁵ This political change meant a loss of support from leaders of the central authority, so the process of shareholding reform stalled.²⁷⁶ If we trace the history of the practice of shareholding reform, it seems that both the leaders of the central authority and the executives of SOEs resisted the shareholding reform.²⁷⁷ In essence, the controversial shareholding reform disappeared into obscurity but the largest transition in shareholding reform was yet to come. This time it had political backing.

In 1992, Deng Xiaoping's famous 'southern tour' and the 14th National Congress of the Communist Party of China created a more conducive political environment for enterprise reform. Deng was determined to go ahead with shareholding reform.²⁷⁸

Moreover, based on the experiences drawn from failed former reforms, the scholars

²⁷⁵ Between June 1981 and September 1982, Hu Yaobang served as chairman of the Central Committee of the Communist Party of China, from September 1982 to January 1987, served as general secretary of the CPC central committee. Hu Yaobang resigned in 1987 due to poor opposition of bourgeois liberalization. Hu Yaobang was the Party leader who supported the shareholding reform. Here an example can show his opinion. According to Xin, in July 1983, approved by the government of Baoan County, Guangdong province, a joint investment company was raising funds from society, and collected more than 1300000 Yuan in the first attempt. China's first stock- Shen Baoan was born after the Opening up. Hu Yaobang, as the CPC Central Committee General Secretary issued a stock's proposal and he had close relationship with the China Youth Press- which enforced share-holding system in new China at the earliest time. For more information see: Su, supra note 3, and Xin Ye. 2014. "Hu Yaobang yu Gaige Kaifang Hou Woguo de Diyizhi Gupiao", *Over the Party History*. (7) 2014.

²⁷⁶ Lose the support of the Central leader- Hu Yaobang, the controversial idea of shareholding system reform has dropped.

²⁷⁷ According to Su, around 1986, the Shenzhen government pushed forward the pilot for joint-stock system in state-owned company, and many people thought that shareholding system set up the board of directors, and added a role which controlled the SOEs, so there was no SOEs tried. Only Vanke's general manager Wang Shi volunteered. He realized "vanke is at a crossroads, the shareholding system reform is a chance for Vanke can gain independent operation". Because since it was founded in 1984, Vanke and its parent company, Shenzhen Special Economic Zone Development Corporation strived openly and secretly. For Vanke, the proposed shareholding system reform, was also rebuffed by the parent company. Visibly even state-owned enterprise itself was not accepted for the joint-stock pilot. Su, supra note 251.

²⁷⁸ In the southern conversation, Deng Xiaoping advanced remarkable insights into the market economy, and reflected to the 14th National Congress of the Communist Party of China, namely, the goal of China's economic reform is to establish the socialist market economy system. Concerning the debate about Joint-stock enterprise and shareholding reform of SOEs, he pointed out that the debates could be lasting, but the reform must be done and tried. After that, the main central leader had a special talk to different subjects scholars such as Li Yining, and most of them agreed that shareholding reform was not only necessary, but also was feasible.

finally agreed on the shareholding reform as a solution forward.²⁷⁹ At the same year, the experimental SOEs developed towards standardization and normalization. The details about experimental SOEs will be stated in the next paragraph.

In 1992, the State Commission for Restructuring the Economic System (SCRES) issued a number of documents including ‘the Pilot Measures for Joint-Stock Enterprises’, ‘Opinions on Standards for Companies Limited by Shares’, ‘Opinions on Standards for Limited Liability Companies’, and other documents about joint-stock enterprises accounting system and human resource management system (a total of fourteen in all). In practice, on the basis of the original experimental enterprises, 400 new pilot joint-stock enterprises were established, and by the end of 1992, the total number of pilot joint-stock enterprises reached 3700, of which 69 enterprises traded their shares in the Shanghai and Shenzhen stock exchanges.²⁸⁰ In addition, the China Securities

²⁷⁹ Su, *supra* note 251.

²⁸⁰ Su, *supra* note 251, at 4 the fourteen instructive rules were promulgated by the State Commission for Restructuring the Economic System (SCRES) are including that: 1. the Pilot Measures for Joint-Stock Enterprises 1992, 2. Opinion Standards for the Companies Limited by Shares 1992; 3. Opinions on Standards for Limited Liability Companies 1992; 4. Regulation on the Transformation of Operation Mechanism of the Industrial Enterprises Owned by the Whole People 1992; 5. Interim Provisions of the State Commission of Science and Technology and the State Economic Restructuring Commission on Several Issues Concerning the Establishment of High and New Technology Incorporated Companies within National High and New Technology Industry Development Zones 1992; 6. Reply of the State Council on the Provisional Measures for Experiments of Employee Stock Option Plans in Joint-Stock Limited Companies of Foreign Trade and Economic Cooperation 1994; 7. Notice of the Ministry of Finance, the State Commission for Restructuring the Economic System, the State Economic and Trade Commission, the State Administration of Taxation and the Bureau of the Legislative Affairs under the State Council on Stopping the Implementation of the Provisions That 40% of Income Tax Will be Refunded if an Enterprise Makes Reinvestment by Using the Retained Profits 1994; 8. Circular of the State Council on Deepening the Reform of the Pension System for Staff and Workers of Enterprises 1995; 9. Notice of the State Council to Standardize Original Limited Liability Companies and Joint Stock Limited Companies in Accordance with the Company Law of the People’s Republic of China 1995; 10. Supplementary Notice of the State Council on the Relevant Issues about the Pilot Implementation of the Merger and Bankruptcy of State-owned Enterprises in Some Cities and the Reemployment of Workers 1997; 11. Circular of the State Council on the Approval and Transmission of the Suggestions of the State Planning Commission, the State Economic and Trade Commission and the State Restructuring Commission on the Work of Deepening the Expe 1997; 12. Letter of the Ministry of Finance Concerning the Issue on the Standard with which the Enterprises with Foreign investment Work out the Accountant Report Forms 1997; 13. Circular on the Related Issues of Granting Import and Export Operation Right and Foreign Contracted Project and Labor Service Cooperation Right to the Trying out Enterprises Group 1998; 14. Letter Reply by the General Office of the State Council on the Legal Status of the Meeting of Employee Stock Ownership in Enterprises of Foreign Trade and Economic Relations 2001.

Regulatory Commission was set up to strengthen and unify coordination and supervision of the securities market.²⁸¹ Moreover, the State Council approved nine SOEs restructuring into stock companies, and listed abroad and in Hong Kong. Shareholding reform was moved further forward in 1993 when the term ‘property rights of SOEs’ was proposed for the first time in a document of the Central Committee of the CCP concerning the establishment of the Modern Enterprises System (MES).²⁸²

Although the central government played an active role in promoting the shareholding reform of SOEs, the reform still developed slowly during the period between 1992 and 1997.²⁸³ According to Su, the main reason was that there was a major debate in China about shareholding reform.²⁸⁴ The debated issues, as summarized by Su, included: first, did the SOEs need any institutional innovation? Secondly, if so, did institutional innovation mean property rights reform? Finally, what was the main form of MES? Would the correct answer be corporations and a shareholding system? The debate and controversy lasted about four years (1993- 1996), but no clear answer came up, even from the government.²⁸⁵

²⁸¹ The China Securities Regulatory Commission is directly under the State Council, in accordance with the laws and regulations and authorized by the State Council, the unified supervision and management of the national securities and futures market, maintaining the securities and futures market order, protect their legitimate operation. The CSRC is in the capital, Beijing, is now composed of one chairman, four vice chairman, one discipline inspection commission secretary, three chairmen of the assistant; Authority with 18 functional departments, an audit team, three centers; According to the Securities Law of the People's Republic of China, Article 14, the CSRC also has the stock issuance examination committee, member of the CSRC's professionals and will be hired by external experts. The CSRC set up 36 securities regulatory bureaux, and the Shanghai and Shenzhen securities regulatory commissioner offices in the provinces, autonomous regions and municipalities directly under the central government and cities. According to the Regulations on the Administration of Futures Trading provisions of the State Council, the CSRC to implement centralized and unified supervision and administration to the futures market". Obviously, the CSRC is legal and regulatory department authorized by the government. <http://www.csrc.gov.cn/pub/newsite>.

²⁸² See Several Problems on Establishing a Socialist Market Economic System of the Decision 1993. The main tasks of MES can be found in the discussions of Chapter One.

²⁸³ Su, *supra* note 251.

²⁸⁴ *Ibid.*

²⁸⁵ *Ibid.*

Before looking at the further reform of Chinese SOEs, it is necessary to pause to consider the reasons why it was that there was so much resistance to shareholding reform. First, new concepts and shareholding model could not be understood in a short time given that there was a lack of economic and resource allocation theory. The traditional mode of SOEs and the chaotic social background led to a fear of new modes and new concepts amongst the public at a time of transition. Another reason is that the reform of SOEs was like ‘a person crossing a river by feeling his way over the stones’ and there was little experience which the SOEs reform could learn from.

Furthermore, the regulations, rules, and laws about shareholding reform were copied from other countries, such as America, the UK, Japan and Germany. Because China needed to develop the economy rapidly,²⁸⁶ some stages were skipped over in the development of SOEs to save time and catch up to modern enterprises in other countries, including related laws and regulations, both of which lacked foundation in China.²⁸⁷ The legal system on SOEs was established by some scholars who compared the pros and cons of laws, legal system, ownership structure of developed countries; the Chinese legal system was developed and transplanted from other countries and lacked previous foundations for that law.²⁸⁸

²⁸⁶ Liu Yan, Lou Jianbo, 2014. “Gongsifa Ziben Zhidu yu Zhengquan Shichang: Zhidu Bianqian, Falv Yizhi yu Zhongguo Shijian”, *Zheng Quan Fa Yuan*. 12 (3) 2014.

²⁸⁷ Ibid. and see another article which holds the same opinion: Huang Hui, 2013. “Lue Lun Gongsifa Yitihua: Zhongguo Shijiao Ji Qishi”, *Journal of Comparative Law*. 05. 2013.

²⁸⁸ See Chen Guangwei, 2011. “Falv Yizhi de Fanshi”, *North China University of Technology*. 2011.

The legal transplantation in China leads to some consequences. First, the law transplanted from other countries was not always suitable for China's national conditions.²⁸⁹ Secondly, because China was undergoing a period of change, the pros and cons of the law could not be identified immediately.²⁹⁰ Finally, the practice of SOE reform is the evaluation of standards of the law,²⁹¹ and the evaluation process is one that takes a long time. Since there was a not adequate relevant law in China, the option was then to transplant laws, but if the law transplanted from other countries was found not very suitable for China's national conditions, it would take more time to rectify these laws.

The discussion above indicates a hysteresis situation concerning legislative development in China in relation to SOEs reform. The situation also explains to some extent the reasons why a new kind of reform was so difficult to be accepted in China and thus a long time was needed. Such new reform or related law transplantation needs to be tested and proved through a long period of practical implementation. It should also be noted that policies were issued before a law was formally introduced and such policies contributed to guiding the reform process. This could serve as a good piece of evidence which can support the argument that it may take many years for the concept of

²⁸⁹ The law was transplanted from other countries with the characteristics of their own country, such as the independent director system originating from Britain and America. China did transplant the law of the independent director system, however, the Chinese legal environment and economic development level cannot reach the British and American level in the development of corporation's aspect. So the independent director system developed slowly in China. See Liu Junhai, 2003. "Woguo Gongsifa Yizhi Duli Dongshi Zhidu de Sikao", *Tribune of Political Science and Law*. 03 2003.

²⁹⁰ Because in China in the time of transition, the law, economic and social conditions were changing a lot more than before, so when some new policy, law or system has been set up through law transplanted in China, the result- pros and cons on its suitability for China needed a period to examine. And the reasons could be summarized and illustrated in a short or long term after the case.

²⁹¹ Ibid.

shareholding reform to be accepted by the public and the government. As discussed above, the nature of shareholding reform of SOEs was defined by the 15th Congress of the Communist Party of China in 1997, as stated “joint-stock system is a kind of capital organization form of modern enterprises, it is conducive to the separation of ownership and managerial authority, it is beneficial to improve the efficiency of enterprises and capital operation, both capitalism and socialism can be used. It cannot be broadly defined if shareholding system is public or private, the stake in the hands of who is critical.”²⁹² This was the first time that the traditional ownership theory in China was made as a major revision in the official documents by the Central Committee of the Communist Party of China. This breakthrough brought to the end of the debate between supporters and sceptics for the shareholding reform. From the time that shareholding reform was first proposed by Li in 1980, until the shareholding system was recognized in 1997, the process took over eighteen years.

3.4 'Grasp the Large and Free the Small' (*Zhuada Fangxiao*)

According to OECD, 'grasp the large and free the small' (*zhuada fangxiao*) is a policy in the time of transition for China to revitalize larger SOEs through corporatization (*zhuada*), while letting the small ones go through privatization (*fangxiao*).²⁹³ Grasp the large and free the small (*zhuada fangxiao*), as a new policy to solve the hardest problems for SOEs, was promulgated officially at the Fifth Plenum of the CCP's 14th

²⁹² See the Report of the 15th National Congress of the Communist Party of China in 1997.

²⁹³ OECD 2000 a :51-53.

Central Committee in September 1995.²⁹⁴ This policy was discussed in Chapter One as consisting of two parts, namely, reform of small and medium-sized SOEs, and reform of large sized SOEs. For the small and medium-sized SOEs, the major industries', the solutions of reform, and the importance of small and medium-sized SOEs for Chinese economy have been analysed in Chapter One as well.

Much research focused on Chinese businesses has emphasized the strategic importance of the 'grasp the large and free the small' policy. They thought this policy was mainly implemented in strategic industries,²⁹⁵ and the evidence on which they based their view was the industries where large SOEs retained a controlling position, whether before or after the reform,²⁹⁶ for example, the public utilities, basic goods industries, pillar industries, high-tech industries and defence industries.²⁹⁷ From a different perspective, without considering the strategic objectives, the rationale of this 'zhuada fangxiao' policy was simple. The smallest and medium-sized SOEs were lost around 1990.²⁹⁸ According to McNally and Lee, 'most of these enterprises were below optimal scale and duplicated industrial activities among provinces and countries'.²⁹⁹ However, the large SOEs were mostly profitable, although most large SOEs were distributed in

²⁹⁴ See Zhonggong Zhongyang Guanyu Zhiding Guomin Jingji he Shehui Fazhan Jiuwu Jihua he Er ling yi er Nian Yuanjing Mubiao de Jianyi, which was promulgated officially at the Fifth Plenum of the CCP's 14th Central Committee in September 1995 (28.09.1995).

²⁹⁵ Zhang, supra note 267, at 41-42.

²⁹⁶ Ibid.

²⁹⁷ More details for large SOEs industries see Chapter One, the part about reform of large of SOEs.

²⁹⁸ The World Bank 1997. For more details about lost around 1990 for the smallest and medium-sized SOEs see Ni Xuying, 1998. "Tan Ruhe Fuchi Zhongxiao Qiye", *Journal of Wuhan Commercial Service College*. Z2 1998. Tong Xueqiong, 1990 "Zhuhai Tequ Guoying Qiye Kuisun Qingkuan Qianxi", *Gang Ao Jingji*. 11 1990; see Shi Jianxiang, 1990. "Woguo Caizheng Butie de Gaikuang, Chengyin ji Duice", *Zhejiang Economy*, 06 1990.

²⁹⁹ McNally and Lee 1998;24.

monopolistic or oligopolistic industries.³⁰⁰ So the burden of small and medium-sized SOEs was the biggest problems for development of Chinese SOEs. The solution of releasing such a burden and developing large SOEs was the best and unique method at the time. Whatever the initial intentions of zhuada fangxiao reform, the result was a restructured state sector which concentrated on the large SOEs. Therefore, this was the biggest contribution to SOEs reform in ownership restructuring in bottom the strategic and non-strategic sectors.

This Zhuda Fangxiao policy was reaffirmed and reinforced at the 15th National Congress of the Chinese Communist Party in 1997. Some scholars hold the opinion that ‘China has undertaken a nationwide corporatization reform, especially targeting large SOEs’.³⁰¹ Their argument asserted: firstly, the policy of “grasp the large and free the small” was a main part of corporatization reform, especially for large SOEs; secondly, the reform of small and medium-sized SOEs started earlier than the large SOEs. This latter opinion reflected the process that the reform of small and medium-sized SOEs (fangxiao) had been almost completed by 1997. As for large SOEs, the core of SOEs reform and the main objective of CG reform in China, is still being carried out today, as the next chapter will show.,.

Regarding the relationship between the reform of small and medium-sized SOEs and corporatization, it is believed that the large SOEs are the targets of corporatization

³⁰⁰ See Shi Jianxiang, 1990. “Woguo Caizheng Butie de Gaikuang, Chengyin ji Duice”, *Zhejiang Economy*,06 1990.

³⁰¹ Zhang, supra note 267, at 40.

reform and the reform of small and medium-sized SOEs was a good preparation for corporatization, because the policy had gradually begun the process of breaking down the monolithic ownership of the state.³⁰² The scope of the state's ownership of SOEs became clearer as a result of the reform of small and medium sized SOEs. So the reform of grasping the large and freeing the small" made a great contribution to ownership restructuring for SOEs reform. And corporatization based on the shareholding system was introduced into the large SOEs.

3.5 Debt-into-Equity Reform (*Zhai Zhuan Gu*)

Debt-into-equity reform as one of three measures to revitalize SOEs was launched by the State Council in September 1997.³⁰³ Another two measures were the availability of national bonds at subsidized interests to quicken technology upgrading and innovation, and written-off bad debt. Because only debt-into-equity was included in ownership restructures of SOEs, the discussion in this chapter will focus only on this reform.

³⁰² Zhang, *supra* note 267, at 42.

³⁰³ Almanac of China's Economy 2001;4-5 Approved by the state council, on March 25, 1997, the Securities Committee of the State Council issued "convertible corporate bonds management interim measures", direct regulated conforms to the condition of the listed company and the key state-owned enterprises can issue corporate bonds in China which converted into shares. Convertible corporate bonds and the "debt-to-equity swap" referred to in this thesis have the same meaning; there is no difference in nature. After that, relevant state ministries and commissions and the State Council issued the relevant administrative regulations and rules on the specification, for example, the State Economic and Trade Commission, the People's Bank of China released on July 30, 1999 "on the Implementation Opinions on some Issues of Debt to Equity ", the State Economic and Trade Commission, Ministry of Finance, the People's Bank of China announced on November 23 In 1999 the Corporate Bonds Convertible Audit Regulations, the State Economic and Trade Commission were announced on November 6, 2000 on the Notice of Debt-to-Equity for Enterprises and Strengthen the Management of Standard Operation, and issued by the State Council on November 10, 2000 of the Financial Asset Management Companies Ordinance. These rules and regulations of financial institutions bonds convertible made specific provision, and the implementation of debt-to-equity as major decisions of the Party Central Committee and the State Council to guard against and defuse financial risks, improving the situation of the reform and development of state-owned large and medium-sized enterprises. This kind of debt-to-equity is often referred to as "policy debt turned stock". In practice, debt-to-equity is not limited to the scope of the "policy of debt turn" and appeared in general increase endowment spread of activity of enterprises, especially in the process of restructuring and reorganization of enterprises, listing. For example, the issuing of shares listed "Keda electrical", "star horse car", and other companies in the restructuring is through debt to equity.

Debt-into-equity reform means that ‘funds from government ministries and state-owned banks are converted from loans to investment so as to lower debt to assets ratios. Debts owed to other SOEs are converted to investment in the same way.’³⁰⁴ This policy focused on large SOEs, and there were two standards for SOEs to be eligible for debt-into-equity reform. ‘First, those who were in heavy losses; second, those who were profitable but with debt-to-asset ratios so high that profit could not cover bank interests.’³⁰⁵ The advantages of debt-into-equity reform for ownership restructures of SOEs can be summarized in three points. Firstly, this reform created the SOE restructuring, changed the single state-owned capital, and increased the activity of state-owned capital.³⁰⁶ Secondly, it strengthened supervision over the business of SOEs. In China, as the capital market had not fully developed in the past,³⁰⁷ the SOEs funds heavily relied on bank loans; however, the bank, as creditor, could not constrain the behaviour of SOEs. After the reform of debt-into-equity, the bank gained more supervision rights for SOEs, increased the restriction on the behaviours and management of the debt SOEs, and safeguarded the rights and interests of the bank.³⁰⁸ Then last but not the least, the debt-into-equity reform reduced the burden of SOEs, and

³⁰⁴ Hassard et al. 1999:67.

³⁰⁵ Zhang, supra note 267, at 45.

³⁰⁶ Zhang Xiaohong, 2001. “Ziben Jiegou yu Guoyou Qiye Zhaizhuangu”, *Zhongguo Shehui Kexueyuan Yanjiusheng Yuan.* li Xueqing, and Zou Jun, 2006. “Youguan Zhaizhuangu Wenti de Sikao”, *Prices Monthly.* (05) 2006. Wei Wei, 1997. “Dui Zhaizhuangu Jizhong Moshi de Sikao”, *China Economist*, 07 1997. Li Zhonghua, 2000. “Guoqi Gaige yu Zhaizhuangu Tanxi”, *Xinjiang Finance*, 04 2000. Chen Chuanxin, Li Xiaoyong, Miu Qihao, 2000. “Guanyu zai Woguo Shixing Zhaizhuangu Ruogan Wenti de Sikao”, *Reform of Economic System*, S1 2000.

³⁰⁷ Asset-liability ratio was 65.81% on average in 1995 state-owned industrial enterprises, of which more than 90% of the debt is on bank debt. This issue not only affects further development of the state-owned industrial enterprises, the state-owned commercial Banks carrying a heavy burden to the real commercial operation, but also has become the enormous obstacle to the whole national economy’s sustained, stable and healthy development. Zhang Xiaohong, 2001. “Ziben Jiegou yu Guoyou Qiye Zhaizhuangu”, *Zhongguo Shehui Kexueyuan Yanjiusheng Yuan.*

³⁰⁸ Zhang Xiaohong, 2001. “Ziben Jiegou yu Guoyou Qiye Zhaizhuangu”, *Zhongguo Shehui Kexueyuan Yanjiusheng Yuan.*

helped SOEs realize the goal of turning losses into gains.³⁰⁹

Legal conflicts of Debt-for-equity and how to solve them

From the angle of the legal system, debt-into-equity reform created a conflict between legality and Chinese Civil Law, Chinese Contract Law and Chinese Guarantee Law. The market's economic behaviours must be regulated by law. First of all, as the one of main bodies of debt-to-equity, the state-owned commercial Banks actually enjoy preferential treatment in China. The present approach is that the State sustains a large number of hidden losses of bad creditors' rights in order for the state-owned commercial Banks actually to enjoy the preferential treatment.³¹⁰ It conflicts with articles of Law of the PRC on Commercial Banks.³¹¹ This behaviour must be changed, or debt-to-equity will promote the moral hazard of state-owned commercial Banks. The result is that state-owned commercial Banks rely on the State too much to dispose of bad creditors' rights.

The conflicts between debt-to-equity and Chinese Civil Law are, on the one hand, that excessive administrative intervention crashes the concept of equality of Chinese Civil Law. Huge bad debt for banks was widespread, and the debt-to-equity allowed only

³⁰⁹ Ibid.

³¹⁰ Zheng Zhijun, 2003. "Zhai Zhuan Gu Ruogan Falv Wenti Yanjiu", Zhouzhou University. 2003. and more discussion about legal issues on debt-to-equity can see Lu Hao, 2005. "Zhai Zhuan Gu Shishi Zhong de Ruogan Falv Wenti Yanjiu", Wuhan University. 2005.

³¹¹ See the Article 4, Law of PRC on Commercial Banks which was approved by the standing committee of the eighth National People's Congress by the 13th meeting, according to the tenth National People's Congress standing committee sixth conference, modified and corrected by" commercial bank law of the People's Republic of China decision", Chinese commercial banks take on their own risks, self-financing and self-discipline.

four state-owned commercial Banks to complete, other commercial Banks having been excluded.³¹² On the other hand, for the corporations in debt-to-equity, only part of the large sized state-owned enterprises can participate,, most other types of enterprises and medium and small sized state-owned enterprises being ineligible to participate, thus artificially breaking the equal status of civil subjects in market economy.³¹³ As for the intermediary financial asset management companies in the process of debt-to-equity, referred to as "independent market main body" in relevant policy document,³¹⁴ this is without the rights that an independent liability subject should have, and this is conflicts with principle that obligations and responsibility should be consistent with rights the Chinese Civil Law.

There are two conflicts between debt-to-equity and Chinese Contract Law: the first one is that both sides of the main body of debt-to-equity are financial asset management

³¹² Zheng Zhijun, 2003. "Zhai Zhuan Gu Ruogan Falv Wenti Yanjiu", Zhouzhou University. 2003. And see Guan Xiuzhong, 2001. "Zhai Zhuan Gu de Jige Wenti", *China Economist*. 02 2001.

³¹³ Ibid.

³¹⁴ In China, due to a surge of bank bad loans and operational difficulties of SOEs, the Notice about Implementing Opinions on some Issues of Debt to Equity approved by the State Council on July 30, 1999, issued by State Economic and Trade Commission and the People's Bank the (the Economic and Trade Industry [1999] no. 727), the Opinions put forward to revitalize the state-owned commercial Banks non-performing assets, and recovery of the state-owned Banks' capital, standardize enterprise company reform at the same time, the four financial asset management companies as the main body executes debtto-equity investment (later increased by the National Development Bank); On September 22, 1999, the Party of the 15th Meeting Four Times approved "the Central Committee of the Communist Party of China about the Reform of State-owned Enterprises and the Development of Certain Major Issue Decision" , and proposed "to improve the state-owned enterprise assets and liabilities structure and reduce the burden to society", and combined with the reform of non-performing assets of state-owned Banks, financial asset management companies through debt-to-equity for part of key state-owned enterprises which because of excessive debt and troubled debts in the difficulty, but the products have the market, development prospects to solve the problems about high debt ratio. Implementing the enterprise debts into shares, must transform operating mechanism, their reform to convert themselves into standard companies, and independent audit of financial asset management companies. According to the principle of market economy and the relevant provisions of the standard operation, prevent the loss of state-owned assets. Later, the State Council approved the study of the work related issues on debt-to-equity, and announced on November 1, 2000 the Financial Asset Management Companies Ordinance which specific regulated the activities of the Financial Asset Management Companies, especially for its creditors' right to engage in equity to make detailed. On February 23, 2003 the State Council general office forwarded the Notice of State Economic and Trade Commission of Finance of the People's Bank on further doing a good job of State-owned Enterprise's Debt to Equity Opinion. This suggested the setting up of the new company creditor's rights shares, reducing the debt burden of the enterprises, revitalizing the bad finance assets, supporting the development of the enterprises of implementing debt-to-equity.

companies and enterprises, therefore, the main signature body should be the same. But in the practice, the main signature bodies are the proposed convertible corporate shareholders and the financial asset management companies. Convertible corporate shareholders, even if they are the only shareholders, cannot replace the proposed convertible enterprise itself.³¹⁵ The second conflict is that the Regulations of Financial Asset Management Companies stipulated in the financial asset management company, the relationship between the state-owned commercial bank creditors' rights and the financial asset management company is "buy", meaning the transaction should be independent and voluntary. However, in fact, the financial asset management companies were "compulsory acquisition".³¹⁶

3.6 The Owner (shareholder) and Control of the SOEs under the Supervision and Administration of SASAC

In 2003, the reform of Chinese State-Owned Enterprises entered into a new era, marked by the establishment of State-Owned Assets Supervision and Administration Commission (SASAC). SASAC is a special commission of the central government, directly under the State Council. It is responsible for managing China's SOEs, including appointing top executives and approving any mergers, sales of stock or assets,

³¹⁵ Zhan Lei, 2009. "Shilun Zhengce Xing Zhaizhuangu de Falv Goujia yu Zhidu Wanshan", *East China University of Policy and Law*. The same topic had been discussed in Qi Qun, 2001. "Zhaizhuangu de Hefaxing Wenti Tantai." *Journal of Shanghai Finance University* 03 2001.

³¹⁶ Zheng Zhijun, 2003. "Zhai Zhuan Gu Ruogan Falv Wenti Yanjiu", Zhouzhou University. 2003. And see Guan Xiuzhong, 2001. "Zhai Zhuan Gu de Jige Wenti", *China Economist*. 02 2001.

as well as drafting laws related to state-owned enterprises.³¹⁷ Enterprises under the administration of SASAC can be divided into two types: firstly, those central SOEs who are administered by the central SASAC, under the State Council'. Secondly, the local SOEs had been administered by the local SASAC. According to Sheng and Zhao, 129 central SOEs owned RMB 6,293.09 billion of state-owned assets and equities, with the total assets reaching RMB 21,058.08 billion.³¹⁸ By the end of 2013, the number of central SOEs had decreased to 113.³¹⁹

According to Article 3 of the Law of the People's Republic of China on the State-Owned Assets of Enterprise, 'the state-owned assets shall be owned by the state, i.e. owned by the whole people. The State Council shall, on behalf of the state, exercise the ownership of state-owned assets', and Article 4 'The State Council and the local people's governments shall, in accordance with laws and administrative regulations, perform respectively the contributor's functions for state-invested enterprises and enjoy the contributor's rights and interests on behalf of the state'. The State Council shall, on behalf of the state, perform the contributor's functions for the large-sized state-invested enterprises that have bearings on the national economic lifeline and state security determined by the State Council and the state-invested enterprises in such fields as important infrastructures and natural resources. The local people's governments shall, on behalf of the state, perform the contributor's functions for other state-invested

³¹⁷ Lu, supra note 48, at p8 More functions and responsibilities of SASAC'S can see <http://www.sasac.gov.cn/n85463/n85976/index.html>.

³¹⁸ Shen, H and Zhao N (2013) China's State-Owned Enterprises: Nature, Performance and Reform, Singapore: World Scientific Publishing Co. Pte. Ltd.. at p. 37.

³¹⁹ State-owned Assets Supervision and Administration Commission of the State Council, <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html>, Accessed 03/12/2013.

enterprises.³²⁰ Both the central SASAC and the local SASACs, are specific representatives on behalf of the state contributors. Hence, the establishment of SASAC promoted the process of establishment of a clear property rights representative system concerning SOEs.³²¹

SASAC is neither an administrative authority, nor a business entity, but a government institution directly under the State Council with national sponsor and takes part of the administrative functions of the government. But from its natural properties, it should be a pure national sponsor, exercise the rights of the investor, and undertake the obligations of the investor. Supervision and Administration State-Owned Assets of Enterprise Tentative Regulations³²² as the main regulations which SASAC should follow, clarify the SASAC's duties, especially highlighting the national sponsor status and the function of state-owned assets supervision and administration commission. This is successful,³²³ but, in terms of specific provisions, was not in accord with the regulations of the investor having the right to regulate the rights of the SASAC. At the same time there are phenomena about right "offside" and "absence".³²⁴ However, in the

³²⁰ See Article 3 and 4 of Law of the People's Republic of China on the State-Owned Assets of Enterprise 2009

³²¹ Shen, Luo 2005: 65.

³²² Supervision and Administration of State-owned Assets of Enterprises Tentative Regulations promulgated by the State Council on 27 May 2003 and effective as of date of promulgation.

³²³ Zhao Kun, 2004. "Guoziwei de Zhineng Dingwei yu Guoyou Zichan Guanli Tizhi Gaige", *Collected Essays on Finance and Economics*. 03 2004 According to Zhao, the establishment of the SASAC and the implementation of, of Supervision and Administration of State-owned Assets of Enterprises Tentative Regulations marked a major reform of the state-owned assets management system in China. SASAC exercising the investor right will help the state-owned capital to be orderly narrowed step by step and the restructuring of listed companies, to provide institutional guarantee for reduction of state-owned shares, can also help in the cultivation of manager market and perfect it. More discussion of SASAC's characters can see Hao Yunhong, and Qu Liang, 2004. "Expound the Beyond Government & Analogous Corporation, Characters of National Assets Supervise and Administrative Committee", *China Industrial Economy*. 3 2004.

³²⁴ Wang Xinhong, Tan Lin and Zhou Junhua, 2005. "Lun Guoziwei de Xingzhi—Jianping Qiye Guoyou Zichan Jiandu Guanli Zanxing Tiaoli Zhi Buzu Zhichu", *Contemporary Finance & Economics*. 05 2005 the same opinion, see Zhang Suohua, 2009. "Lun Guoziwei Falv Diwei de Zaidingyi", *Seeker*. 11 2009. According to Zhang, The legal status of the SASAC has been the disputed. Due to Supervision and Administration of State-owned Assets of

years (2003-2015) of the implementation of the process, the SASAC carried out the investors' rights and regulatory powers at the same time, attracting numerous queries. The nature of the investor rights and regulatory powers are completely different: the former is the private right, the latter is a public right. Both of them had been vested in SASAC at the same time, inevitably led to conflicts, resulting in the nature of the state-owned assets supervision and administration being in chaos. So the investor rights and regulatory authority shall be given responsibility for two main bodies, and two formal relations - the state-owned assets supervision and state-owned capital operation.³²⁵ This situation need to be further improved. The SASAC should be positioned by regulators in the choice of investors and regulators.³²⁶ The reasons can be summarized into three points. first of all, the background of the SASAC' s security administration with a lack of exercise investor rights consciousness, makes it easy to "offside";³²⁷ Secondly, the SASAC takes sponsor's duties, the limitations are existing personnel and institutions, so the security administration management radius tends to be too large, personnel management is difficult to reach the designated position, with defects such as insufficient incentive; lastly, SASAC positioning as regulators helps the

Enterprises Tentative Regulations making the legal status of the SASAC fuzzy, led to SASAC's functional dislocation. On October 28, 2008, the law of the People's Republic of China State owned assets of enterprises adopted by vote of the standing committee of the 11th National People's Congress fifth meeting, SASAC was positioned to sponsor responsibilities on behalf of the state institutions. Zhang thinks SASAC shall become as a government agency or institution and return to the state-owned assets supervision, spin off its "identity, and strengthen its administrative duties.

³²⁵ Jiang Xiangyu, 2006. "Luelun Guoziwei de Gongneng Dingwei", *East China University of Policy and Law*. 2006 For further discussion about the legal relationship between SASAC and the main object of the operation for state-owned assets see Wang Quanxing, Fu Lei and Xu Chengyun, 2003. "Guoziwei yu Guozi Yunying Zhuti Falv Guanxi de Dingxing Tantaoy", *Studies in Law and Business*, 05 2003.

³²⁶ Ibid Jiang Xiangyu, 2006. "Luelun Guoziwei de Gongneng Dingwei", *East China University of Policy and Law*. 2006.

³²⁷ Ibid. and for the same opinion see Zhu Hongbo, 2007. "Guoziwei de Juese Chongtu", *China Reform*, 05 2007 According to Zhu, After the establishment of SASAC, although SASAC is positioned in the investor, in the operation, the investors, operators and regulators, these three roles are taken by SASAC at the same time. Dislocation of roles will reduce the effective CG of SOEs, and will lead to interest conflict, impede fair competition, and damage the interests of society as a whole.

unification of the state-owned assets supervision. After the SASAC chooses the positioning of regulators, it needs to be clear about the functions, the nature and powers of SASAC, spin-off its role on some functions of the investor and the function of public service.³²⁸

³²⁸ Jiang Xiangyu, 2006. “Luelun Guoziwei de Gongneng Dingwei”, *East China University of Policy and Law*. 2006. and see Wu Jinglian, 2003. “Dui Guoziwei Chengli Hou Guoyou Jingji Gaige de Ruogan Jianyi”, *Economy and Management Digest*, 15 2003.

Chapter 4: Internal Governance of Chinese State-owned Listed Companies (I)

It becomes very important to perfect the corporate governance mechanism for safeguarding the market, as the reform of corporate governance has become a global problem.³²⁹ Over the past twenty years, the global focus of research on the main issue of corporate governance has gradually extended from the United States to the main developed countries such as Britain, Germany, and Japan.³³⁰ In recent years it has been extended to the developing countries.³³¹ Research content has developed from the study of the theory of the governance structure and mechanism, to the governance mode and principle of pragmatic research.³³² At present, the quality of governance and the governance environment has attracted more attention, and research on corporate governance has moved to corporate governance evaluation.³³³ The current research can be divided into two generations. The first generation of research is about the corporate governance mechanism, generally focusing attention on two questions about the

³²⁹ With the deepening of globalization, economic and cultural exchanges between countries are increasingly frequent, the company system of different countries mutually interact. The evolution of corporate governance modes has shown new trends: the United States is seeking to evaluate other corporate governance models, especially corporate governance modes of Japan and Germany. Japan and other countries' corporate governance have started to move towards the American model in different degrees. Grasping the new trend of the evolution of corporate governance modes will help to perfect the system of corporate governance in China. More discussion about this issue can be seen in Wan Junyi, and Ou Xiaoming, 2004. "Quanchihua yu Gongsi Zhili Muoshi Yanjin de Xin Qushi", *Contemporary Finance & Economics*, 05 2004 and see Li Jiming, 2005. "Quanchihua Xia Gongsi Zhili Qushi Fenxi: Moshi Qutong huo Gongneng Qutong", *Zhejiang Academic Journal*, 06 2005. and see Zhou Xinjun, and Xi Shuping, 2007. "Jingji Quanchihua Xiade Kuaguo Gongsi Zhili: Wenti yu Tiaozhan", *East China Economic Management*, 10 2007.

³³⁰ Li Weian, 2012. *China Corporate Governance and Development Report 2012*, Beijing: Peking University Press P.135.

³³¹ Zhang Ni, 2007. "Development Convergent Inclination Phenomenon of the Two Typical Corporate Governance Modes and the Enlighten Meaning to China", *Journal of Liaoning University (Philosophy and Social Sciences Edition)*, 35 (1) 2007.

³³² Guo Yinhua, 2005. "Guowai Gongsi Zhili Fazhan Bianhua de Qushi ji Qishi", *Xiangtan University Xuebao: Zhixue Shehui Kexueban*, 04 2005

³³³ Li, supra note 339, at 135.

specific mechanism; first, whether the company governance mechanism affects firm performance; Second, whether the company governance mechanism influences a company's specific decisions?³³⁴ For example, management change, investment policy, and external quotation reflect problems for control.³³⁵ Generally, legal and regulatory issues in the study of the first generation research of international corporate governance have played a small role.³³⁶ The character of the second generation of research is that legal structure, especially the protection for investors' rights, became a hot topic.³³⁷

For Chinese companies, CG reform is the core of enterprise reform. China's enterprise reform has developed over 30 years as the main development pattern of CG. If the establishment of the stock exchange in early 1990s was really a starting point for China's listed company to pay attention to governance practices, it is from then on that China's listed companies experienced the introduction of the concept of CG and its structure and mechanism, followed by a focus on governance mode and governance quality. Some achievements have been made after these years' experiences: relevant laws and regulations have been promulgated,³³⁸ a multi-level governance regulatory

³³⁴ Keasey, K. (2005) *Corporate Governance: Accountability, Enterprise and International Comparisons*. John Wiley & Sons, Ltd. P.252.

³³⁵ Ibid.

³³⁶ Li, supra note 339, at 224.

³³⁷ Ibid.

³³⁸ Such as The Company Law of the People's Republic of China, has been amended and adopted at the 18th session of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on October 27, 2005. The amended Company Law of the People's Republic of China is promulgated hereby and shall go into effect as of January 1, 2006; and The Securities Law of the People's Republic of China, which was revised and adopted at the 18th Meeting of the Standing Committee of the 10th National People's Congress of the People's Republic of China on October 27, 2005 are hereby promulgated and shall be implemented as of January 1, 2006. The Opinions of China Securities Regulatory Commission on Improving the Quality of Listed Companies, approved by the State Council in 2004.

system has been established,³³⁹ and the CG of listed companies has gradually improved.

Although the CG of Chinese listed companies started later than the West developed countries, the first two steps have been completed: an establishment of governance structure,³⁴⁰ and an improvement of the governance mechanism.³⁴¹ At present, Chinese listed CG has developed to a new and important stage – to pursue the quality of CG. That is because it is not enough to establish the governance structure and mechanism, but it is more important now to achieve the effectiveness of governance. For example, the nominating committee has been set up, but it is important to see whether the committee can truly make nominations.³⁴² This is the third step of the development of corporate governance of Chinese listed companies. Among all the issues of CG which need to be improved, the evaluation of CG is a very important link; through a timely evaluation, problems of governance can be identified and improvements can be made on the effectiveness of governance.

In this Chapter, the scope and elements of CG of Chinese state-owned listed company will be discussed. How can the elements of CG of Chinese state-owned listed company be defined? Here CG evaluation is a helpful standard.³⁴³ The reason for choosing CG

³³⁹ SASAC in the central level and local level had been established in 2003, and China Securities Regulatory Commission (CSRC) had been established in October 1992.

³⁴⁰ MES had been basically established in China now, therefore, the Chinese SOEs, especially Chinese state-owned listed companies, completed the transfer into modern enterprise. The shareholder meeting, board of directors and board of supervision, managers and the stakeholders are the main factors in the CG of Chinese SOEs.

³⁴¹ Governance mechanism contains different elements, such as Supervision mechanism and incentive mechanism.

³⁴² Zhu Fangzhou, 2014. “Woguo Shangshi Gongsi Timing Weiyuanhui Zhidu Tanjiu”, *Legality Vision*. 06 2014.

³⁴³ Corporate governance evaluation is the evaluation for corporate governance structure and mechanism. See Li

evaluation as a standard to check the CG is that Chinese SOEs and the CG of SOEs are still at a in the process of transition. The form of CG of Chinese state-owned listed company had been established and prescribed in the laws and regulations. In the process of operation, the targets for every state-owned listed company in the development process are different. From the academic point of view, as stated in Chapter one, different scholars hold different opinions. In addition, industry association and industry autonomous institutions are lacking unified standards of governance.³⁴⁴

Therefore, it is hard to compare different state-owned listed companies' level, result, and efficiency; and how to improve CG is a puzzle. However, CG evaluation of a listed

Weian. 2005. *Corporate Governance Evaluation Index and Research*, Beijing: Higher Education Press.

³⁴⁴ China Association for Public Companies is based on the "securities law of the People's Republic of China" and "social organization registers regulation" and other relevant provisions, by the listed Companies and related institutions, etc., in the capital market as a link to a unified, standardized form, maintaining the legitimate rights and interests and forming a nationwide self-disciplined, non-profit social organization with the status of a legal person. The CSRC is the business supervisor departments for it. It was established in 2012. More information can see <http://www.capco.org.cn/content/6.shtml> (assessed 10 September 2015) The business scope:

- (1) widely contact listed company and its branch of industry, reflect the company group calls to government authorities, safeguard the legitimate rights and interests of the listed company, to create a good environment for the healthy development of listed companies.
- (2) with regulators, government agencies, local association of listed companies and investors, the media, such as establish communication mechanism, constructing of dialogue and exchange platform, open channel.
- (3) the enterprise using the successful experience of the development of capital market, the exchange of information disclosure, law-abiding good self-discipline, standardize the development of typical example, inductive extract establish good corporate governance, enhance the use of capital market development potential and the elements of law, builds the platform for communication between the listed company for discussion.
- (4) in view of the enterprise and the problems in the development of capital market, or commissioned by the government department, to carry out the investigation and study, actively participate in relevant policy argumentation and formulate, puts forward Suggestions for the relevant policies and legislation, to assist the implementation of relevant state policies and measures.
- (5) Advocate the healthy, active shareholder culture and the culture of integrity, emphasis on the rights of stakeholders and role, and promote to perfect the corporate governance system of listed companies and improve the level of governance.
- (6) in corporate social responsibility, integrity, and the relationship between investors and stakeholders, etc., organization of the listed company to formulate self-discipline or demonstration "guidance", "principles" and "convention" corporate citizen ethics, as well as the directors, supervisors and senior managers of professional ethics and the directors, supervisors and senior management personnel behavior guide, advocate and promote the company autonomy and self-discipline, build good corporate culture.
- (7) To the listed company chairman, general manager and chief financial officer training, strengthening the legal consciousness, responsibility consciousness and good faith consciousness, raise the level of business.
- (8) Organization to conduct international exchanges and cooperation, to promote mutual recognition of qualifications; For the member internationalization development and implementation of the strategy of "going out" service.
- (9) to organize the formulation of the advocacy of listed corporate governance standards, promote the establishment of scientific governance of listed companies and related evaluation system, promote the listed company governance structure and mechanism of perfecting.
- (10) Statistical information of listed companies, to provide basis for decision-making for the related departments.
- (11) to the China securities regulatory commission and other relevant government departments entrusted by the other work.

company can offer a unified standard. In this Chapter, the evaluation system of CG of listed company in different countries will be listed and compared. Through a comparison and analysis, the similarity and difference of the focus of different countries' CG of listed company can be summarized. Then by contrast with China's CG evaluation system, Chinese characteristics of CG of listed company can be identified, and the problem of CG of Chinese listed company can be checked.

In this Chapter, some data comes from China Listed Company Governance Index.³⁴⁵ Through an analysis of this data, the CG structure of listed company and the risk sources of CG can be found, and the existing problems and measures for improvement can be further analysed. Moreover, the China Listed Company Governance Index includes the data of Chinese wholly state-owned listed companies and Chinese state-holding listed companies, and therefore it is relevant to the subject of this thesis.

The study of corporate governance evaluation has developed research on the theoretical framework, on principles and their application, and on the evaluation system. The evaluation of corporate governance has developed from the evaluation of commercial organization to non-commercial organizations. Chinese and foreign scholars focus on corporate governance evaluation to meet the demand of the development of corporate

³⁴⁵ It is the first CG evaluation system of listed company in China. It was established and introduced by the Corporate Governance of Nankai University Research Center and the China Securities Regulatory Commission, Shanghai and Shenzhen Stock Exchange, financial institutions and listed companies' management department. For more information see <http://www.cg.org.cn/> (accessed 10 September 10, 2015). The sample of Chinese listed corporate governance index data has been taken from two aspects: on the one hand, with the help of the CSRC and other departments concerned, in June 2002, the corporate governance status of 1307 Chinese listed corporate was surveyed (the data had been upgraded every year, here we use the data 2002 because it the earliest data); on the other hand, the source is the annual report of listed companies.

governance practices, especially the demand of institutional investors.³⁴⁶

Corporate governance evaluations sprang up in 1950, when Jackson proposed board performance analysis, which was followed by some commercial organizations that also launched corporate governance evaluation systems.³⁴⁷ Firstly, the American Association of Institutional Investors in 1952 standardized corporate governance evaluation by introducing a formal evaluation procedure of the board of directors, followed by a series of diagnoses and evaluation of the corporate governance research, such as the diagnosis of the board of directors using the 22 questions asked by the Walter J. Salmon in 1993; in 1998, the S&P launched its management service system; CLSA introduced the corporate governance evaluation system in 2000;³⁴⁸ in 2003, the Nankai University Research Centre on Corporate Governance proposed the first corporate governance evaluation system in China for Chinese listed companies³⁴⁹. All the details about specific compositions can be seen the Table 4-1 the main CG evaluation system in Appendix.³⁵⁰

The Institutional Shareholder Service in the United States has also established a global database system of corporate governance and offered corporate governance services to its members.³⁵¹ Other corporate governance evaluation systems are providing similar

³⁴⁶ Li, *Supra* note 339. at 137.

³⁴⁷ *Ibid.* And the main elements of Jackson' work for CG evaluation system can be summarized into: Contribution to the society, service for shareholders, the board performance analysis and the company's financial policy.

³⁴⁸ *Ibid.*

³⁴⁹ *Ibid.* P. 136.

³⁵⁰ Table 4-1, Table 4-2, and Table 4-3 are all conducted from the Corporate Governance of Nankai University Research Central, 2012 Chinese listed corporate governance evaluation report.

³⁵¹ *Ibid.*

services, such as Brunswick Warburg, ICLCG (Institute of Corporate Law and Corporate Governance), ICRA (Information and Credit Rating Agency), the corporate governance evaluation systems from the World Bank, the corporate governance evaluation systems from Thailand, South Korea, and the corporate governance evaluation systems from Japan (CGS, JCG Index). For more details, see Table 4-1.

In general, the common characteristics of the evaluation system of corporate governance are: firstly, all the evaluation systems are composed of a series of detailed indicators, and each evaluation system includes three factors³⁵², namely the shareholders' rights, the board structure, and information disclosure.³⁵³ Secondly, the methods of collecting information about evaluation systems are consistent, mainly from publicly available information, and other information through interviews with the company's key employees.³⁵⁴

There are two main differences among various evaluation systems. On the one hand, some evaluation systems are used to evaluate a certain individual country's corporate governance (such as DVFA, and Brunswick Warburg),³⁵⁵ and some other evaluation systems are designed for corporate governance evaluations for a number of countries, such as S&P, Deminor, and CLSA.³⁵⁶ On the other hand, the main issues, and the standards and evaluation indices of the different evaluation systems are not the same.

³⁵² See Table 4-1. Table 4-2 Table 4-3.

³⁵³ Ibid P139. In general, the higher of marks for the evaluation, the better of the CG.

³⁵⁴ Ibid.

³⁵⁵ Ibid.

³⁵⁶ Ibid.

For example, the S&P which is based on some well-known principles of corporate governance, the guidelines or regulations, such as the OECD guideline of corporate governance and CalPERS, has gained international recognition as a high level of standard. The S&P system proposed that corporate governance should be divided into two parts, namely: national factors and company factors.³⁵⁷ The national factors include legal basis, supervision, and information disclosure system and market infrastructure. The company factors comprise the ownership structure and its influence, stakeholders, financial transparency and disclosure, and the structure and operation of the board of directors.³⁵⁸

As discussed above, different evaluation systems have different applicable conditions. Governance environment, governance structure and mechanisms of China's listed companies differ markedly from foreign companies. Modern corporate governance mechanisms are from Europe and the United States. And European and American countries can gradually establish and improve the modern corporate governance mechanism, not only because of the developed product market and capital market, and not only just because of perfect constitutional and judicial regulatory system, but also because of the beliefs which are rooted in the national culture, religion and social system. The core of corporate governance is the checks and balances of the contract on the basis of good faith, trust and mutual benefit. This spirit originated from western countries' contract and the spirit of the rule of law, also came from the capital market's

³⁵⁷ Ibid.

³⁵⁸ See Table 4-1.

turbulent history, and then gradually formed sound management philosophy. If the foreign standards had been transplanted to China, the result is likely to have been a culture dislocation with standards unable to develop properly. The development of China's corporate governance was first advocated by the academic circles. It is totally different with the development of CG in European and American countries. The only way to improve the corporate governance of listed companies in China is to learn lessons from international experiences combined with the legal environment, political system, market conditions and the development of Chinese companies themselves, then trying to establish a corporate governance standard and system with Chinese characteristics. The task of China's corporate governance research is how to build its own corporate governance evaluation standards and system. Such a system and standards would, on the one hand, provide investors with investment information, and on the other hand help companies and investors to pay more attention to the problem of corporate governance structure, and to promote corporate governance quality and the value of the company.

The corporate governance of listed companies in China includes internal governance and external governance. The internal governance is the core of corporate governance, and it is related to the joint governance of all internal stakeholders.³⁵⁹ The internal governance mechanisms of listed companies mainly include investment decision-making mechanism, risk control mechanism and management incentive

³⁵⁹ All the stakeholders include shareholders, the board of directors, the board of supervision, and the managers.

mechanism. The external governance, such as market (product marketing, and so on), government (government regulation and judicial intervention), and news media, includes the legal mechanism, regulatory mechanism, marketing mechanism and social mechanism.³⁶⁰

4.1 The Shareholder Meetings and the Rights of Shareholders

The shareholders' Meeting was defined as the 'organ of power' of a company in China.³⁶¹ The Company Law defines the function and the position of the shareholders' meeting and 'the other governance organs in the company derive their powers from the general meeting'³⁶² The powers that are conferred upon the shareholders' meeting are divided into three groups by some scholars as follows: the first group involves the powers to make decisions on such important matters as the business policies and investment plans of the company, the increase or reduction of the registered capital, the amendment of the articles of association, the issuance of debentures, merger, division, liquidation and so on. The second group relates to the appointment, dismissal and remuneration of members of both the board of directors and the supervisory board. The last group of powers allows the general meeting to oversee the performance of the board of directors and the supervisory board, by examining and approving their

³⁶⁰ Li Weian. 2005. *Corporate Governance Evaluation Index and Research*, Beijing: Higher Education Press. Pp. 39-42.

³⁶¹ 1993 Company Law, Art 37,102; 2005 Company Law, Art 37,99.

³⁶² Xi Chao. 2009. *Corporate Governance and Legal Reform in China*, London: Wildy, Simmonds & Hill Publishing, p.37 and see more details about the position of shareholders' meeting of Chinese Company in Bian Yaowu & Li Fei, 1994: 208.

reports.³⁶³

The sheer complexity of China's economy in the time of transition determines the complexity of the behaviour of shareholders of listed companies in China.³⁶⁴ In the analysis of the characteristics of the shareholder's behaviour, the scope should include controlling shareholders of listed companies, the subsidiaries of listed companies, other affiliated companies, and the whole Group (analysis of the degree of control of controlling shareholders for the Group, which shows in some cases, that the behaviour of controlling shareholders for listed companies always oversteps the boundary as a legal person).

From the perspective of protecting minority shareholders, there are three elements that manifest the behaviour of shareholders and the shareholders' governance. The equitable treatment of shareholders is the main element. Under the majority principle, the controlling shareholders always control the general meeting of shareholders. The controlling of shareholders through some means to improve the cost of minority shareholders' participation, means that the minority shareholders will reduce their participation in the general meeting of stockholders. Then the controlling shareholders can enhance their control, for example, by formulating the procedure of the general meeting of stockholders and improving the conditions for shareholders to participate

³⁶³ Ibid 37-38 the original provisions see 1993 Company Law, Art 38.

³⁶⁴ Bai Haiquan, 2008. "Guoyou Konggu Shangshi Gongsi Touzi Xingwei Yingxiang Yinsu de Shizheng Fenxi". West south Finance University.

in.³⁶⁵ The result is that the participation of minority shareholders has been restricted.³⁶⁶

It is difficult to ensure all shareholders receive enough information of the company on time. Therefore, it is important how to test the relationship between controlling shareholders and general meeting of shareholders.

Secondly, in the process of shareholding reform in China, the distorted concept and nature of property rights inevitable leads to confusion about the legal personality of the corporation and shareholders. A complete separation between the corporation and shareholder is the premise for corporations to qualify as independent legal persons, and it is also the foundation of the shareholders' limited liability principle. The separation is not only reflected in the separation of the property of corporation and shareholders, but also showed in the way in which the shareholders are kept away from the corporation's operation and management. The modern corporation is characterized by the separation of the property rights of shareholders and the management of the corporation. But in practice, the confusion of the property of company and shareholders is serious in China.³⁶⁷ Although the company is the independent legal personality in the law, the company's personality is symbolic, and it is actually the shareholders who control the company.³⁶⁸

³⁶⁵ Chen Xi, 2011. "Woguo Shangshi Gongsu Zhili Zhong de Xiao Gudong Liyi Baohu Yanjiu", *Shanghai Academy of Social Sciences*, 2011.

³⁶⁶ Ibid. And the same argument can see Ren Jingping, 2002. "Shangshi Gongsu Xiaogudong Quanyi Baohu Jizhi Yanjiu", *Shanghai Maritime University*.

³⁶⁷ Wang Lei, 2012. "Kongzhiquan Xingshi de Falv Yueshu Jizhi Yanjiu", *Northeast University of Finance*.

³⁶⁸ Qi Jiali, 2006. "Guanyu Guoyou Dagudong Zhanyou Shangshi Gongsu Zijin de Fenxi", *The Science Education Article Collects*. 07 2006. According to Qi, The problem of major shareholders of state-owned listed company of huge funds of listed companies is peculiar to the Chinese securities market phenomenon. This situation is quite striking; and it seriously weakens the independence of listed companies and asset quality. This kind of phenomenon is a type of major shareholders abuse of controlling power. Since 2006, under Chinese Company Law, the behaviour of major shareholders has been regulated more seriously than before, but due to the imperfection of legislation and unsound responsibility system, the major shareholders of listed companies abuse of controlling power is still outstanding. For more discussion about the major shareholders of listed companies abuse control power can see Zhang Ludong, 2012. "Woguo Shangshi Gongsu Kongzhi Gudong Lanyong Kongzhiquan de Falv Guizhi Yanjiu",

According to a report,³⁶⁹ the main problems appear to be in that the operation of business or residence of shareholders should be completely consistent; the company's book of accounts is not unified with shareholders' book of account; the company's ownership or company's other property is mixed with shareholders' capital, such as if the company's property is illegally transferred or easily stolen by shareholders.³⁷⁰ From a business point of view, the main problem is that the shareholders and company are performing the same business activities, and the company's business is in the name of the shareholders, so the dealing party cannot distinguish whether they are dealing with the company itself or with the shareholders.³⁷¹ As the confusions about property between company and shareholders and the confusion about business activities occur, the conditions are created for controlling shareholders to abuse the listed company's resources, damaging the interest of minority shareholders and other stakeholders.³⁷²

The Personality Confusion Phenomena mainly include the following elements:

- The personality confusion between the parent and subsidiary. Article 77 of the Opinions on Standards for Limited Liability Companies prescribed that 'when a company's investment reaches holding of shares for another company (enterprise) which has been invested (hereafter refers to the latter one), the former shall be the parent company, and the latter shall be the subsidiary company (enterprises) of the

Fudan University. 2012.

³⁶⁹ Ye, Y. 2011:80.

³⁷⁰ Ibid.

³⁷¹ Ibid.

³⁷² Ibid.

former and still have the independent legal person qualification.³⁷³ Because the parent has control over the subsidiary entities, although the subsidiary is an independent legal entity, it does not have its own independent property, so it is difficult to guarantee the independence of its own will.³⁷⁴ To maintain the fairness principle, according to the Article 14 of the 2005 Company Law, corporate personality of subsidiary, the parent company may set up a subsidiary company, and the subsidiary company has its own personality, and can independently take civil liabilities according to law.³⁷⁵

- The personality confusion caused by enterprises of mutual investment, namely, cross-shareholding.³⁷⁶ Cross-shareholdings can realize coordinated strategic objectives between enterprises, and defend against hostile takeover.³⁷⁷ But,

³⁷³ 1992 the Opinions on Standards for Limited Liability Companies, Article 77.

³⁷⁴ Yang Yuqing, 2007. "Mu Gongsi Zhong de Renge Fouren", *Southwest University of Political Science and Law*. According to Yang, the corporate personality is not only abused by the natural person shareholders, in the modern society, it is more often abused by institutional shareholders (namely the parent company). Because with severe economic and social changes, parent-subsidiary relationship as an effective mean can achieve business control and form the enterprise group management, and has become an important part of management strategy for large enterprises. Parent-subsidiary are respectively an independent legal person, manage with individual effort, and be responsible for their own profit and loss; but the parent company is controlling shareholders for the subsidiary company. Especially in a wholly owned subsidiary, the parent company as the sole shareholder is firmly in control of the subsidiary. The feature of parent-subsidiary determines the parent company can easily abuse corporate personality of the subsidiary company, and engage in the operation of the high risk but with limited liability principle to escape legal liability, so as to harm the interests of the subsidiary company's creditors. The parent company enjoys the greatest benefit with the smallest risk, and ultimately hurts the interests of creditors and social public interests. It violates the law principle of fairness and justice, and deviates from the purpose of designers of the company legal person system and the limited liability system.

³⁷⁵ See the Article 14 of the 2005 Chinese Company Law. And see the Article 20, which is the first time to define the disregard of corporation personality in Chinese Company Law, it is helpful to regulate the major shareholders' abuse of the corporation personality, although this Article is not specific enough.

³⁷⁶ Taking a stake in each other's companies, is in fact cross shareholding. 1998, since Guangfa Securities Company limited and the Liaoning Cheng Da securities company limited holding each other; the cross-shareholding phenomenon is increasingly appearing among the listed companies in China. In August 2003, Cheng Siwei, vice-chairman of the Standing Committee of the National People's Congress put forward that the problem of SOEs' sole majority shareholder can be addressed by taking a stake in each other between Chinese listed companies. For More discussion see Wang Yanling, 2007. "Gongsi Jian Jiaocha Chigu Xiangguan Wenti Tanjiu", *Economic Tribune*, (3) 2007.

³⁷⁷ Du Jingliang, 2011. "Lun Gongsi de Jiaocha Chigu Ji Falv Guizhi," *CUPL (China University of Political Science and Law)*. According to Du, the advantages of cross shareholding can be summarized into achieving the strategic alliance between the enterprises, to prevent a hostile takeover. Cross-shareholdings can save business capital spending and also provides very convenient conditions for enterprises to raise funds, and cross-holdings is a good

cross-shareholding brings some problems such as inflated capital, sudden and sharp price rises in the securities market, serious internal control problems,³⁷⁸ and illegal profits.³⁷⁹ In China, the legal system, laws and regulations are lacking specific provisions for cross-shareholding, which led to the defects caused by the cross-shareholdings in Chinese capital market which cannot be corrected.³⁸⁰ Therefore, in the Chinese capital market is not possible to maintain normal order nor to protect the legitimate rights and interests of investors effectively.

Before the current Company Law was promulgated, some Chinese normative documents involved rules of cross-shareholdings. In February 1992, the Provisional Regulations of Shenzhen Municipality Concerning Joint Stock Limited Companies stated that where a company had more than 10 percent of the shares of another enterprise, the latter cannot buy a stake in the former; where a company had more than 50 percent of the shares of another enterprise, it became the former's parent company, and the latter a subsidiary who could not buy a stake in the former; where an enterprises obtained a more than 10 percent of shares of the total shares, the former must inform the

means to achieve industry layout.

³⁷⁸ Ibid. According to Du, in recent years, the cases in China's capital market caused by the cross shareholding appeared frequently, therefore, the company cross-ownership as a law system issue has become hot topic for academia and investors. (The cases include Delong Case, Zhong Guang Case, Yong Jing Case and Tianbao Case, the case about De Long can see Miu Pengchong, 2007. "Jiyu De Long Xi de Binggou Rongzi Wenti Yanjiu", <http://d.wanfangdata.com.cn/Thesis/Y1343309> (assessed on 13 September 2015)) The significantly negative effects of cross-shareholdings are: fourfold. The first problem is inflated company capital; the second one is disruption of the capital market trading system, inducing insider trading and related party transactions; the third problem is that a mutual shareholding company easily be formed between the internal control and cause the absence of supervision mechanism; the fourth problem is that shareholders are built on stilts, even causing the company's governance structure to be can not able to play the role investors expect, and in extreme cases will promote the economic bubble.

³⁷⁹ Ibid.

³⁸⁰ Yang Zhenyu, 2013. "Lun Jiaocha Chigu de Falv Guize", *East China University of Political Science and Law*, 2013. According to Yang, There is no clear rule in Chinese Company Law for cross shareholding; it will affect effective utilization of the cross shareholding system.

latter within ten days.³⁸¹ In addition, Opinions on Standards for Limited Liability Companies promulgated by the State Commission for Restructuring the Economic System (SCRES) on May 15, 1992, stated that ‘where a company had another enterprise’s more than 10 percent of the shares, the latter could not buy a stake in the former’.³⁸² Furthermore, in 1992, Provisions on Hainan Special Economic Zone Concerning Joint Stock Limited Companies provided that where A company had more than 10 percent of the shares in another enterprise (B), A company must notify B. If A did not notify B, its excess shares in B Company would have their voting rights suspended ; companies holding more than 10 percent, in each other the company which notified the other party later, as did not notify. The excess shares in another company must have their voting rights suspended, and must be dealt with in six months.³⁸³

But after Company Law was promulgated in 1993, the administrative rules and local rules lost efficacy. In the Company Law, relevant provisions just regulated for the company’s total investment.³⁸⁴ Although the relevant provisions in the Company Law were not specific, the Company Law played an indirect limitation regarding cross shareholdings. However, the provision on cross-shareholdings which had been removed in 2005 Company Law led to the current blank state for cross-shareholding. For the same topic, the CSRC formulated the Provisions for Trial Implementation on Establishing Subsidiary Companies in 2008 which touched upon this issue. Article 10

³⁸¹ See the Article 30 and 31, 1992, the Provisional Regulations of Shenzhen Municipality Concerning Joint Stock Limited Companies.

³⁸² See 1992, Opinions on Standards for Limited Liability Companies promulgated by the State Commission for Restructuring the Economic System (SCRES).

³⁸³ See Article 40, 1992 Provisions on Hainan Special Economic Zone Concerning Joint Stock Limited Companies.

³⁸⁴ See the Article 80.

stated that a subsidiary company may not directly or indirectly hold the equity or stock of its controlling shareholders or other subsidiary company under the control of the same securities company, or invest in its controlling shareholder or other subsidiary company under the control of the same securities company in other forms.³⁸⁵ The limitations imposed by the above provisions of CSRC just focused on securities companies, not involving other investment companies and listed companies.

- The personality confusion between sister companies. When one contributes to a number of companies, each company is independent ostensibly, but in fact, they are a whole in different aspects, such as property, interest, and distribution. In this kind of company, the directors and supervision are the same and each company's decision-making powers are held by investors - sometimes the investor is one person.

Finally, a sound and complete system protects the interests of minority shareholders. It is a common method to protect the minority shareholders by means of strengthening minority shareholders' influence on the general meeting of shareholders and the meeting's proposal, and limiting the rights of the controlling shareholders. In 2002, the Guidelines for Corporate Governance of Listed Companies made several rectifications in the principles, and it was a good supplement to the Company Law.³⁸⁶ Therefore, in

³⁸⁵ see 2008, the Provisions for Trial Implementation on Establishing Subsidiary Companies formulated by the China Securities Regulatory Commission.

³⁸⁶ See 2002, Chinese Listing Corporation Governance Guidelines made several rectifications in the principles. And after the Company Law of the People's Republic of China had been in effect for two months, the CSRC issued the Guidelines for Listing the Company's Articles of Association. In 1997 the old Guidelines underwent a substantial

China, the standard to measure whether a listed company can effectively restrict the controlling shareholders' behaviour is whether the system is perfect and whether the system can be implemented effectively.

Through analysing the behaviour of shareholders and the shareholders governance above, we could identify three standards to measure the shareholders' governance for Chinese listed companies. First of all, concerning the independence of Chinese listed companies, due to the promulgation of the laws and regulations, the strengthening of the supervision, the improvement of independent governance of Chinese listed companies, and the independence of listed companies has been developed; for example, employee, business, financial, assets and institutions had reached the basic standards of independence of listed company. But the most aspects of independence just stay on the superficial level; for example, the independence of shareholders should be strengthened. There are three aspects that can be addressed and improved in future. The first point is that in a company, whether the directors of listed companies are the controlling shareholders. The second point is whether the main business of listed company and the main business of controlling shareholders' company are the same or parts of the same. The third point is the longer the controlling chain, the more difficult it becomes for the ultimate controllers to manage risks, especially financial risks.³⁸⁷ The

revision=, and again in 2006 released and implemented on March 16,.

³⁸⁷ In China, many listed companies are products of the SOEs reform. The ultimate controller of this part of listed companies is still governments in different levels and the SASAC. They are affected by government intervention more than non-state-owned holding companies, enjoy some industrial policy support, and take some multiple targets at the same time. All the advantages and disadvantages will also finally affect the enterprise financial risk. See Gu Jiyu, 2012. "Xinxi Pilu Zhiliang, Zhongji Kongzhiren yu Qiye Caiwu Fengxian de Shizheng Yanjiu", *Xinjiang University of Finance and Economics*. And for the same opinion see Tang Nan, 2012. "Minying Shangshi Gongsu Zhongji Kongzhiren dui Caiwu Fengxian de Yingxiang Yanjiu", *Northeast Agricultural University*.

interest of minority shareholders is reduced by a pyramid-style ownership structure.³⁸⁸

Then last but not the least, the supervision department should observe whether the controlling shareholder makes the company to overall listing. Because compared with split listing, overall listing is more able to avoid horizontal competition, congener competition or inter-industry competition, and it also helps the supervision department to straighten out relationship between upstream and downstream industries of listed companies. Furthermore, it tends to reduce the connected transaction.³⁸⁹

Furthermore, protection of the rights and interests of minority shareholders is another standard by which to measure the shareholders' governance of listed companies.³⁹⁰

Minority shareholders don't like majority shareholder holding a dominant position in the listed company. Their interests often exposed under the power of majority shareholders, may suffer seriously harm by the majority shareholder making decisions from its own economic interests and other unfair trading. With the continuous development of modern social economy, the social legal system is constantly improving to protect the interests of vulnerable groups. The minority in a company is attracting more and more attention from society. It is necessary to take various measures to protect and remedy the legal rights and interests of minority shareholders

³⁸⁸ Xu Xiangyi, and Xu Ning, 2010. "Jin Zita Jiegou Xia Guquan Jili de Shuangchong Xiaoying Yanjiu—Laizi Woguo Shangshi Gongsi de Jingyan Zhengju", *Economic Management*. 09 2010 and see Dubian Zhenlizi, 2011. "Guoyou Konggu Shangshi Gongse de Kongzhiquan, Jinzita Jiegou he Qinzhan Xingwei—Laizi Zhongguo Guquan Fenzhi Gaige de Zhengju", *Journal of Financial Research*. 06 2011.

³⁸⁹ Overall listing can effectively improve the efficiency of the allocation of resources, promote the agglomeration of market capital, promote the further expansion of the enterprise, enhance the competitive power of enterprise, and it is conducive to the healthy and long-term development of industries in China. Spin-off listing for the listed company, can help the company continuously optimize asset quality, develop the advantage internal projects, and looking for more development space for the company. See Li Ganlin, 2014. "Yangqi Zhengti Shangshi he Fenchai Shangshi Bijiao Fenxi", *Manager Journal*. 01 2014.

³⁹⁰ Du Xiaodong, 2012. "Tansuo Guoyou Konggu Gudong dui Shangshi Gongsi de Guanli Jizhi", *Modern SOEs Research*. 10 2012. pp 52-59.

and to restrain majority shareholders' various irregularities, and to make the rights and interests of minority shareholders become more fully guaranteed.³⁹¹ This part will focus on the situation of the implementation of the principle, legal regulations, and laws on protection of the rights and interests of minority shareholders of listed company: for example, whether to establish detailed rules for implementation according to the relevant laws and regulations, and whether to protect the rights of minority shareholders through practical action.³⁹² Firstly, we should measure whether the minority shareholders' advice will show up in the decision-making of a listed company and the specific measures includes the listed company that establishes the system of cumulative voting, and adopts online vote in the general meeting of shareholders in the listed company. Moreover, we need to measure the enthusiasm of shareholders to participate in the general meeting of shareholders through analysing the participation of the shareholders.³⁹³ In addition, the supervision organization examines whether the listed company abuses rights and rules to raise money, and observes whether a listed company makes changes to raise funds, whether the change procedure is approved by the shareholders meeting, and whether to show the reasons. Finally, the listed company in return for shareholders is another standard; such as cash dividend payments scale and continuity.³⁹⁴

³⁹¹ The same issue has been discussed by Chinese scholars: Wang Changrui, Tanxin, 2013. "Zhongxiao Gudong Gongsu Zhili Canyon Jiqi Quanyi Baohu Jizhi Yanjiu", *The Chinese Certified Public Accountant*. 11 2013. pp. 53-56. Li Yong, 2014. "ST Changyou Jiang Chengwei Yangqi Tuishi Diyigu Zhong Xiaogudong Weiquan Zhize qi Eyi", *China Economic Weekly*. 14 2014. pp. 63-64 and Zou Xiyu, 2013. "Yangqi Shehui Zeren yu Zhongxiao Gudong Liyi", *Journal of the Postgraduate of Zhongnan University of Economics and Law*. 06 2013. pp. 75-80.

³⁹² Xue Hui, 2011. "Lun Xiaogudong Quanyi de Falv Baohu", *Guofang Zhinan*. (10) 2011 and Liu Zheng, "Zhongxiao Gudong Quanyi Baohu de Xiangguan Falv Wenti Yanjiu", *Industrial & Science Tribune*. 08 2007. Pp' 67-69.

³⁹³ Liu Qian, 2013. "Qiantan Gaizhi Qiye Xiaogudong Quanyi Baohu", *Chi Zi*. 21 2013. P. 283.

³⁹⁴ Chen Xi, 2011. "Woguo Shangshi Gongsu Zhili Zhong de Xiaogudong Quanyi Baohu", *Shanghai Academy of Social Sciences*. 05 2011. Pp. 1-58.

The final standard for measuring the shareholders governance of listed company is the connected transaction.³⁹⁵ The connected transaction could be reflected through three indicators, namely, whether controlling shareholders use the funds of a listed company for free, whether the listed company provides loan guarantees for controlling shareholders and other related parties, and whether the listed company and controlling shareholders, through the connected transaction, get profits and benefits.

4.2 The Board of Directors

The board of directors is the core of corporate governance. As a link between shareholders and managers, the board of directors is the agent for shareholders, and is the client and supervisor for managers as well. The board of directors plays an important role for company's strategic development and major decisions. Therefore, on the one hand, with the aim developing the company, from the point of the investors' view, the board of directors should lead the company to create more profit for investors; on the other hand, the directors have to focus on the interests and demand of consumers, so as to gain their support and trust. Under the dual principal-agent relationship, the questions are whether the board of directors can inhibit the opportunistic behaviour of the managers for the interests of shareholders, and whether the board of directors can avoid the controlling shareholders grabbing the interest for free, and whether the

³⁹⁵ Liu Chunmei, 2011. "Qianxi Shangshi Gongsi Konggu Gudong Guanlian Jiaoyi de Guizhi", *East China University of Political Science and Law*. 11 2011.

directors can realize the maximization of shareholders' wealth. All these questions depend on making some basic problems clear, such as the functions of the board of directors and distribution of the power. The construction of the board of directors is the key for improvement of corporate governance, but if a company only has a better board of directors' governance structure, it cannot make the company's operation efficient.³⁹⁶ Scientific and reasonable decision-making is the target for good governance of the board of directors, because it will guarantee investment and financing decisions, the production and business operation decisions, and the company's financial quality. As a core of corporate governance, the main duty of the board of directors is to guard against all possible kinds of risky governance. A better method is that the board of directors should establish a risk control structure and mechanism, and identify, control and prevent the accumulation of risks and their outbreak.³⁹⁷

There are two different approaches to the duties of the board of directors worldwide. The duties of the board of directors were not defined by laws in most European countries. The maximization of shareholders' profit was not the only target for the board of directors in those countries. In contrast, in the UK, Switzerland and Belgium, shareholders' profit is the priority for the board of directors of companies.³⁹⁸

³⁹⁶ Because the board of directors' governance structure is an aspect of corporate governance for SOEs, efficiently company operation needs a sound CG, not just a perfect aspect.

³⁹⁷ Li, *Supra* note 339, at 146.

³⁹⁸ Li-juan Chen, 2007. "The Study of the German Corporate Governance Code", *Tunghai University Law Review*. No. 26. (2007/06/01) p 45-84.

The history of the legal framework of the board of directors of Chinese companies can be traced back to 1993. In 1993 Company Law, the power of board of directors and the election procedures of the board of directors were prescribed in Articles 112 and 113. According to the nature and managerial functions of board of directors, the categories fall into four groups: ‘the first category relates to the implementation of the general meeting’s resolutions. The second concerns the formulation of plans for the general meeting to deliberate and approve. The third includes decision-making powers in relation to business and investment plans and to the establishment of the company’s internal management organs and system. The last category of powers entitles the board of directors to appoint, dismiss and remunerate managers.’³⁹⁹ In the process of the development of corporate governance of listed company and at a practical level, the functions of directors acquired an undeserved reputation. For example, in many cases, the right to make salary related decisions, the right to nominate, and the right to object a motion for the Board of directors had been gradually weakened.⁴⁰⁰ In addressing the question of how to improve the governance’s quality of the board of directors, there are five aspects that can be summarized as follows:

First of all, the status of the rights and obligations of directors is the important standard

³⁹⁹ see 1993 Chinese Company Law, Arts 112 and 113.

⁴⁰⁰ Guo Tao, 2010. “Guoyou QIye Dongshihui Yanjiu”, *Business China*, 04 2012. P. 129 According to Guo, in the State-owned listed company, the employment of the members of the board of directors and general manager are designated by the competent department of the government. If the the general manager is not appointed by the board it distorts the employment relationship between the board and general manager. The general manager will no longer be responsible to board but directly responsible to the government departments, over the head of the rights of board of directors and the board of shareholders. On behalf of the government agencies of the state’s shares, on the other hand, because the agent, the power and responsibility, information asymmetry, they and the manager can conspire or be bribed more easily, it decided they couldn’t try their best to supervise the board of directors. Therefore, the functions weaken as a trustee of the board of directors’ pressure decreases, and the sense of responsibility is not strong.

that can show the quality of the board of director governance. On the one hand, the relationship between the directors and company means that the legal status of the board of director is determined by the rights, obligations and liabilities of directors.⁴⁰¹ The law must balance the rights and obligations of the directors, and reasonably transfer and assign the risks as well.⁴⁰² On the other hand, a better understanding of the status of the rights and obligations of the directors can help improve the quality of board of director governance. Such understanding would focus on the sources, training, and performance of their duties in good faith and diligently including: 1) the total number of per year for training, the rules of investigating the director's responsibility, D&O liability insurance, the age composition of directors; 2) the proportion of directors of A serving on the shareholder for another company B (the company B belongs to the shareholders of A company); 3) official performance of listed company and positions of directors outside of the listed company.

Secondly, an efficient board of directors directly determines a degree of completion of the duties for directors as well as the degree of realization of corporate targets. A good and efficient board of directors will take the responsibility better, establish more scientific development planning, and even supervise the managers more effective, so as to increase the company's continuing value. There are six points that can determine

⁴⁰¹ Chen Xiangyi, 2005. "Dongshi Quanli Xianzhi Zhidu Yanjiu—Yi Gongsi Zhili Wei Shijiao", *Xiamen University Institutional Repository*. According to Chen, "The expansion of the authority inevitably leads to the abuse of the authority. While strengthening director's authority, the corporation legislation sets up the regulation of restricting of director's authority. However, the regulation of restricting of director's authority in China is weak, and corresponding legislation is far from enough. In order to consummate the corporation governance and enhance the compatibility of corporation, it is necessary to improve the legal system of restricting director's authority in our law."

⁴⁰² Ibid.

the efficiency of directors, namely: composition and size of the board of directors; whether the chairman and manager are separate; the overlap positions between directors and executive;⁴⁰³ gender composition of the members of the board; the procedures for board of directors meeting; and the status of board of directors meeting.

Thirdly, the board of directors' structure defines the means of board internal division of labour and cooperation. There are a number of elements that could affect the operation of the directors, such as the establishment of the professional committees of the board and the part-time situation of directors. So, how is it possible to determine whether a board of directors for Chinese listed companies is good? The following factors need to be considered: the establishment status of the strategy committee, audit committee, remuneration and appraisal committee, the nomination committee, and other professional committees.⁴⁰⁴

Fourthly, the directors of listed company take the responsibility for formulating the company strategy and supervising the managers at the same time; they need to fulfil the diligence and honesty obligations. As such, as an important factor for a listed company, the enthusiasm of the directors cannot be ignored. Appropriate compensation is one of the incentives which includes both the short-term incentive and long-term incentive. Specific factors of short-term incentive and long-term incentive need to be considered

⁴⁰³ The executives are from the members of the board, and the chairman of the board majority is the general manager or the CEO concurrently. As the board of directors and senior managers overlap, it is easy to form insider control phenomenon.

⁴⁰⁴ See Article 52, Code of Corporate Governance for Listed Companies in China issued by CSRC and State Economic and Trade Commission on January 7, 2002.

for appropriate compensation: paid status of directors in the listed company, cash compensation, directors' shareholdings and equity incentive.

Finally, the independent director system is introduced in the board of directors of the listed company. There is no interest relationship between the listed company and the independent directors. Therefore, to some extent, the independent directors can give their advice and opinions with a more objective view, so as to protect the interests of investors. In China, most listed companies have to face up to an industry dilemma: the state-owned shares of listed company account for more than half.⁴⁰⁵ Therefore, in China, the independent director system is so important because it can ensure the independence of the board of directors and the scientific nature of decision. The main aspects should be noted as follows: the proportion of independent directors; the professional background of independent directors the working situation of independent directors in other companies or work places – part time or full time; the participation status in company meetings, and the allowance for independent director.

4.3 The Supervisory Board

The supervisory board is a key for improving the quality of corporate governance and reduces the governance risk of a listed company. Although in different countries the

⁴⁰⁵ Hu Shijun, Tang Liang, 2004. "Gufen Huigou Lilun zai Woguo Shangshi Gongsi Guoyougu Jianchi Zhong de Zuoyong", *Contemporary Economics*, 02 2004 pp. 58-59. The same issue had been discussed by Xu Limin in 2000, see Xu Limin, 2000. "Shangshi Gongsi Jingxing Guoyougu Jianchi de Fangan Tanta", *State Assets Management*, 12 2000.

name of the supervisory board is not unified, some are named “supervisors” while some called *Jian Cha Yi* かんさやく⁴⁰⁶, but the nature and the function are the same. In Chinese Company Law, the board of supervisors shall be composed of at least three people.⁴⁰⁷ The board of supervisors has a range of powers to monitor the board of directors, which can be summarized as follows:⁴⁰⁸

- “1. Check the financial affairs of the company,
2. Supervise the duty-related actions and put forward proposals on the removal of any directors and senior managers who violate any law,
3. Order any director or senior managers to make corrections if his act has injured the interests of the company,
4. Propose the convening of an extraordinary meeting and put forward proposals to the shareholders’ meeting.”

The board of supervisors is a main component of the internal corporate governance for listed company. Setting up a reasonable and effective board of supervisors could control or prevent directors and managers from doing something arbitrary, and protect the rights and interests of the investment from shareholders and corporate creditors. However, in the current situation in China, the functions and effectiveness of the board of supervisors of listed company cannot be guaranteed. The supervisor cannot play a main role in a company, because supervisors are not independent.⁴⁰⁹ Therefore, it is

⁴⁰⁶ Li, *Supra* note 339, at 148.

⁴⁰⁷ See Article 51, The Company Law of the People’s Republic of China revised in 2005.

⁴⁰⁸ *Ibid.* See Article 53, 54, 55, 56.

⁴⁰⁹ Li Weian, Hao Chen, 2006. “An Empirical Research of Supervisory Board Governance in China Listed Companies.” *Journal of Shanghai University of Finance and Economic*, 8 (3) 2006. According to Li and Hao, from

necessary to analyse the governance of the board of supervisors.

The problem for the governance of the board of supervisors is a worldwide problem, not just one for China.⁴¹⁰ There are some complicated reasons, but before analysing these reasons, the supervisory structure should be first introduced. The patterns of supervisory structure are divided into two kinds of patterns in general, namely the one-tier board model and the two-tier board model.⁴¹¹ The difference between them is that in the one-tier model company the managing function and the supervisory function are in one single body - the board of director; but the two-tier model exercises the functions in two different bodies - the board of directors and the supervisory board. For the two-tier model, the lower tier seems to make an executive strategy, takes the ‘management’ responsibility, while the upper tier plays a role with a supervisory function and monitors the management board. The UK and US, Ireland and some southern European countries such as Spain, Portugal, and Greece use the one-tier board model.⁴¹² Germany, Switzerland, Austria and some Scandinavian countries choose the

the running status of the board of supervisors, the structure and size of the board of supervisors and supervisors’ competencies, these three aspects illustrate and evaluate the status of Chinese listed company governance of the board of supervisors. The evaluation result showed that the board of supervisors of listed companies in China is at a low level, and the board of supervisors is unpractical. The reason is not the board of supervisor’s governance system itself, but because there are many deficiencies in the running process, such as structure and size of the board of supervisors it should be further optimized, and the supervisors of low competence need to be improved.

⁴¹⁰ Guo Xiangdong, 2001. “Dui Wanshan he Chuangxin Gongsì Zhili Jiegou de Jidian Sikao”, *The Planning and Market*. 01 2001.p 30 Since the 1990 s, corporate governance has attracted worldwide attention and caused the globalization of corporate governance reform. Corporate governance has become a key factor of the modern company to improve its core competitiveness. Corporate governance structure includes internal governance and external governance, the internal governance including the board of directors and board of supervisors, management remuneration and majority shareholder control. The board of supervisors, as the main part of the internal governance, is important to construction of corporate governance structure, especially for the improvement of the regulatory functions. Therefore, the board of supervisors has also been discussed widely. The same opinion can be seen in Sun Xiaohui, 2010. “Woguo Shangshi Gongsì Jianshìhui yu Dongshìhui Jianguan Zhineng Hubuxing Tantaò”, *Southwestern University of Finance and Economics*.

⁴¹¹ Xi, Supra note 371, at 39.

⁴¹² Ibid.

two-tier board model.⁴¹³ There are some countries where these two kinds of model are mixed together in the practice, such as Belgium, France and Italy.⁴¹⁴ China follows German model establishing a legal framework of two-tier system - the board of directors and the supervisory board.

Following the discussion above, the first reason can be summarized clearly: the one-tier board model of corporate governance, represented by UK and US, has mainstream status for international level.⁴¹⁵ Missing out the board of supervisors does not mean missing a supervision mechanism, because the implementation of main monitoring for the board of directors in their countries can be done through relevant committees of the board of directors, external independent directors and external market. Because the number of national public ownership companies in UK and US is large, equity highly fragmented, the large shareholders made the price of the agent too high, so it is impossible for the individual shareholder to supervise or jointly supervise the company.⁴¹⁶ In addition, because of the free-rider problem, individual shareholder supervisors lose motivation and commitment. Furthermore, the national agent markets of the UK and the US are developed; there are enough conditions and chances to support strong external supervision for the operator.

The second reason is the reality of listed companies in China. From the perspective of

⁴¹³ Ibid.

⁴¹⁴ Ibid.

⁴¹⁵ Wan Wei, 2008. "Gongsi Zhili Shijiao Xia Shangshi Gongsi Jianshahui Zhidu Yanjiu", *Communication of Finance and Accounting (Academy Version)*, 02 2008. pp 13-15.

⁴¹⁶ Sun Manli, Wang Zhujun, and Jiang Yanxia, 2012. "Daili Wenti, Gongsi Zhili Moshi yu Yeji Zilixing Guiyin Qingxiang—Jiyu Mei Zhong Ri Sanguo de Shuju Bijiao", *Accounting Research*. (1) 2012.

corporate governance structure, China's corporate governance mode is more close to the continental system - the two-tier board model – of Germany and Japan. Compared with America, these two countries' securities markets are undeveloped, and the basic characteristic of their corporate governance is that the manager occupies dominant position in the listed company. Therefore, the board of supervisions in these two countries is the requisite for their countries' development. However, the boards of supervisors in Germany and Japan are different. According to German Law, the company must have a system of two-tier structure of the board of directors: management committee and the board of supervisors.⁴¹⁷ The former is responsible for the daily affairs of the company, and is composed of the managers with a title. who are working in the company The latter as the main body for company, controls the company, and is responsible for the appointment of the management committee members, approving major decisions and supervising their behaviour, but not to perform the specific management functions. The supervisors' system in Japan is different from the countries with one-tier board model - the US and the UK - but Germany's two-tier board model is not the same as Japan's. In Japan, the board of directors and the board of supervisors are at equal level in a company, both of them are elected by the shareholder meeting, and the board of supervisors supervises the board of directors. As stated in Chinese Company Law, the functions and power of the board of supervisors in Chinese listed company⁴¹⁸ are different from other countries which discussed above; therefore, it is hard to collect relevant experience from the countries

⁴¹⁷ Li, *Supra* note 339, at 149.

⁴¹⁸ The functions and power of the board of supervisors of Chinese listed company can see the Article 117, 118, and 199 of the Company Law.

with the two-tier board model.

Latterly, the evaluation system and standards for the board of supervisors has not received enough attention in China. Some well-known securities companies did not pay more attention to the board of supervisors, but just focused on other factors, such as the evaluation systems of shareholders, directors, and information disclosure.⁴¹⁹ The researches of these well-known securities companies hardly involved the evaluation system and standards for the board of supervisors.⁴²⁰ The lack of evaluation for the board of supervisors means the corporate governance cannot be examined exactly, and it is important to improve for the board of supervisors.⁴²¹ Because of the special position of the board of supervisors in Chinese listed companies, the conditions of

⁴¹⁹ Some “famous securities companies” refer to Haitong Securities Company Limited. and other famous securities companies in the history of development of securities companies and listed companies, for example, Dapeng Securities Company. Both are key Securities Companies in China, therefore the data and conclusions from them has attracted more attention. Because Dapeng Securities was bankrupt in 2005, here we just introduce Haitong Securities Company. Haitong securities co., LTD. (hereinafter referred to as the “company”) whose predecessor is the Shanghai haitong securities company, was founded in 1988 and is the earliest generation securities company in China. In 1994, it restructured into limited liability Company, and developed into the national securities firm. At the end of 2001, company's overall restructuring for co. LTD. In 2002, approved by the China securities regulatory commission (CSRC), the company registered capital of 8.734 billion yuan, to become the domestic securities industry in the capital's largest integrated securities company. In May 2005, approved by the China securities industry association review, Haitong securities became an innovative pilot brokerage, and corporate development entered the new period, but the business continued to maintain the market. In 2006, as the reform of non-tradable shares and brokers comprehensive control, capital markets are the real point. During the year, the company seized the opportunity, deepen the reform, speed up the development of the company in business, management, wind systems and process control, construction on a new step, initiated the process of listing the substantial progress that has been achieved. On July 31, 2007, the company successfully listed. In October 2007, the China securities regulatory commission approved the company non-public offerings are not more than 1 billion shares, and has set up a complete introduction of the CITIC group, peace, Pacific and other strategic investors, optimize the structure of the shareholders of a company, the company capital of 8.22782 billion yuan. In domestic securities industry it is one of the capital's largest integrated securities company. At the end of 2009 the company's total assets of 2009 (?) yuan, net assets of 43.4 billion yuan, net capital of 34.4 billion yuan. For the first time in 2009, the company borrows the professional organization; formulate the development strategy of company in the next five years.

⁴²⁰ Wang Shoujun, 2013, “Zhongyang Qiye Gongsi Zhili Yanjiu”, *Harbin Institute of Technology*. According to Wang, because there is no a clear evaluation system and standards for the board of supervisors, some tensions are hardly, solved for example, the procedures for the meeting of the board of supervisors is not clear, human resources management system is not scientific, internal supervisors’ independence is too low, and the communication mechanism between the board of supervisors and the external directors had not been established. According to the research of Wang, the articles of association of most of the state-owned listed enterprises are not mentioned the supervisory board’s rules of procedure, and the vast majority of respondents believe that incentives to the board of supervisors is not operable. Most of the respondents-full-time supervisors feel confused about their future.

⁴²¹ Ibid.

listed company, market environment and the reform process, the most urgent problem is to establish an evaluation system for the board of supervisors.⁴²² The nature of the supervisory determines that the board of supervisors cannot perform any business activities in the name of the company both internally and externally. For example, in Germany, the supervisory cannot simultaneously be the board of director.⁴²³ In Chinese Company Law, there is a similar provision: the directors, managers and financial officer cannot serve as the board of supervisors at the same time in a company.⁴²⁴ The aim of Chinese Company Law is to ensure a good exercise of supervision specifically to target the board of supervisors. The basic work of the board of supervisors is to oversee the company's business and financial position, and the main targets are the directors and the general manager. During the monitoring process, the directors and the general manager could be requested to correct their ultra vires (beyond his own power) activities which violate the articles of the association of the company. Therefore, the goals and standards of the evaluation system of the board of supervisors are the effectiveness of the supervision. The structure and size, operational conditions and the competency of the supervisors will be discussed below.⁴²⁵

First of all, the operational conditions of the board of supervisors refers to whether the

⁴²² The term of "special position" refers to the board of supervisors which has been set up in listed company, but because of the insider control or government intervention, the function of the board of supervisors has been restricted. The Chinese listed companies which just completed the establishment MES, have already established the basic framework of modern enterprise, but in those developed at the transition time in China, all the relevant legal system are not sound.

⁴²³ Peng Zhenming, Jiang Hua, 2003. "Meiguo Duli Dongshi Zhidu yu Deguo Jianshahui Zhidu zhi Bijiao- Yelun Zhongguo Gongsu Zhili Jiegou Moshi de Xuanze", *Law Review*, 01 2003. p 37-43.

⁴²⁴ See the Article 117 of Chinese Company Law.

⁴²⁵ These three factors of the standards of evaluation of the board of supervisors are from China's listed company governance evaluation index system of the board of supervisors. The data collection and analysis have been done by the Corporate Governance of Nankai University Research Central. Also can see Table 4-5.

board of supervisors held meeting, , how many times the meetings of the board of supervisors took place, whether the meeting's times are higher than, equal to or lower than the times specified by Chinese Company Law.⁴²⁶ Secondly, a good structure and size of the board of supervisors are the precondition of the effective operation of the board of supervisors, and include that the number of the supervisors and the situation of employee supervisors.⁴²⁷ Lastly, the competency of the supervisors is an important element.⁴²⁸ for a good board of supervisors of a listed company., This is because the listed company is a complex group with huge economic resources and interests, so working for it as supervisors requires professional knowledge on legal, financial, accounting and relevant working experience. In addition, the ability to communicate with shareholders, employees and other stakeholders is required. Furthermore, the education background and age of the supervisors also have an important influence on the company. Moreover, when the member of the board of supervisors holds the listed company's shares this will help to arouse their enthusiasm their responsibility.⁴²⁹ According to the discussion above, the evaluation system of the board of supervisors involves two parts: on the one hand, the professional background, education background, age and shareholding allocation of the chairman of the board of supervisors will be shown in the system. On the other hand, for other supervisors, professional background, education background, age and shareholding allocation are the main factors which should be examined.

⁴²⁶ Ibid.

⁴²⁷ Ibid.

⁴²⁸ Ibid.

⁴²⁹ The result comes from the Corporate Governance of Nankai University Research Central.

4.4 The Manager

All around the world, most listed companies take manager governance as an important element to examine in relation the corporate governance. But the difference is that they focus on different aspects of the manager. According to S&P, there are some key parts of the Directors' governance which should be addressed in corporate governance, such as nomination of managers, salary system of manager and dismissal or resignation status.⁴³⁰ According to the reports from ICLCG, ICRA and ISS, senior manager structure, salary of manager, stock equity of manager were the professional and key factors to define the corporate governance.⁴³¹ Deminor focused on another standard: stock opinion and the relationship between the chairman and managers.⁴³² For CLSA, the top important elements are manager stock incentive and distribution of cash flow for shareholders.⁴³³ Although different listed companies used different standards and factors to analysis manager governance, the importance of manager cannot be ignored.

This part will address three aspects of manager governance for Chinese listed companies. The first one is appointment and removal of manager system. This system includes the hiring of the managers and other senior managers; the part time working status for Chairman and general manager, and stability or any changes therein of the

⁴³⁰ Li, *Supra* note 339, at 151.

⁴³¹ *Ibid*

⁴³² *Ibid*

⁴³³ *Ibid*

senior manager. The second point is on the implementation of a manager governance plan. The education background of the manager and whether the manager is working full time (or working part-time in some other company) for the shareholder's company are both included. And the final criterion is incentive and restrains mechanisms, including salary, total equity, and the relationship between salary, equity and company performance.

4.5 Information Disclosure

The higher information transparency a capital market has, the more effective it is and the easier it is for the investors to make effective decisions. If the market information is transparent, the investors can make a reasonable judgment in advance before carrying out any business activities or decisions and can enhance better supervision after transaction. Investors have more chances to choose the appropriate investment or financing projects, and managers can get the money they need. By contrast, any information asymmetry between investors and managers will prevent the idle funds of investors and investment opportunities from being matched quickly. If there is incomplete information, the investors can only rely on the average profit of market to estimate the profitability of a project. For the high quality projects, it will cause financing constrains for the company. Myers and Malouf considered that when investors underestimate an enterprise's financing securities, and the manager cannot pass a good investment chance on to external investors, the result is the stalling of the

investment project.⁴³⁴ In addition, in some extreme cases, the bond market will also appear to be credit rationing. Although the borrower is willing to pay average interest rates, they are unable to raise all the money they need.⁴³⁵

Through information disclosure to alleviate the information asymmetry, investors can more accurately estimate the value of securities and the risk of the project. For good investment opportunities, if investors want to buy securities, they will require in a lower risk premium to reduce the cost of financing of the company. For the high risk project companies, the investors buying securities would require a higher risk premium to compensate for the losses it may suffer and thus reduce the company's financing costs. This information disclosure is conducive to investors supervising the manager after trading. It is hard for investors to collect the internal information about enterprise. Or the investors may be unable to afford all the necessary cost for gathering information. Under this situation, it is difficult to implement effective supervision of agency problems. Thus, when investors cannot supervise their own investment in real time with complete access, and they realize that managers will have the problem of agency, they will be wary of investing.⁴³⁶

Based on the research mentioned previously, on the reference to the OECD Corporate Governance Principles, and on the Chinese Company Law, Securities Law, the Chinese Listed Company Governance Guidelines, The Code of Public Offering of Securities

⁴³⁴ Li, *Supra* note 339, at 153.

⁴³⁵ *Ibid.*

⁴³⁶ *Ibid.*

Companies to Disclose Information Content and Format No.2, Chinese Enterprises Accounting Standards, the Rules for the Implementation of Information Disclosure of the Listed Company, and other laws and regulations relating to the listed company, the evaluation system of information disclosure can be discussed from three aspects, namely reliability, relevance and timeliness.⁴³⁷

First, the reliability of the information disclosure requires the company's public information to accurately reflect the objective facts or the development trend of economic activity, and whether the information disclosure can meet the certain standards. The reliability of the information is relative and dynamic. In general, external people cannot judge the reliability of the data of listed company through public information.⁴³⁸ But whether the listed company and its related personnel violate company records and other assessment information could help us to judge.⁴³⁹ From the perspective of information transmission, the way regulators and intermediary organization collect and analyse information, and verify the reliability, the test results for evaluating information disclosure is feasible and reasonable.⁴⁴⁰ The evaluation

⁴³⁷ These three factors of the standards of evaluation of the information disclosure are from China's listed company governance evaluation index system of the board of supervisors, the data collection and analysis have been done by the Corporate Governance of Nankai University Research Central. Also can see Table 4-7.

⁴³⁸ Listed company information disclosure violations occurred frequently, seriously impacted on the securities market, and harmed the interests of investors. Delay of disclosure or major omissions (not timely and not comprehensive) are the main problems of the listed company information disclosure violations. See Wu Guoping, 2009. "Type of Rule Breaking by Publicly Listed Companies during Information Disclosure and Their Main Characteristics", *Contemporary Economic Research*, (7) 2009. Also see Zhu Weihua, 2003. "Shangshi Gongsi Xinxu Pilu Weigui Gongkai Qianze Xiaoguo de Shizheng Yanjiu", *Economic Management*, (16) 2003.p 92-96 there is some data about cases which can support this argument, 188 A-share listed companies were punished because of information disclosure violations during 2001-2005. See Qu Wenzhou, Cai Zhiyue, 2007. "Woguo Shangshi Gongsi Xinxu Pilu Weigui de Dongyin Shizheng Yanjiu", *China Industrial Economics*, 04, 2007. p 98-105.

⁴³⁹ Wang Delu, Liu Mingyuan, 2009. "Information Disclosure System of Listed Companies in China: Proposals for Solving Problems", *Journal of Tianjin University of Commerce*. 29 (2) 2009.

⁴⁴⁰ Zhang Zongxin, Zhu Weihua, 2007. "the Empirical Study on Disclosure Quality of Listed Companies in China", *Nankai Economic Studies*, (1) 2007.

standards of reliability of the information disclosure are: whether the annual financial report is issued by the standard unqualified audit opinion; any irregularities of company in nearly three years; and negative reports about company.⁴⁴¹

Secondly, the timeliness of information disclosure refers to how the information should be provided to the decision maker before the information loses its ability to influence decisions. Reality, integrity and timeliness are the characteristics for the information. Because investors, regulators, the public and the internal managers of company gain the information at the different times, in order to solve the problems resulting from asymmetry of the time, the system information disclosure requires management departments to show the information according to the laws within the prescribed period. This measure will help to reduce the chances for relevant personnel to use internal information to do insider trading. Therefore, enhancing corporate transparency and decreasing the difficulty of regulation will push the management to more standardization, and protect the interests of the investors. From the point of view of public investors, disclosure of information can help the investors to make a rational judgment about the value of project and make a good investment decision. From the point of view of the listed company, disclosure of information will adjust the price of share on time, and ensure continuous and effective disclosure. The standards of evaluation system of the timeliness of information disclosure are mainly drawn from the annual reports of listed companies.

⁴⁴¹ These three factors of the standards of evaluation of information disclosure are from China's listed company governance evaluation index system of the board of information disclosure, the data collection and analysis have been done by the Corporate Governance of Nankai University Research Central.

Finally, the correlation of information disclosure requires that listed companies must disclose all information as the laws require, the information shall not be ignored. Through this method, the information users will understand the corporate governance, financial status, operating result, cash flow management risk and the degree of risk, so that they can understand the business results. The correlation of information disclosure includes complete contents and form. The information disclosure relevance evaluation index mainly concerns whether to fully disclose the following aspects: corporate strategy, governance structure, the competitive environment, product and service market, the profit forecast information, empirical risk and financial risk, social responsibilities, employee training plans and costs, foreign investment projects, the distribution of business, the business status of the holding company and taking a stake in the company, related party transactions and events occurring after the date of the balance sheet.

4.6 The stakeholders

Until the 1980s, the enterprise's management objective was considered to be to maximize shareholder interests, and the core of corporate governance research was mainly about how to establish a reasonable incentive and constraint mechanism and minimize the agent's moral hazard risk, eventually to maximize the value of the

company.⁴⁴² In 1963, SRI proposed a group named ‘stakeholders’; ⁴⁴³ Freeman and Reed believed that the stakeholders were very important for the development of the company, without whose the support companies or organizations could not survive.⁴⁴⁴ However, in the area of management science this view did not attract enough attention at that time. Since the 80s, the business environment has changed from planned economy to market economy. The rights and interests of the shareholders, creditors, employees, customers, suppliers, government, community residents and other stakeholders became noticed by the business operators, and the company in the management process of business transaction and the operation process needed to pay more attention to stakeholders.⁴⁴⁵ In addition, the consumer rights movement, the environmental protection lobby and other social activities created a great influence.⁴⁴⁶ Consequently recognition of the importance of employees had greatly improved.⁴⁴⁷ The mode of corporate governance also developed from the traditional --unilateral governance pattern of shareholders to the co-governance mode involving stakeholders.

According to Blair, a company should be an organization with a huge social

⁴⁴² Xie Huobao, Yang Mingze, 2007. “Shehui Zerenguan Xia Qiye Jingying Mubiao de Goujian”, *Construction Machinery Today*, 01 2007. pp. 80-83 According to Xie and Yang, there are two views of an enterprise management’s goal in academic research: one is the traditional theory of "shareholder first" which argues that shareholders enjoy the right of control and ownership of the enterprise, and to maximize shareholder interest is its basic goal; the other one is gradually formed in the 1970s and 1980s-- "stakeholder theory", which argues that shareholders, creditors, suppliers, employees, customers, government and community, social public and other stakeholders share the control and ownership of the enterprise, and argues that the enterprise’s management goal is to serve the stakeholders.

⁴⁴³ Li, *Supra* note 339, at 155.

⁴⁴⁴ *Ibid.*

⁴⁴⁵ Jie Min, Jin Wei, and Cui Jing, 2001. “Guoyou Qiye Caiwu Guanli Mubiao Wenti Tanxi”, *Coal Economic Research*, 07 2001. pp. 56-58.

⁴⁴⁶ The corporate social responsibility movement was born in European and American countries, against the background of the development of economic globalization the civil society movement, the consumer movement, the labour movement and environmental movement. Consumers, investors, government and other stakeholders required enterprises to meet their responsibility about economic, legal, ethical, and charity aspects. Complete economic responsibility is the material basis for the completing their social responsibility. While, the implementation of the responsibility on charity, legal and ethical aspects for enterprise is the guarantee of promoting of economic responsibility of the enterprise. See Guo Jinlin, 2002. “On the principle of interest correlation and the mechanism of consumer involvement for corporate control”, *Consumer Economics*, (1) 2002.

⁴⁴⁷ *Ibid.*

responsibility, and the company exists to create wealth for the society.⁴⁴⁸ The main point of the corporate governance reform is (also is the biggest difference between the unilateral governance pattern (shareholders) and the co-governance mode (stakeholders) is that shareholders should not be given more power and control, managers should be separated from the shareholder pressure, and more power should be passed to other stakeholders.⁴⁴⁹ Li Weian considered that corporate governance is a set of system arrangements, and it includes formal or informal, internal or external systems to coordinate the relationship between company and all stakeholders, to ensure that the company's decision-making will be scientific, and to safeguard the interests of the company in all aspects.⁴⁵⁰ Corporate governance is not confined to the shareholders, and includes shareholders, creditors, employees, customers, suppliers, government, the community and other stakeholders. Currently, it has become a widely accepted point of view to give full consideration to the rights and interests of stakeholders in corporate governance and encourage appropriate stakeholders to participate in corporate governance.⁴⁵¹ Although the issue stakeholders is very important in the study of corporate governance, most of research both at home and abroad does not involve and emphasise stakeholders in connection with corporate governance evaluation systems.⁴⁵² According to SP, the evaluation system of corporate governance just involves financial interests. Although it refers to the shareholders, other stakeholders

⁴⁴⁸ Ibid.

⁴⁴⁹ Ibid.

⁴⁵⁰ Ibid.

⁴⁵¹ Li Weian, Hao Chen, 2009. "Zhongguo Gongsì Zhili Zhuanxing: Cong Xingzhengxing Dao Jingjixing", *The Capital Market*, (9) 2009. Pp.112-114.

⁴⁵² According to the research on China's listed company governance evaluation index system, done by the Corporate Governance of Nankai University Research Central. See Li, *supra* note 339, at 155.

are not covered.⁴⁵³ The corporate governance evaluation system of CLSA which focused on corporate transparency, management constraints, the independence and accountability of the board of directors, the protection of minority shareholders, the reasonable control of the debt and corporate social responsibility evaluation, so to some extent it covers the stakeholders.⁴⁵⁴ The corporate governance evaluation systems of Deminor and Haitong did not involve stakeholders.⁴⁵⁵ This thesis agrees with the opinion of Li Weian, and considers that Chinese listed company must establish a system to involve and balance the relationship among shareholders, creditors, employees, customers, suppliers, government, community and other stakeholders. In addition, the issue of stakeholders should be discussed in corporate governance as one of the main issues.

The standards to evaluate stakeholders can be divided into two parts.⁴⁵⁶ The participation of stakeholders is the first part, and includes four elements: namely, employees' participation, protection of the rights and interests of minority shareholders, and management of investor relations. First of all, amongst the participating stakeholders the employee is the important stakeholder for company. The condition of the human capital becomes more and more important. Providing effective ways to participate in the company's major decisions and daily operation and management for the employees is conducive to enhancing employees' sense of belonging, improving

⁴⁵³ See Table 4-1 the Main Corporate Governance Evaluation System in Appendix.

⁴⁵⁴ Ibid.

⁴⁵⁵ Ibid.

⁴⁵⁶ According to the research on China's listed company governance evaluation index system, done by the Corporate Governance of Nankai University Research Central. See Li, *supra* note 1, at 156 and See Table 4-8.

loyalty and motivating employees continually to achieve higher personal and corporate goals.⁴⁵⁷ Employee shareholding can show the status of employee participation in corporate governance of monetary capital and property rights. An employee stock holding plan is also the important measure for employees on the property right incentive.⁴⁵⁸ Second in importance is protection of the rights and interests of minority shareholders. Sometimes controlling shareholders in the company absolutely dominate low, minority shareholders. They are a vulnerable group, due to various reasons, such as: the participation in corporate governance costs too much; they can't participate in company's decisions of corporate governance practice, so that their own interests often have been harmed.⁴⁵⁹ Accordingly, there are three indicators to measure whether the rights and interests of minority shareholders get effective protection: the system of cumulative voting, online voting system, and the proxy voting system, namely whether to adopt a solicitation voting method. Finally, management of investor relations means that the Company through the timely disclosure of information, can strengthen communication with the investors, and try to form a good relationship between the company and investors with the aim of maximizing the value of the company.⁴⁶⁰ In China, listed company investor relations management is at the development stage. This thesis considers that Chinese listed companies should build investor relations management system from the following angles: the establishment of the company's

⁴⁵⁷ Li Weian, Tang Yuejun, 2005. "Shangshi Gongsu Liyi Xiangguanzhe Zhili Jizhi, Zhishu Jizhi yu Qiye Yeji", *Management World*. (9) 2005. Pp. 127-136.

⁴⁵⁸ Ibid.

⁴⁵⁹ Liang Mengyao, Peng Shiyu, 2011. "Qianxi Shangshi Gongsu Zhongxiao Gudong Quanyi Shou Qin Hai Yuan Yin Ji Duice", *Journal of Gansu Lianhe University (Natural Science Edition)*, S2 2011. Pp. 32-34.

⁴⁶⁰ Li Weian, Tang Yuejun, 2005. "Shangshi Gongsu Liyi Xiangguanzhe Zhili Pingjia Ji Shizheng Yanjiu", *Securities Market Herald*. (03) 2005. Pp. 37-43.

website and updating it; the review of the company's investor relations management information disclosure and the establishment of communication channels; and establishment of an investor relations management system and its execution, inspecting whether there is a specific department in charge of investor relations management. This measure is helpful to promote the effective development of investor relations management.

On the other hand, coordination of stakeholders is the other factor must be considered. It mainly include three elements, namely, corporate social responsibility, the relationship between company and supervisory and administration departments, litigation and arbitration.⁴⁶¹ Firstly, knowing the importance of corporate social responsibility, paying more attention to the protection of the natural environment and correctly handling the relationship with society and the community are the three prerequisites for enterprises to pursue long-term development.⁴⁶² The following two points should be established as key issues for the listed company: the company spending on public welfare donations can demonstrate the listed company's contribution to the society; and the company's environmental protection measures, reflects listed company's protection of the natural environment.⁴⁶³ Secondly, in the relationship between company and administration department Enterprises engaged in legitimate business must fulfil the corresponding legal responsibility, therefore, to

⁴⁶¹ According to the research on China's listed company governance evaluation index system, conducted by the Corporate Governance of Nankai University Research Central. See Li, *supra* note 1, at 157.

⁴⁶² Xiao Zuoping, Yang Jiao, 2011. "Gongsi Zhili dui Gongsi Shehui Zeren de Yingxiang Fenxi—Laizi Zhongguo Shangshi Gongsi de Jingyan Zhengju", *Securities Market Herald*. 06 2011. Pp. 36-42.

⁴⁶³ *Ibid*.

coordinate and correctly handle the relationship between company and its regulators is essential. Through quantitative analysis of fine spending and income, the harmonious degree of the listed company and its regulators can be judged. Finally, through investigating the amount of company's litigation, arbitration and their nature and characters, the relationship between the listed companies and shareholders, suppliers, customers, consumers, creditors, employees, communities, government and other stakeholders can be measured.

Chapter 5: Internal Governance of Chinese State-Owned Listed Companies (II): the Tension Issues for Internal Governance

In overseas mature markets, there is a set of good governance structures for the listed companies.⁴⁶⁴ However, the situation of listed companies in China is more special. This is because most of the domestic listed companies have been changed from the original⁴⁶⁵ or local companies (most of original or local companies had been operated without any standard of corporate governance at that time). In the process of reform of Chinese SOEs, many problems appeared in some aspects linked to corporate governance, the main issues of which are fivefold. The first issue is that the ownership of SOEs' asset is not clear. The second one is that the controlling shareholders take the funds of company. The third problem is that related party transaction is serious. The fourth problem relates to *San Hui* (the board of directors, the board of supervisors and the shareholder meeting) and is one of formalisation.⁴⁶⁶ Finally, insider control and

⁴⁶⁴ As discussed in Chapter 4, a good governance structure can be divided into different types, such as the U.S. mode, Japanese mode and German mode. But in general, the main factors can relate to company's equity structure, the company's independent legal status, the allocation of power between the shareholders of a company's directors and managers and the interests of the checks and balances. Also to be considered are; The supervision and incentives of the company management, and the corresponding social responsibility, and a series of legal and economic problems. For more relevant articles see Liu Qi, 1996. "Jiejian Guowai Gongsi Zhili Jiegou, Tuijin Woguo Guoyou Qiye Gaige". *China Business & Trade*. 11 1996. And see Liang Neng, 2000. "Gongsi Zhili Jiegou: Zhongguo de Shijian yu Meiguo de Jingyan", *Journal of Renmin University of China*. 04 2000. and see Song Zengji, Li Chunhong, and Fan Pengtao, 2004. "Guowai Gongsi Zhili Moshi dui Woguo de Qishi", *Reform of Economic System*. 06 2004.

⁴⁶⁵ The companies system in the West ishas directly developed from the private enterprise system while in China, the corporate governance system is evolving from a planned economy, as China's listed companies have more directly developed from public ownership of the state-owned enterprises.

⁴⁶⁶ The framework of Sanhui is complete in form, butthe function of Sanhui is not fully playing a role. In the current style of company, shareholders, especially minority shareholders', rights and interests cannot get effective guarantees, and as a result the corporate governance is not as effective as expected. For example, major shareholders have absolute control over business investment decisions. See Huang Qiang, Chen Lan, 2001. "Ruhe Baohu Ruoshi Gudong Chanquan", *Tian Fu New Idea Bimonthly*. (1) 2001.

untimely information disclosure are the core tension issues for listed companies. In this chapter, the following issues will be discussed: first, the problems about the ownership structure the controlling shareholder behaviour, followed by the problems on the related party transactions and information disclosure, and then the problems for *San Hui* will be analysed,. Finally, the problem about stakeholders will be illustrated.

5.1 The Problems about the Ownership Structure and the Controlling Shareholder Behaviour

5.1.1 The Problems about the Ownership Structure: Equity Concentration have not been Fundamentally Solved

- *Compared with the largest shareholder, other shareholder and their shares are superficialities*

In China, the listed company had been perceived as being the listed SOE, because an overwhelming majority of the listed companies were SOEs.⁴⁶⁷ The high ownership concentration as a main feature of the shareholding structure of Chinese listed SOEs, was described as excessive by a study of the Shanghai Stock Exchange (SSE).⁴⁶⁸ According to the SSE, at the end of 2002, in 40.9% of all the companies (a total of 300 companies, according to data from the annual reports of 734 companies listed on the SSE), the largest shareholders owned more than half the shares. On average, in all 734

⁴⁶⁷ Wang, 2004: 40-42.

⁴⁶⁸ Zhongguo Gongsi Zhili Baogao, 2003; 46.

companies, each largest shareholder possessed 44.3% of its company's shares.⁴⁶⁹ After almost seven years' development of corporate governance in China, the listed companies were not all synonymous with listed SOEs. However, the situation of equity concentration has not been solved fundamentally. According to Lu's annual reports of the central SOEs 2010, the largest shareholder played an absolute role for corporate governance, the board of directors and the board of supervisors finding it hard to work for a company.⁴⁷⁰ The high ownership concentration may lead to the largest shareholder attaining the majority rule to control the shareholder meeting, the board of directors and the board of supervisors. Moreover, the largest shareholder may harm the benefit of minority shareholders and the company through means including capital occupied, an illegal guarantee, related party transactions, insider trading, manipulation of the stock price and other irregularities. Here, the largest shareholder refers to the Chinese State, which means the state dominance of shareholding in the listed SOEs. Therefore, the first problem which has not been solved fundamentally is that in comparison with the largest shareholder, other shareholders and their shares are superficial, as they do not play a substantial role for corporate governance of Chinese listed companies.

As stated, the establishment of the SASAC in 2003 demonstrated the state's renewed efforts to tackle long-standing problems concerning SOEs ownership. The SASACs can be seen as the government agencies and with some functions including representing

⁴⁶⁹ Ibid.

⁴⁷⁰ Lu, *supra* note 339, at p. 111.

the State ownership, regulating and supervising SOEs. The SASAC at the central level supervises central SOEs which are those owned and controlled by the Central Government, and the SASAC at the local level supervises local SOEs which are owned and controlled by the provincial government.⁴⁷¹ The following discussion will focus on the central SASAC and the central SOEs which are controlled by it.

The number of the central SOEs has reduced from 196 in 2003 to 113 in 2014 as a result of continuous restructuring⁴⁷² and of the state's plan to foster larger and global Chinese companies.⁴⁷³ These 113 companies which the central SASAC supervises and controls are the 113 companies which are considered as core to national security and strategically important enough to warrant the maintenance of State control.⁴⁷⁴ The SASAC drafts laws, administrative regulations and rules on the management of State-owned assets, and the central SASAC exercises ownership rights on behalf of the Central Government to accelerate the process of SOEs reform, but in fact, the State retains significant ownership control over key SOEs, and the State is the leader in the restructuring of SOEs. Therefore, for the most listed central SOEs in China, the actual controller is the SASAC.

- *Insider control*

⁴⁷¹ See the Interim Regulations on the Management of Enterprises State-owned Assets 2003.

⁴⁷² See, <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html>, at 27 June 2014.

⁴⁷³ See Wen Jiabao, Government Work Report 2007, the Central People's Government of the People's Republic of China.

⁴⁷⁴ The part about the SASAC was discussed in Chapter 1, and the reason, strategic for State controls vital industries and companies also was discussed in former chapter. And some more detail see Edward Tse, *Context and Complexity 2007, Strategy + Business*.

The first situation involving insider control is about the largest shareholder of the central SOEs being the Group Company of SOEs,⁴⁷⁵ and the actual controller is the SASAC, the central SASAC on behalf of the Central Government. Therefore, as the SASAC's decisions always reflect the Central Government's will, it amounts to insider control for a SOE. There are many links, steps or procedures in the process of a SOE reform, such as evaluation, acquisition and mergers. The SASAC plays a key role in those links involving SOEs. The insider control is serious, and the SOEs are controlled by SASAC- the spokesperson of the State. If so, corporate governance is just a decoration for SOEs, and the rights of the shareholders, even the largest shareholder are weakened.

The second situation of insider control is that the legal person of state-owned equity position cannot be personified, and so the rights of the company operator or managers also are at the risk of being undermined.⁴⁷⁶ State holding listed companies in China are divided into three types: the government holding company, state-owned asset management holding company and state-owned legal person holding company.⁴⁷⁷

Firstly, the largest shareholders of the government holding company include

⁴⁷⁵ The state holding listed companies are mostly established by relatively high quality assets which had been split out as part of SOEs. A large number of non-operating assets and debt burden had been left in the Group. The Group Company with diversified goals and controlling status of the listed company formed a strong control of state holding listed companies. For the same opinion see Lu, *supra* note 4, at 112.

⁴⁷⁶ Guan Xinchun, 2008. "Woguo Shangshi Gongsi Neiburen Kongzhi de Fajingji Fenxi", *Legal System and Society*. 28 2008 and the same issue had been discussed in He Yabin, 2005. "the Greatest Risk in China Property Market Development Originating from the Control of Relevant People on Assignor's Side", *Property Rights Guide*. (10) 2005.

⁴⁷⁷ Yang, Y, 2011. *Reconstruction: New Path for Corporate Governance*, Beijing: China CITIC Press P. 82 The same opinion with Yang can see Li Zengquan, 2002. "Guojia Konggu yu Gongsi Zhili de Youxiao Xing", *Shanghai University of Finance Economic*. According to Li, In order to maintain the dominant position of public ownership, state-owned enterprises have adopted listed state-owned equity mode in the process of restructuring.

state-owned assets supervision and administration commission, the Ministry of Finance and the competent administrative department for enterprises.⁴⁷⁸ Secondly, the largest shareholders of a state-owned asset management institution holding company include state assets management company and Industry Corporation.⁴⁷⁹ Lastly, the largest shareholders of a state-owned legal person holding company include the state-owned Group or Corporation. For state holding listed companies, the SASAC as the representative of state-owned equity, is also the agent of the state-owned investors at the same time; the SASAC is responsible for the largest shareholder, in fact, is responsible for the higher administrative departments of original enterprises or Group Co. In addition, because these holdings are virtual subjects, it is difficult to monitor the agent. Therefore, the managers can get rid of the control of the board of directors, either as a representative of state shareholders then ignore the opinions of the minority shareholders, and can as insiders then ignore the opinion from the state-owned controlling shareholders.

The third situation of insider control takes place where the SASAC has replaced the operators and the board of directors, and also limits the SOEs' international

⁴⁷⁸ Such as the 110 Central-owned enterprises which investment by SASAC, the list can see <http://www.sasac.gov.cn/n86114/n86137/c1725422/content.html> (accessed 12 July 2015) the largest shareholder of them is SASAC.

⁴⁷⁹ The state assets management companies mean state-owned non-banking financial institutions whose functions are acquisition of state-owned Banks non-performing loans, management and disposal of assets formed by the acquisition of state-owned Banks non-performing loans. In 1999, approved by the State Council and the People's Bank of China, p four state-owned financial asset management companies (AMC) were set up: Orient asset, CINAD Asset, Huarong Asset Management, the China Great Wall Asset Management Corporation, respectively responsible for the acquisition, management and disposal of the corresponding Bank of China, China Construction Bank and China Development Bank, Industrial and Commercial bank of China, Agricultural Bank of China by the stripping of non-performing assets. After 2009, as policy tasks had been completed, the four AMCs since then had to strengthen the commercialization process. For more about the classification of the state holding listed companies see Wen Zongyu, Tan jing, 2008. "Guoyou Konggu Shangshi Gongsi Fenlei Fenxi". *Review of Economic Reseach*. (6) 2008.

competitiveness, and decides the direction of development of SOEs. It is hard to separate the functions of Chinese government and the SASAC for SOEs, so when the SASAC controls SOEs, such control inevitably caused the government's intervention in the State holding listed company. The function of the government's public management is to maintain overall social, political and economic stability, and ensure the value of state-owned assets, but the goal of listed company is profit maximization. These two goals are inconsistent. Therefore, in many cases, government intervention, and even excessive intervention, is inappropriate for SOEs, especially the state-owned listed companies. (Government intervention through the SASAC can be seen as a kind of insider control, and at the same time, government intervention is one of the characteristics of Chinese SOEs. More details about government intervention as a characteristic will be discussed in the next chapter). For example, the aim of mergers of SOEs is to improve their international competitiveness through increasing scale and consolidating operations. There were 818 acquisitions of Chinese companies by foreign companies in 2006.⁴⁸⁰ Although only a small proportion of foreign acquisitions were blocked by the Chinese Government, no single foreign company acquired a controlling stake in the Chinese SOEs.⁴⁸¹ From the point of view of competition, under the control of the SASAC, the central SOEs did not liberally develop to accord with the market, especially the international market. For Chinese central SOEs, it seems that SOEs were protected by the State through restricting foreign enterprises and aimed to guarantee that the SASAC can maintain control of SOEs absolutely. Why must the

⁴⁸⁰ Yan and Torchia, 2007.

⁴⁸¹ See Ministry of Commerce, the CSRC et al, and Administrative Measures on Strategic Investment of Foreign Investors in Listed Companies, issued on 31 December on 2005, effective 30 January 2006.

SASAC or Chinese State control the central SOEs, although they also want to strengthen central SOEs' global competitiveness through mergers? The reason lies in the method of injecting State resources into central SOEs and taking an absolute control, which was explained by a manager of the SASAC.⁴⁸² He said that this was not just a strategic method for Chinese central SOEs. But there were some objections, some of which thought that foreign enterprises could reduce more costs than Chinese central SOEs in the same project, and if so, people could enjoy the result of the project at a lower price. Therefore, they insist that it is not necessary to obtain a controlling stake for the State in central SOEs, if the foreign enterprises can create more profit for Chinese people with lower costs. However, he did not agree with that. His opinion can be summarized as follows. First of all, who obtains controlling stake of Chinese central SOEs is a legal, economic and management topic for a country, therefore, we could not research and evaluate it just from an individual field or just from costs and profits. Moreover, political factors or diplomatic strategy will affect the economic transitions between countries. If the controlling stake is held by a foreign company, political rupture and tensions of international relations will lead to the unstable development of Chinese SOEs. Ultimately, most of central SOEs are, in terms of national security, strategically important enough to warrant the maintenance of State control. If the controlling stake was held by a foreign enterprise, the SOE's development instability would lead to national security concerns. This method is weakening the corporate governance and market effectiveness for Chinese SOEs. It cannot be relied as a long-

⁴⁸² Data from the interview with a manager of the SASAC on 27th, June 2012, it was a part of fieldwork in my second year of PhD, in this thesis, the view of this manager cannot represent the SASAC; it was a personal view just from a senior manager who worked for the SASAC.

term solution, if Chinese SOEs try to gain strong international competitiveness. But it should be the only route which can juggle both stability and development before finding a better way.

- *Tradable shares and non-tradable shares (non-circulation shares) of SOEs exist in China's capital markets*

Apart from the factors of the SASAC's controls over the central SOEs and limitation on foreign enterprises, another factor (also the third problem) which is weakening the corporate governance and market effectiveness for Chinese SOEs, is caused by equity concentration of Chinese SOEs.⁴⁸³ Because tradable shares and non-tradable shares (non-circulation shares) of SOEs⁴⁸⁴ exist in China's capital markets at the same time, it is hard to realize control over the company through market practice for external potential investors, which may lead to internal operators' slackness, and may also strengthen the monopoly position of the controlling shareholder of the SOE. Moreover, it can cause State assets to be misappropriated and siphoned off by the managers.

⁴⁸³ The status of state-owned major shareholders of SOEs is Absolute control, SOEs formed a highly centralized equity, and namely the equity structure of state-owned shares a dominant. See Yin Bocheng, Xue Feng, 2001. "Woguo Shangshi Gongsi de Guquan Jiegou yu Neiburen Kongzhi", *Collected Essays on Finance and Economics*. 06 2001.

⁴⁸⁴ Prior to 2005, the proportion of non-tradable shares was too high in a lot of state-owned listed companies, but between 2005 and 2008, through the reform of non-tradable shares, the proportion state-owned shares are far greater than the number of state-owned shares. The so-called equity division reform restricted the circulation of state-owned shares and legal person shares all lifted a ban, and became tradable shares. What is the proportion of tradable shares and non-tradable shares? There is no answer for this question. The proportion of tradable shares and non-tradable shares of listed companies is not strictly limited, should be completely according to particular case about different companies. The State did not have any laws and regulations about their proportion. The conditions of socialism with Chinese characteristics determines that the non-tradable share holding is greater than tradable shares for the SOEs which controlled by the SASAC. For example, 600028 China Petrochemical, with a total of 116.5 billion shares, has 91 billion A shares in circulation, but China Petroleum & Chemical Croup Co., Ltd. has controll over and holds 85.6 billion shares, the actual current A-share only (910-856 = 856), less than 10% of the tradable shares. Many tradable shares of the listed SOEs which are controlled by SASAC, had been controlled by relevant group company. In fact, they are not really in circulation.

5.1.2 The Problems about the Controlling Shareholder's Behaviour

- *It is difficult to guarantee independence of the listed company under the controlling shareholder*

To ensure the legal person status of the controlling shareholders is a core issue in order for controlling shareholders to play a better role, and improve corporate governance. However, for Chinese State holding listed companies, the controlling shareholder plays a dual role. On the one hand, it acts as an agent of the SASAC; on the other hand, it is the company's principal. Therefore, it is difficult to guarantee the independence of operators or managers due to the dual role for the listed company. In practice, controlling shareholders always influence the operation of listed companies through three main ways: intervene in personnel matters, intervene in the management and operation, and in selecting auditors. For example, the directors and managers of Chinese central enterprises listed companies are largely political appointees (appointed by the SASAC or organization department) whose job is to safeguard State assets.

- *Intervention in personnel matters*

According to the Code of Corporate Governance for Listed Companies in China, the nomination committee is responsible for the directors and managers' election, review

and nomination.⁴⁸⁵ But in fact, the board of directors and senior management of some of the state holding listed companies, which came from the reorganization or restructuring of central enterprises or came from the overall listing, are mainly from the controlling shareholders, who belong to the Organisation Department of the Central Committee of the Communist Party of China⁴⁸⁶ and the SASAC. Therefore, the recommended candidate nomination needs to collect the support of the controlling shareholders or others directly recommended by them. The major persons-in-charge of the large central enterprises mainly be appointed by the Organization Department of the Central Committee,⁴⁸⁷ while in the other listed companies which are held by the central and local enterprises, the main principals are appointed by the SASAC (the central and local) respectively.⁴⁸⁸ The other executive personnel need to obtain the state-owned shareholders' approval. The board of directors and the review of the shareholders' general meeting are a formality.⁴⁸⁹

There is a high degree of dependence on Chinese government departments or the SASAC for executives when the executives engaged in the business activities, in that they must consider the opinion of government department, the controlling shareholders,

⁴⁸⁵ See Code of Corporate Governance for Listed Companies in China, Article 55: the main duties of the nomination committee are 1. to formulate standards and procedures for the election of directors and make recommendations, 2. to extensively seek qualified candidates for directorship and management, and 3. to review the candidates for directorship and management and make recommendations.

⁴⁸⁶ The Organisation Department of the Central Committee of the Communist Party of China is one of the important functional departments for the Central Committee and is mainly responsible for the Party's organization structure and the cadres' team structure and the talent team structure, etc. In May 1924, the Central Committee of the Communist Party of China formally decided to set up departments about publicity, organization and workers and peasants. See <http://news.12371.cn/dzybmbdj/zzb/> (accessed 15 July 2015).

⁴⁸⁷ Cheng Xin, 2010. "Woguo Guoyou Qiye Fuzeren Xuanpin Jizhi Gaijin Yanjiu", *Shandong Jingji Xueyuan*.

⁴⁸⁸ Ibid.

⁴⁸⁹ Ibid. and the same opinion also can see Shen Zenghong, 2007. "Pinren erfei Renming Zhuzhi shi Gaohao Guoqi de Guanjian", *Jingji Guanli*. 01 2007.

promotion being their priority, rather than the interests of listed companies and investors.

- *Intervention in operations*

The controlling shareholder with the background of the government not only carries out the examination and approval in advance for the major issues of the state holding listed companies, but also reviews the business plan, budget and some other daily business matters, even some issues which do not need to report to the board meetings, such as purchase of vehicles and office equipment. In some large SOEs groups, especially the SOEs with more subordinate members, the managers think it is necessary to copy the whole enterprise group's internal management system including financial accounting and money management of their holdings of listed companies.⁴⁹⁰ This thesis does not agree with this position, but argues that the administrative intervention from the SASAC or SOEs Groups is harmful and a challenge for the standardised operation of listed companies and the regulation of the capital market.

The modes of controlling shareholder or actual controller gaining the profit can be summarized into three types. The first mode is based on the inherent stakes obtained from the operating results of listed companies, such as the investment interest or return. The second one is based on its intrinsic value or premium transfer profit. The final one

⁴⁹⁰ Yang, *supra* note 486, at 85.

is the controlling shareholder or actual controller transfer, taking up corporate resources, and receiving beyond the proportion of equity returns.⁴⁹¹ On the one hand, the controlling shareholder or actual controller control and effectively manage the listed company, which is the foundation for profitability and development of the company, and is the source of profit for the minority shareholders. On the other hand, the controlling status of controlling shareholder of listed companies provides a lot of possibilities and opportunities to harm minority shareholders through irregularities. For Chinese state-owned listed companies, corporate governance does not play a beneficial role, because it is easy for the group company, as the major shareholders of listed companies, to misappropriate funds of the listed company, for example, through related party transactions, and cash dividend.⁴⁹²

5.2 The Problem about the Related Party Transactions and Information Disclosure

Related party transactions between the controlling shareholder and State holding listed companies is a common phenomenon, the main reason being that when the SOE was originally listed, part of the auxiliary business had been left in the controlling shareholder's name. The listed company signed a comprehensive service agreement with the controlling shareholder, and then controlling shareholders provided supporting

⁴⁹¹ Ibid.

⁴⁹² See Shen Youlun, Yu Bangqing, 2004. "Lun Dagudong Nuoyong Shangshi Gongsu Zijing Xingwei zhi Youxiao Guize---You Zhongguo Zhengjianhui, Guoziwei Linhe Qianfa Tongzhi Suo Yinfa de Sikao", *Chinese Criminology Review*. 04 2004. Since the latter half of 2003, 57.53% of the listed company (676 listed companies) had misappropriated huge amounts of money by the major shareholders. Among the 1175 listed companies with the occupied capital totalling 96.669 billion Yuan, the average embezzlement was 143 million Yuan.

services for listed companies. In addition, part of the industry chain of listed companies is not complete; they have to purchase a large quantity of raw materials or components, or they need to sell finished product via the controlling shareholder. All the links above have resulting in a large number of related party transactions going on for a long time.

The main problems of related transactions of Chinese central SOEs are: related transactions are more subtle and complex; how to determine whether the related transactions' price is reasonable; and inadequate disclosure of information about related transactions. After the shareholding reform, an important trend of related party transactions of listed companies is that controlling shareholders and actual controllers go through more hidden, indirect connection transaction to avoid regulation, and achieve the goal of transfer of interests of listed companies. In such ways, the controlling shareholder through seemingly independent third party affiliates or other affiliated parties can encroach on the interests of the listed company. The harm caused by related transaction to listed companies is very serious.

5.2.1 The Main Methods of Related Transactions

First of all, it is difficult to define the “related party”; some parties do not work for affiliated enterprise, and there is no equity relationship between the parties and SOEs. But the parties often emerge as customers or partners;⁴⁹³ therefore, it is a big challenge to make an accurate judgment about the related party. There are provisions about

⁴⁹³ Yang, *supra* note 486, at 80.

related party and disclose in the Company Law,⁴⁹⁴ Securities Law,⁴⁹⁵ Accounting Standards⁴⁹⁶ and other relevant documents. In addition, the rules about related party transactions of stated in Stock Market Listing Rules⁴⁹⁷ are stricter. Therefore, some companies tend to adopt some related transactions - non-related methods to circumvent the rules. These methods can be divided into two levels:⁴⁹⁸ One is the company indirectly controls the listed companies through looking for a non-related party as a trading intermediary or multiple participation of listed companies.,⁴⁹⁹ Another method, under the condition of certain definite related party transactions, uses various means to conceal the essence of the transaction or the transaction itself..⁵⁰⁰ If the transaction is non-monetary, there are certain rules or codes which restrict them, so it is hard to achieve the purpose of manipulating profits. Therefore, some listed companies try to make the non-monetary transactions change to monetary transaction. One of the main methods is splitting a non-monetary transaction into two deals, namely selling assets and buying assets. The other one is that the listed companies get high valuation of assets from a related party for low value assets, and then sell the low value assets at

⁴⁹⁴ See Article 21 of Company Law of the PRC. 2007 And for more discussion and analysis for Article 21 see Shi Wenting, 2008. "Jianli Guanlian Jiaoyi de Sifa Shencha Biaozhu---dui Gongsifa Guanyu Guanlian Jiaoyi Guifan de Yidian Jianyi", *Legal System and Society*. 25 2008. Also see Luo Huanping, Wang Yanli. 2005. "On the Regulation of Associated Deal in the Newly- amended Corporation Law", *Journal of Political Science and Law*. 23 (2) 2006 the same issue is referenced in Shi Tiantao, Du Jing, 2007. "Woguo Gongsifa Shang Guanlian Jiaoyi de Guiyi Jiqi Falv Guize—Yige Liyi Chongtu Jiaoyi Faze de Zhongguo Banben", *China Legal Science*, 06 2007.

⁴⁹⁵ See Law of the People's Republic of China on Securities, adopted at the 6 th Meeting of the Standing Committee of the Nine National People's Congress on December 29, 1998; amended in accordance with the Decision of the Standing Committee of the Tenth National People's Congress on Amending the Securities Law of the People's Republic of China adopted at its 11 th Meeting on August 28, 2004; and revised by the Standing Committee of the National People's Congress at its 18 th Meeting on October 27, 2005. The disclosure principle, subject, way and responsibility of information disclosure had been regulated in Law of the People's Republic of China on Securities.

⁴⁹⁶ Accounting System for Business Enterprises (applicable to Joint Stock Limited Enterprises effective 1 January 2001 and applicable to Foreign Investment Enterprises effective 1 January 2002). In the Chapter 12 between pages 72-74, related party relationship and transactions had been regulated.

⁴⁹⁷ Rules Governing the Listing of Stocks on Shanghai Stock Exchange, amendment in 2008. The Chapter IX and Chapter X are Discloseable transactions and related party transactions (pp. 39-48).

⁴⁹⁸ Lu, supra note 339, at 115.

⁴⁹⁹ Ibid.

⁵⁰⁰ Ibid.

normal market price. The assets with the high value are swapped out, and the assets with low value are sold at a higher price than its worth, and the listed companies achieve their goal.

5.2.2 Difficulties of Determining the Reasonable Price of the Related Transactions

The second problem is how to determine the standard price of related transactions. In daily management, the listed companies buy or sell assets to the related party; the object of transaction is often based on the consideration of assessed value.⁵⁰¹ However, the industry of assets appraisal in China is undeveloped. Moreover, the different evaluation methods and parameters of assessment value lead to different results.⁵⁰² Therefore it is difficult to ensure the objectivity of evaluation results.

5.2.3 Inadequate Disclosure of Information on Related Transactions

The final issue is inadequate disclosure of information on related transactions. Disclosure of information on related transactions involves multiple aspects, including the trading main body, time, quantity, price, and accounting for the company's assets, as well as the company's convening of general meeting of shareholders and other items.⁵⁰³ Accounting standards for business enterprises require disclosure of related party transactions information including: the amount of trading or equivalent ratio, the

⁵⁰¹ Ibid. at 114, and the same opinion see Yang, *supra* note 10, at 80.

⁵⁰² Yang, *supra* note 486, at 80.

⁵⁰³ Lin Meileng, 2009. "Shangshi Gongsi Guanlian Jiaoyi Xinxi Pilu Zhidu Yanjiu", *Southwest University of Political Science and Law*.

amount of outstanding project or corresponding proportion, and pricing strategy.⁵⁰⁴

However, the listed companies often only vaguely disclose the above content, especially when facing up to some kind of information which could have adverse effects to the company's business. The listed companies always show the 'cop out' answer, or hide the truth. Therefore, the real information and message is very limited. In addition, in terms of the disclosure of related transaction prices, there is chaos such as lack of disclosure of transfer price, and lack of comparability and understandability.

According to a research from Lu,⁵⁰⁵ in practice, almost all the listed companies said they would follow the principles of equity and reciprocity concerning the related transactions, but a proportion of them showed a different approach when the related transactions were exposed. For example, there are many kinds of ways to name related party transactions, such as market price, contract price and cost price, preferential price and evaluating price and so on. There is a big difference between different disclosures of information by listed companies who do not have a unified standard. The standards of the interest of fund income and expenses are different, mainly involving agreement interest rates and bank interest rates during the same period. Some listed companies just reveal the interest calculated amount, but do not provide the information about money and interest at a pre-determined standard. Moreover, there is no specific provision about the fees for providing or accepting guarantees. Finally, there are only a handful of companies who disclose the fees, but all the listed companies need a standard of charge to avoid the irregular charge. The disclosure of information of related transactions of

⁵⁰⁴ Accounting System for Business Enterprises (applicable to Joint Stock Limited Enterprises effective 1 January 2001 and applicable to Foreign Investment Enterprises effective 1 January 2002).

⁵⁰⁵ Lu, *supra* note 339, at 114.

Chinese listed companies is inadequate, because the listed companies pay more attention to form, and the useful content of the disclosure of information is not enough. In general, the listed companies just disclose the relationship between listed company and related enterprises, business properties, the main business, the registered address, legal representative and so on.⁵⁰⁶ However, the related transaction elements have not been shown to the public by listed companies, such as transaction amount or the corresponding proportion, the amount of outstanding project or the corresponding proportion, transaction price, and pricing policy. Even if the listed companies show above information to the public, they do not state whether the price of assets is after the audit and assessment, or whether the price was in accordance with the principle of independent business accounting of the listed company. Therefore, it is hard to fully understand the nature of the relationship between listed company and related enterprises, the type of transaction, and other transaction elements, and it is easy to cause a deviation in understanding and even lead investors to make wrong judgments. Some of listed companies are trying to escape or avoid disclosing related party transactions.⁵⁰⁷

⁵⁰⁶ Wang Jun, 2007. "Woguo Shangshi Gongsi Xinxi Pilu Neirong Fenxi", *Financial Supervision*, 04 2007. Also can see He Lin, 2001. "Qianxi Shangshi Gongsi Xinxi Pilu", *Modern Management Science*. 04 2001.

⁵⁰⁷ The case named 'Kai En Listed Croup'. More detail about related party transactions. And the case about Kai En will be attached later.

5.3 The Problems for *San Hui* (General Meeting of Shareholders, Board of Directors, and Board of Supervisors)

5.3.1 A formalized *San Hui*

In the operation of state holding listed company, and their shareholder meeting, board of directors, board of supervisors, two factors lead to a strong control over *San Hui* by the state-owned shareholder of listed companies, namely the fact that the legal status of state-owned shares is dominant and the principle of capital majority decision of general meeting of shareholders. The state-owned shareholder exerts control over *San Hui* through three ways including: nominating directors (including independent directors), supervising candidates, taking advantage of the right to vote for the election of directors and supervisors, directly appointing the chairman, general manager and the impeachment motion for directors and supervisors. So, state-owned controlling shareholders have the right to vote, and have the decision-making power and executive power at the same time. It is too easy to formalise *San Hui*.

5.3.2 Problems of the Board of Directors

The board of directors is the core of the governance structure of listed companies, and plays an important role. Chinese Company law stipulated the duties and functions of the board of directors.⁵⁰⁸ The SASAC introduced the Interim Measures for the Standard Operation of the Board of Directors of a Central Enterprise in the Pilot

⁵⁰⁸ See the company Law of the People's Republic of China (2013 Amendment), the Article 108, 109, 110, 111, 112, 113, 114.

Program on Board of Directors since 2009,⁵⁰⁹ which was a good development and enabled the board of directors of the central enterprises to establish a normative governance mechanism. But in the actual operation, there are still many problems. For example, the major decisions of listed companies are always made the corresponding decision-making procedures by the board of directors after prior approval by the department of state-owned assets or state-owned shareholder, and some issues involving major development strategy or decisions of merger, acquisition and reorganization of listed companies. Decisions are also driven by management department of state-owned assets or state-owned shareholders, even though listed companies sometimes do not know the details. Therefore, listed companies just go through the motions of being the decision of the board of directors. In the state holding listed companies, the role of the board of directors is greatly weakened, and the board of directors fails to play its due role. This part will analyse the main problems.

- *The composition of the Board of Directors*

1. Members of the board of directors and managers are overlap in the same listed company. The proportion of part-time members of the board of directors of Central enterprises is as high as 78.53%.⁵¹⁰ The board members of some enterprises are all from management, except of a staff worker can be a director. Or the chairman might

⁵⁰⁹ See the Notice of the State-owned Assets Supervision and Administration Commission of the State Council on Issuing the Interim Measures for the Standard Operation of the Board of Directors of a Central Enterprises in the Pilot Program on Board of Directors, which issued on 03-20-2009 by SASAC.

⁵¹⁰ The financial report 2010 of Chinese central enterprise conducted by Lu.

also be the general manager of the same company. This kind of circumstance causes an imbalance for the structure of corporate governance. The imbalanced proportion of Board composition is not conducive to the division of rights and responsibilities, and it is harmful to the scientific decision making of the board of directors.

2. There is a low proportion of external directors. The term of full-time external directors refers to a person who is specifically appointed or employed as an external director of a pilot enterprise for working on the board of directors by the SASAC. A full-time external director shall not assume any other position in the enterprise in which he works, nor assume any position in any other entity during his term of office.⁵¹¹ According to the report in 2010, the proportion of external directors was 37.8%⁵¹² of all the members of directors, less than the numbers prescribed by the Interim Measures;⁵¹³ members of the board of directors need to absorb more external independent directors.

3. The component of the external directors is not reasonable. ‘As a general rule, the chairman of the board of directors shall not be the general manager of a company... where a non- external director serves as the chairman of the board of directors, an external director may serve as the vice-chairman to assist the chairman in organizing the operation of the board of directors. Where neither the chairman nor the vice-chairman of the board of directors of a company is an external directors, the external directors may, in turn, serve as the convener of external directors for a term of

⁵¹¹ See the Notice of the State-owned Assets Supervision and Administration Commission on Issuing the Administrative Measures for the Full-time External Directors of Pilot Central Enterprises for the Work on the Board of Directors (for Trial Implementation), issued on 10-13-2009 by SASAC, Article 3.

⁵¹² Supra 519.

⁵¹³ Supra 518, Article 22: The board of directors shall have 7 to 13 members. As a general rule, more than half of all members of the board of directors of a company shall be external directors.

one year; or all external directors may jointly recommend the convener of external directors, but the convener of external directors shall be recommended again after three years at most.⁵¹⁴ This provision explains the methods and the basic principles of elections for external directors. The details on the selection and employment of external directors are set out in the Notice of the State-owned Assets Supervision and Administration Commission on Issuing the Administrative Measures for the Full-time External Directors of Pilot Central Enterprises for the Work on the Board of Directors (for Trial Implementation)⁵¹⁵. The selection and employment of external directors showed that the aim of external directors was to solve the problem of insider control.⁵¹⁶ Another evidence to support this argument is that administration of external directors has been influenced by political elements. The administration, political attitude have to close with the incumbent persons in charge of Central enterprise, in such aspects as a reading document, attending relevant conferences and taking part in relevant activities.⁵¹⁷ In addition, the selection and employment, evaluation, incentives and training, and the routine administration are authorized by the SASAC.⁵¹⁸ However, the function of external directors is not effective. The main problems relate to the component of the external directors. It can be summarized into three points.

First of all, the business ability of external directors cannot achieve the standard of

⁵¹⁴ Supra 518, Article 27.

⁵¹⁵ Supra 520, Article 11-14.

⁵¹⁶ Kong Fantai, 2010. "Waibu Dongshi Zhidu Shi Yaoshi", *Directors & Board*. 09 2010. and see Li Qiulei, 2010. "Duli Dongshi yu Waibu Dongshi Zhidu Bijiao Yanjiu—Jiyu Woguo Shangshi Gongsi he Zhongyang Qiye", *Yunnan Finance & Economics University Journal of Economics & Management*. 03 2010. The relevant document can see Dongshihui Shidian Zhongyang Qiye Zhuanzhi Waibu Dongshi Guanli Banfa, released on 06.11.2009 by SASAC. See <http://gzw.bjdc.gov.cn/n5687274/n5723562/n5745439/n5745634/8854405.html> (accessed 9 September 2015)

⁵¹⁷ Supra 520, summarized from Article 5, 6.

⁵¹⁸ Ibid. Full articles see Article 7, 8, 9.

development required for listed companies. The basic requirements for a full-time external director were stated clearly:

- ‘1 having a good political quality, abiding by disciplines and laws, being faithful
And diligent and having a good occupational reputation.
- 2 having the professional knowledge required for the performance of the relevant duties and being familiar with the macroeconomic policies and relevant laws and regulations of the state, being familiar with the information about the domestic and overseas markets and about the relevant industry,
- 3 having strong capabilities of decision-making, risk management, discovering and using talents, and making innovations,
- 4 having 10 years or longer enterprises management or relevant work experience, or being a professional in strategic management, capital operation, law or other aspect and having made good performances,
- 5 not having attained the age of 55 at the time of initial taking of the position,
- 6 having a bachelor’s degree or above or having a senior professional title,
- 7 having good psychological quality, and being in good health,
- 8 Other requirements as prescribed by the Company law and the articles of association.’⁵¹⁹

Because of the sources of external directors are limited, it is hard to select a qualified external director. For example, ‘at least one external director shall have a work background as chief financial officer or be an expert in financial accounting of

⁵¹⁹ Supra 520, Article 10.

enterprises...'⁵²⁰. However, in practice some external directors are without such a financial background.⁵²¹ in addition, senior managers of companies, can find themselves in the same situation as most senior managers of listed companies are not professional experts, and without relevant experiences.⁵²² Due to the strict limitations of employment conditions, most central SOEs cannot reasonably select the external directors.

Secondly, it is not easy to find the external directors with good qualifications for the central enterprises, nevertheless, the central enterprise need qualified external directors, so the qualified candidates often act as part-time external directors for several central enterprises. Some part-time external directors have been known to work for seven central enterprises at the same time.⁵²³ This part-time status means the part-time external directors cannot participate in the decision-making and management of central enterprises very well, because the huge workload absorbs the part-time external directors' energy and research time. However, how to deal with the issue of the part-time external directors and the numbers of part-time jobs of enterprises was not explicitly stipulated in the relevant laws and regulations.

Finally, civil servants and administrators serve as part-time external directors and the percentage is too high. The external directors of more than half of the listed central

⁵²⁰ Supra 518, Article 26.

⁵²¹ From the interview with the officer who works for SASAC, the interview time was 2012.

⁵²² Supra 518, Article 26, '...at least one external directors shall have experience in the selection, appointment, performance evaluation and remuneration management of senior managers of enterprise...'

⁵²³ Supra 530.

companies (the total number is 109) were civil servants and administrators.⁵²⁴ The disadvantage of this situation is that civil servants and administrators don't have enough time and energy to understand and research the enterprises; moreover, because they lack management experience, they cannot play the director's role well.

- *The rights and responsibilities of the Board of Directors are not clear*

In accordance with the provisions of the Company Law, there are four rights for the board of directors, namely, the rights of making important decisions in the operation and management,⁵²⁵ investment management rights,⁵²⁶ the right for performance appraisal and compensation decisions for managers,⁵²⁷ and the election rights for managers⁵²⁸. Most senior managers of the listed central companies have government background. For example, the chairman of the board of directors or general manager often have achieved administration headship level in the government, as the discussed above, and they may think more about their own promotion than the development of companies. If so, the basic obligation and responsibility of the board of directors can be evaded.

5.3.3 Problems of the Board of Supervisors

The board of supervisors is significant and irreplaceable for SOEs in supervision and inspection. The supervisors make a huge contribution to ensure the value of

⁵²⁴ Supra 519.

⁵²⁵ Company Law of the People's Republic of China (2013 Amendment), see Article 110, and 111.

⁵²⁶ Ibid, see Article 112.

⁵²⁷ Ibid, Article 113.

⁵²⁸ Ibid. Article 113.

state-owned assets and maintain the rights and interests of state-owned assets. But in the operation, there are some problems which need improvement.

- *Organization and management and positioning of the board of supervisors are not reasonable*

The chairman of boards of supervisors shall be selected in accordance with the prescribed procedures and appointed by the State Council.⁵²⁹ And full time supervisors shall be held by the administrative organ for boards of supervisors.⁵³⁰ The boards of supervisors in the key large SOEs shall be dispatched by the State Council, accountable to the State Council.⁵³¹ So how is it possible to understand the relationship between boards of supervisors and the State Council? They are neither parent-child relationships, nor cooperative relationships between the various departments of the State Council. This organizational form and position setting has introduced barriers to supervision. There is no clear answer to some questions, such as: “Who is in charge of the chairman?” and “Who could constrain the chairman?” The unfortunate consequences caused by the fuzzy rules are very clear: on the one hand, it affects the supervision’s work of SOEs, on the other hand, it leads to a misunderstanding about the functions of the chairman of the supervisions, including an understanding of whether the position of chairman is used to solve some issues about leading cadres retirement and job promotions.⁵³² Therefore, improving the authority relationship between the SASAC

⁵²⁹ Interim Regulations on the Board of Supervisors in State-owned Enterprises issued by State Council on 03-15-2000 See Article 15.

⁵³⁰ Ibid.

⁵³¹ Supra 538, Article 2.

⁵³² Lu, supra note 339, at120.

and the supervisions of SOEs is helpful and necessary to eliminate the doubts concerning the supervisors system of SOEs.

- *The human resource management system of the board of supervisors is not scientific and reasonable*

First of all, the membership of supervisors is not enough, and when they are under a burden of heavy workload, they cannot offer everything, and this affects the effectiveness of supervision. According to the report from Lu, the number of supervisors of central listed companies on average is four, the least is two, and the most is nine.⁵³³ The scale of the supervisors is small. Therefore, when the supervision must be before or in the process of the event instead of after the event, the supervisors will feel understaffed.

Secondly, the board of supervisors did not establish a scientific mechanism of choosing and employing members. Although the supervisors' duty requires every supervisor to carefully monitor the directors and managers' behaviour, and avoid the insider control to violate shareholders or other stakeholder's interests, most supervisors of listed SOEs are insiders. So they cannot play their oversight role, except the worker supervisors who are stipulated by the Company Law as 'the representatives of the employees' of the company at an appropriate ratio (not less than one third) to be specifically prescribed in

⁵³³ Ibid.

the bylaw'.⁵³⁴ The other supervisors of listed companies are generally the trade union chairman of the company, discipline inspection commission secretary, and secretary of the party committee concurrently. From an administrative level perspective, the supervisors are the subordinates of the chairman of the board of directors or general manager; their salary, positions are determined by the chairman or general manager. It is difficult to effectively fulfil their duties of supervision because the supervision are in a position of being led and commanded. Moreover, the full-time supervisors lack a career development plan, and this situation impacts on the professionalism and stability of the supervisors. Finally, the chairman of the supervisors does not receive any punishment when they make serious mistakes concerning SOEs.⁵³⁵

Finally, the board of supervisors has not established a reasonable performance management system and incentive mechanism. 'Those members of the boards of supervisors who have made outstanding achievements in carrying out supervision and inspection and important contributions to safeguarding the State interests shall be rewarded'.⁵³⁶ However, in the process of supervision and inspection, this incentive mechanism's operability is poor and the result is not good.⁵³⁷

⁵³⁴ Company Law 2013, Article 51.

⁵³⁵ Since 2013, represented by the case of China National Petroleum Corporation (CNPC), scandals about executives frequently occurred. It meant the board of supervision did not play its role well in SOEs. Between August and September 2013, five former executives and current executive of China National Petroleum Corporation (CNPC) had been *Shuanggui* because of serious disciplinary violations. *Shuanggui* is a special survey of the Chinese Communist Party Discipline Inspection Organs and Government Administrative Supervisory Organs. The term of "Shuang Gui" appeared in paragraph 1 of article 28 of the Chinese Communist Party Discipline Inspection Authority Case Inspection Regulations, "asked relevant personnel within the prescribed time, place, to explain the case involved in the problem". The details of CNPC's case can see <http://www.ccstock.cn/subject/zhongshiyouwoan/> (assessed 9 th September 9, 2015). For the research on punishment for the chairman of supervision see Yan Xuefeng, 2013. "Wenze Yangqi Jianshihui Zhuxi", *Directors & Boards*, 10 2013.

⁵³⁶ Interim Regulations on the Board of Supervisors in State-owned Enterprises issued by the State Council on 03-15-2000 Article 23.

⁵³⁷ Yan Ran, 2014. "Qianxi Jianshi zhi Jili Zhidu", *Chinese Time*,1 (2) 2014.

- *The lack of formal communication mechanism between the board of supervisors and external directors*

The communication between the board of supervisors and external directors is arbitrary. The listed central companies did not establish a formal communication mechanism.⁵³⁸ The external directors and supervisors are appointed by the SASAC, and they share the aim of ensuring the value of state-owned assets and maintaining the target and interest of state shareholder. Therefore, it is necessary to establish a formal communication mechanism to promote an expansion of communication.

5.4 Problems about Stakeholders

- *Employee participation*

Firstly, in China, a good corporate governance of listed SOEs' employee participation lacks effective laws and policy to support the legal status of the Employee Stock Ownership Plan (ESOP).⁵³⁹ Chinese law confirmed three methods to improve the

⁵³⁸ Wang Shoujun, 2013. "Zhongyang Qiye Gongsi Zhili Yanjiu", *Harbin Institute of Technology*.

⁵³⁹ Employee stock ownership plan, an effective enterprise system arrangement, is widely popular in developed market economy countries such as in Europe and America. It is helpful in motivating employees to supervise operators' behavior consciously, and participate in business management so as to improve the operational efficiency of enterprises. For more details about ESOP, see Xie Gang, Zhong Weizhou, Wandifang, 2003. "The Nature, Function, and Application of Employee Stock Ownership Plan", *Forecasting*. 22(3) 2003. And according to Wu Chunbo and Zhao Yaping, the first ESOP was from America, and proposed by a lawyer. See Wu Chunbo and Zhao Yaping, 2001. "Zhengque Lijie Yuangong Chigu Jihua", *Human Resource Development of China*. (9) 2001.

workers' participation in the corporate governance involving the congress of workers and staff,⁵⁴⁰ worker participation in management, and equal consultations between worker and companies. However, there was no corresponding legislation to provide further details and steps more clearly. Therefore, the legal status of the ESOP is not guaranteed, which is a legal obstacle for the implementation of the ESOP. Moreover, because Company Law laid down a strict limit to the purchase the company's own shares,⁵⁴¹ the source of shares of ESOP had been fixed on the original shareholders' transfer. The result is that the source of shares of ESOP is narrow, and cannot reserve shares in the company for later.

Secondly, the management of the ESOP is confusing. On the one hand, because of the lack of support from national legislative, there is no unified standard for management. The listed SOEs in different cities manage the ESOP differently. Some companies entrusted management to securities business institutions to manage; some entrusted the local authority card custody centre to manage, and others entrusted the accounting department of companies to manage.⁵⁴² The employee group should be an unofficial, not-for-profit organization and be voluntarily composed of internal employees, whereas existing employee groups are mostly held in the name of the workers union.

The ESOP needs a reasonable legal status to function. On the other hand, the proportion

⁵⁴⁰ Constitution of the People's Republic of China (2004 Amendment) issued by National People's Congress on 03-14-2004 Article 16; Labor Contract Law of the People's Republic of China (2012 Amendment) issued by Standing Committee of the National People's Congress on 12-28-2012 Article 4; Company Law of the People's Republic of China (2013 Amendment) issued by Standing Committee of the National People's Congress on 12-28/-2012 Article 18, 44,51, 67.

⁵⁴¹ Company Law of the People's Republic of China (2013 Amendment) issued by Standing Committee of the National People's Congress on 12-28-2012 Article 138,139,140,141,142,143.

⁵⁴² Lu, *supra* note 339, at124

of ESOP for every employee is the same. To some extent, this situation weakens the result of the incentive and reduces the enthusiasm of the employees. The ESOP should have some variation between different individual position and different responsibilities.

Finally, some listed SOEs issued employees with shares which are for employee's welfare, not in order to realize a long-term cooperation between the staff and listed companies. A successful ESOP needs to establish a long-term cooperation system and an effective incentive mechanism for managers and employees, with the aim of forming a community of risks and benefits to employees and companies, and to improve efficiency. There is obviously a price difference between worker shares and ordinary shares; in addition, the policy did not strictly limit the circulation of worker shares. In general, many shareholders will sell all the shares to get the cash in the secondary market. The incentive effect of ESOP had been weakened by this practice of seeking short-term interests.

- *Management of relationship between listed companies and Stakeholders*

The first problem is that interaction in the process of communication between investors of listed companies and companies is not enough. Looking at the official website of 113 listed central companies,⁵⁴³ reveals that because of the requirements of listed company information disclosure, all central enterprises set up their own website. However, the

⁵⁴³ <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html> access on 12-10-2014.

interactivity of the website is poor, in that the investors can only receive the information passively to understand the enterprise, but they cannot interact with the enterprise's personnel responsible for information disclosure.

The next problem which should be discussed is that the special relationship between regulators and central enterprises reduces the likelihood of the central enterprises being punished. When a central enterprise is wandering at the edge of the legal norms, and even if regulators can follow the rules and laws, the degree of punishment is still difficult to define. Most central enterprises are injected with funds by the SASAC, and the supervision by local regulatory bodies of central enterprises has declined because of the lower permissions and effectiveness of local regulatory body. Central enterprises also underestimate the local regulatory because of central enterprises' own special identity.

Last but not least, the attention the central enterprises pay to crisis management is limited in China. The 113 central enterprises have not established the evaluation standard for crisis management and risk events. The methods and results concerning risk events solved by managers are not included in the performance appraisal of central enterprise. As a result, the possibility of damaging the economic interests of the central enterprises caused by risk events will increase, and then the social concern and market value of central enterprises will reduce.

- *Social Responsibility*

First of all, there is no standard definition of central enterprises' social responsibility.⁵⁴⁴

In the operation of the central enterprises, there is no clear guidance for dealing with violation of regulations in a central enterprise, and in general, solving any problems relies on the senior managers' personal understanding. The main problems concerning the content of the social responsibility are vague, the targets of responsibility are uncertain, responsibility and tasks are not quantitative. According to the specific content of corporate social responsibility of central enterprise in 2010, 2011 and 2012,⁵⁴⁵ there is a big difference between different central enterprises, most of which lack a detailed description of the social responsibility. Therefore, when the social responsibility report is completed in form, it has violated the original intention of the SASAC to promote the central enterprise to discharge social responsibility. The reports just stated the goals of the enterprises, but did not list specific measures and industry standards in order to achieve pre-defined goals. Thus the fulfilment of social responsibility obligations by enterprises cannot be measured. Some reports of social responsibility are a simple textual description, which just use the words 'significant', 'a lot', 'very' to describe the report, but there are no charts, and digital quantitative analysis, so the reports lack credibility and persuasion.⁵⁴⁶

⁵⁴⁴ So far there is no a set social responsibility evaluation system of central enterprises. According to the Guidance on the Performance of Social Responsibility of Central Enterprises, the central enterprise's social responsibility is divided into eight aspects. However, secondary and tertiary segment index did not constitute the index system. See Wang Bing, 2013. "Woguo Zhongyang Qiye Shehui Zeren Pingjia Zhibiao Tixi Gaijin Tanta", *Jiangxi University of Finance*.

⁵⁴⁵ Heng Jianxin, and Li Zhijian, 2012. "Yangqi Shehui Zeren Xinxi Pilu Xianshi Kunjing Ji Duice", *Communication of Finance and Accounting*. 09 2012.

⁵⁴⁶ The argument comes from Xu Jialin and Liu Haiying, according to them, social responsibility reports of 125

Secondly, as discussed in the former section, in China the leaders of central enterprises hold administrative positions at the same time; therefore, the leaders tend to hide bad news about central enterprises in the report which is published for the public, because the bad news may affect their own achievements. Because of incomplete information disclosure, the information users realise the information is incomplete. Most central enterprises just disclose information about public welfare, donations, and energy conservation, but the negative information is less.⁵⁴⁷

Thirdly, as a result of indistinct definition of the standards and evaluation system of social responsibility, some central enterprises tend to pursue campaigns for short-term commercial benefit, but call it fulfilling social responsibility. The Chinese government did not establish a complete system and set of standards to guide and promote central enterprises to take social responsibility. The government pays more attention to taxes and social security. The public did not realize the importance of supervision on implementation of social responsibility by themselves; therefore, the effective supervision by public had not been realized.⁵⁴⁸

central enterprises between 2006 and 2010 had been analyzed, the reports lacked credibility and persuasion was the common problem. See Xu Jialin and Liu Haiying, 2010. “Woguo Yangqi Shehui Zeren Xinxu Pulu Xianzhuang Yanjiu—Jiyu 2006-2010 Nian Jian 100 Fen Shenhui Qiye Zeren Baogao de Fenxi”, *Journal of Zhongnan University of Economics and Law*. 06 2010.

⁵⁴⁷ Ibid. And also can see Heng Jianxin, and Li Zhijian, 2012. “Yangqi Shehui Zeren Xinxu Pulu Xianshi Kunjing Ji Duice”, *Communication of Finance and Accounting*. 09 2012.

⁵⁴⁸ Wang Kelei, 2011. “Shilun Woguo Gongsi Shehui Zeren”, *China University of Political Science and Law*. And the same opinion can see Wang Yixu, 2014. “Yangqi Shehui Zeren Pingjia Zhibiao Tixi Chutan—Shehui Gongzhong Shijiao”, *Chinese & Foreign Corporate Culture*. 10 2014. More discussion of this issue are contained in Jiang Zhiyu, 2014. “Tanxi Yangqi Lvxing Shehui Zeren de Weilai Zouxiang”, *Guide to Business*. 05 2014.

Finally, most central enterprises' social responsibility refers to the Guidelines for Central Enterprises to Fulfil Social Responsibilities issued by the SASAC, or social responsibility instructions to listed companies issued by the stock exchange. The reports on social responsibility are supposed to achieve the goal that the board of directors and all the directors should guarantee their reports' content has no falsehoods, misleading statements or major omissions, and they can take individual or joint liability for the authenticity, accuracy and completeness of content. Since the central enterprises did not hire a third party to inspect the report, the credibility of the report was not confirmed. The aim of releasing the social responsibility report is to help the central enterprises fulfil social responsibility better, but if the authenticity and reliability of the report has not been required, it may lead to consumers and investors feeling deceived.

Chapter 6: The Characteristics and the Suggestions of the Corporate Governance of Chinese State-Owned Listed Companies

6.1 Characteristics

6.1.1 Strong Government Intervention and the Government-led Driving Force

The formation and development of China's corporate governance mechanism of SOEs has experienced continuous trial and error, and constantly improved the process in the Chinese capital market.⁵⁴⁹ The reform and opening-up policy and construction of the capital market are the social environment for the early development of Chinese CG. The planned economy and strong government administrative control are the features of Chinese SOEs in 1980s. The reform and opening-up policy was dominated by the government's top-down process which meant that reforms in the fields of corporate governance were also driving force employed by the government-led top-down process.⁵⁵⁰ The reform lack driving force for the construction of corporate governance.

At the beginning of development of China's capital market, the Chinese government tried to decentralize administrative, but due to the lack of unified national legal rules, the result was that the local government could not control the SOEs very well. The construction of the capital market system was not mature against the background of the

⁵⁴⁹ Guo Shuqing, 1999. "Zhongguo Shichang Jingji Zhong de Zhengfu Zuoyong", *Reform*. 03 1999. Pp. 48-57.

⁵⁵⁰ Zhou Tianyong, 2010. "Lun Gaige Kaifang Yilai Zhengfu Zhudao dui Zhongguo Jingji de Tuidong Zuoyong", *Studies on Socialism with Chinese Characteristics*. S1 2010. Pp. 57-70.

capital market emerging in the transition time, because the domestic market management was weak, the market adjustment ability was not good, intermediary agencies and other social organizations were unable to play a strong role, and capital market was in a state of having no regulation and supervision.⁵⁵¹ In this case, the central government asserted its authority through repatriating powers from the local governments into their own hands. That included beginning to practice administrative control, and developing and implementing a wide variety of multifarious, detailed administrative regulations and administrative discipline.⁵⁵² The central government, once a bystander in the early period of development of capital market, became a strong leader and a controller.⁵⁵³

The formulation and implementation of the laws and regulations on Chinese corporate governance of SOEs, are often oriented by problem and task, namely with the appearance of specific issues and experience related to repeated trial and error about corporate governance, the regulations and laws targeted at the those problems and lessons, then formulated and adopted. The formulation and implementation of the laws and regulations on Chinese corporate governance of SOEs is step by step, developing from less to more, and from the very general to specific and professional.

In the process of establishing rules and regulations on CG, the government departments

⁵⁵¹ Huang Fanzhang, 2012. “Zhengfu Zhudao yu Zhengfu Shoushen—Jianlun Chongsuo Guoziwei he Chengli Guojia Ziyuan Guanli Weiyuanhui”, *Tribune of Study*. 12 2012. Pp. 33-38.

⁵⁵² Ibid.

⁵⁵³ Chi Fulin, 2013. “Gaike Zhongdian: Lishun Zhengfu yu Shichang Guanxi”, *Zi Guang Ge*. 11 2013. Pp. 31-33.

and related organization operating in the forefront of Chinese SOEs' CG, acquired more relevant information, professional knowledge and practical experience. In addition, those departments and organizations have the stronger professional ability for drafting law than the legislature, and therefore they dominated the corporate governance of the legislative process. Under the situation of lacking of laws, regulations and a code of corporate governance and lacking of independent enforcement mechanism, the government-led model, becomes a strong power, which can be used to quickly fill the gap of the law and the market mechanism.

6.1.2 Transplantation of Chinese Corporate Governance

The development of corporate governance is in line with the development of modern enterprises with the basic characteristics of the separation of ownership and managerial authority. Solving the problem of operator's incentive and supervision mechanism is the core of CG. Different solutions were born from different countries with their own politics, economy and culture. This led to different corporate governance models in the world. At the beginning of establishing the modern enterprise system, China adopted a system transplant strategy. The introduction of corporate governance model, established *XinSanHui* as the basic framework of corporate governance system, and then learned lessons from other countries and regions on a good governance system.⁵⁵⁴

Because there are so many differences between our country's current situation and the

⁵⁵⁴ Shi Xiaohong, 2009. "Zhongguo Gongsi Zhili de Chansheng he Yanbian Lujing: Cong Falv Yizhi dao Bentuhua Tansuo", *China Economic & Trade Herald*. (20) 2009.

introduced corporate governance's cultural background and economic basis, many problems are arising, such as that of employee participation system becoming formality.⁵⁵⁵

Compared with capitalism, if socialism in the pursuit of superiority wants to win greater development, it must boldly absorb and draw lessons from all achievements of other countries including the production modes of operation and advanced management methods of developed capitalist countries which reflect modern social regulations.⁵⁵⁶ According to Montesquieu, law made for the people of a country, should be very applicable to its people. So if the law of one country can apply to another country, it is just a coincidence.⁵⁵⁷ If from these two perspectives, the CG of SOEs has been copied from other countries, but with Chinese characteristics caused by the legal transplantation, it merits the corresponding explanation.

Corporate governance is a kind of culture. The United States, Europe and Japan's corporate governance models have their own culture. Liberalism is deep-rooted in America; it is generally supposed that the concentration of private economic rights will make the public extremely nervous. So the political power of the United States repeatedly blocked the development of the financial institutions to acquire enough

⁵⁵⁵ Zhang Wenting, Shi Guanglong. 2012. "Fansi Falv Yizhi Moshi xia de Ziben Shichang Chuangxin Jizhi—Yi Zhonggaigu Chouwen Beihou de Gongsi Zhili Wenti Weili", *Zheng Quan Fa Yuan*, 7(2) 2012.

⁵⁵⁶ Deng Xiaoping, 1994. *Selected Works of Deng Xiaoping, Volume III. (1982-1992)*, Beijing: Foreign Language Press. P373.

⁵⁵⁷ Charles de Montesquieu, 1961. translated by Zhang Yanshen, "*the Spirit of Law*". The Commercial Press. P6.

stock to exert influence in most large companies.⁵⁵⁸ Furthermore, the company's shareholding structure is also highly dispersive. Under this background, corporate governance in America emphatically limits the infringement of board of directors of the interests of the shareholders.⁵⁵⁹ In German companies, the board of directors, board of supervisors, and the union used to cooperate.⁵⁶⁰ In addition, in Germany the Government created large Banks as a driving force to develop German industry, which would like to supervise the projects which use their bank loans for investment, and to participate in the enterprises' corporate governance.⁵⁶¹ Therefore, for the CG in Germany, the board of supervisors provides effective supervision mechanism for the staff and the external supervisor.⁵⁶² Japanese companies' equity structure was mainly controlled by Zaibatsu families after the Second World War, so the stock quickly became concentrated by the Banks and insurance companies, with cross-shareholdings as the main method tying the industry and finance sector together.⁵⁶³ Zaibatsu families often through Banks and insurance company over the company crisis' period; moreover, their workers with heartfelt mental and cultural traditions, will stay and over the hard time with company. Furthermore, companies also tried to take various measures to improve the cohesion.⁵⁶⁴ Japan's corporate governance reflects consistency between

⁵⁵⁸ Zhao Yuan, 2009. "Dongshihui Zhongxin Shuo yu Gudong Zhongxinshuo: Xiandai Meiguo Gongsi Zhili Xueshuo Zhibian", *Journal of Comparative Law*, 04 2009. Pp. 93-99.

⁵⁵⁹ Song Yongxin, Yang Rong, 2003. "Research American Corporate Governance from Enron Crisis", *Wuhan University Journal (social sciences)* 56 (1) 2003.

⁵⁶⁰ Cui Xuedong, Sheng Feng, 2006. "Deguo Gongsi Zhili Moshi Cunzai de Wenti yu Gaige", *Contemporary Economic Management*, 04 2006. Pp. 108-111.

⁵⁶¹ Ibid.

⁵⁶² Li Chuanjun, 2005. "Liyi Xiangguanzhe de Gongtong Zhili—Deguo Gongsi Zhili de Jingyan", *Information for Entrepreneurs*. 09 2005. Pp. 60-61.

⁵⁶³ Cui Xuedong, 2007. "Jiaocha Chigu de Bianhua yu Riben Gongsi Zhili Gaige", *Contemporary Economy of Japan*. 02 2007. Pp. 43-47. and more information about the cross-shareholding of CG for Japanese companies can be seen in Sun Shichun, 2001. "Cong Dangqian Riben Gongsi Zhili Jiegou Kan Farenjian Huxiang Chigu de Zhengfu Xiaoying", *Japan Studies*. 03 2001. Pp. 6-11.

⁵⁶⁴ Sun Li, 2001. "Jiandu, Jili yu Gongsi Zhili- Qianxi Riben Gongsi Zhili Jiegou de Youxiaoxing", *Japan Studies*.

the actual control and staff under the common goal.⁵⁶⁵

Compared with the countries mentioned above, the highly centralized management mode is the main method of management in China - both family management habits in the past and the governance mode of the contemporary economy.⁵⁶⁶ Related ethics and social acquaintances constitute the internal and external environment of corporate governance - shareholders, senior management and staff. In a company, internal governance lacks the habit of democratic decision-making, and excludes external supervision mechanism.⁵⁶⁷ However, the core of the modern corporate governance - the separation of powers - is totally different with the Chinese enterprises' cultural background. So, when the CG system had been transplanted and applied in Chinese companies, some new problems appeared.⁵⁶⁸ Major cultural differences require that the CG of Chinese SOEs must absorb the experience of home and abroad, and explore the modern management with Chinese characteristics. Innovation in the process of trial and error is the correct method to explore the governance system of listed companies which are suitable for China's national conditions.

6.2 Suggestions

04 2001.

⁵⁶⁵ Ping Tian Guang Hong, Li Weian, 1998. "Ribei Gongsi Zhili: Biange yu Qishi", *Nan Kai Business Review*. 06 1998. Pp. 6-15.

⁵⁶⁶ Yang Hua, 2011. *Reconstruction: New Path for Corporate Governance*, Beijing: China CITIC Press.

⁵⁶⁷ Ibid.

⁵⁶⁸ For The case about Zhonggai Gu see Zhang Wenting, Shi Guanglong, 2012. "Fansi Falv Yizhi Moshi Xiade Ziben Shichang Chuangxin Jizhi- Yi Zhonggai Gu Chouwen Beihou de Gongsi Zhili Wenti Weili", *Zheng Quan Fa Yuan*, 7(2) 2012.

The characteristics and problems of corporate governance of Chinese listed companies are good evidence to support changes and further development of corporate governance in China. Although in accordance with the requirements of the modern enterprises system and through a transplantation of western corporate government modes, Chinese listed companies so far established the general meeting of shareholders, board of directors, board of supervisors and managers in form, the original SOEs management system in the state holding listed companies is still dominant, and plays an important role. Under the operation of such a mixed mode, the reform of SOEs itself is not the only method, and more suggestions for solving the problems will be discussed below.

6.2.1 Fundamentally Solve the Problem of Related Party Transactions

The related transactions and horizontal competition, as the main and difficult problems restricting long-term development of China's capital markets, are the key reasons for weakening the independence of the state holding listed company. Part of the issues of related transactions and horizontal competition are caused by the irregular and halfway reform of SOEs.⁵⁶⁹

For the different types of cases which have problems left over from history, the first step is to understand the details and specific situation, then solve them one by one: for example, creating a solution for the specific case, and encouraging, guiding and

⁵⁶⁹ The emergence of China's securities market is the system arrangement which was introduced in the period of economic transformation, with the aim of pushing the reform of state-owned enterprises and state-owned enterprises listed on the stock market. In order to achieve the standard for listing, Chinese SOEs mainly adopts the model of overall listed and business spin-off listed in the past, so the resulting companies lack the ability to operate, making it difficult to avoid horizontal competition and related transactions. See Wang Hao, "Woguo A Gu Shichang Qiye Jieke Shangshi Xiangguan Wenti Yanjiu", *Southwestern University of Finance and Economics*, Pp. 19-78.

supervising the company to seize favourable opportunities, through methods such as merger, acquisition, reorganization, to make the integrating controlling shareholders, related party and their affiliates assets integrate, and after the integration, make all of them into the system of listed companies.⁵⁷⁰ At the same time, the regulatory authorities should focus on the holistic listed companies, to prevent the listed companies using the chance of holistic listing to do insider trading, manipulate the stock price, obtain illegal interests, or disrupt the capital market with the related parties.⁵⁷¹

In addition, as the related party transactions in recent years are more subtle and indirect, the measures for dealing with this trend should be as follows: firstly, in the operation of supervision, strengthen the analysis of cases about specific related transactions,⁵⁷² and find the commonality and breakthroughs, collect more experience for solve the problem about how to define the specific related party, and perfect relevant legislation.⁵⁷³ Moreover, there should be a strengthening of independent directors for

⁵⁷⁰ Yang, supra note 486, at 88.

⁵⁷¹ Ibid.

⁵⁷² In order to circumvent the law, the form of related party transactions of listed companies renews itself ceaselessly, and subsidiaries and joint-stake Company become the main related party. See Huang Na, 2012. "Zouyi Woguo Shangshi Gongsi Guanglian Jiaoyi Xinxu Pilu Cuzai de Wenti he Gaijin Jianyi", *Securities & Futures of China*, 10 2012.

⁵⁷³ The definition of related party is important. First of all, the Chinese Company Law just simply defined the affiliated party, and the Chinese Securities Law did not define about related parties. The Shanghai and Shenzhen's Stock Listing Rules, adopt a way of enumeration which specifies the scope of the related parties, but unavoidably omissions appear. Secondly, accurately defining the related party transactions is the key to solving the unfair related transactions of listed companies. There are some defects the existing laws, embodied in regulations and rules for the legal regulating of the unfair related transactions. The existing legal norms' level is low, the legal framework about related transactions lacks overall plan, and the information disclosure system of listed companies and related transaction of listed company shareholder voting rights system and responsibility-tracing system still have deficiencies. The imperfection of the legal regulation system about related party transactions of listed companies could lead to unfair related transactions escaping legal regulation, which would affect the legitimate rights and interests of minority shareholders and creditors, and even affect the safety, stability and prosperity of economic market in Chins. Therefore, it is necessary to abide by the principle of good faith, fairness and efficiency and the principle of procedural justice, on the basis of these principles, and improve the legal system from these three aspects: first of all establishing procedural rules in advance and restricting related transactions of listed companies

the prior review duty and afterwards to investigate responsibility for related party. The independent director should be supervised and urged to really diligently to fulfil the obligations to review related party transactions, issue independent opinion and realize justice. Furthermore, the supervision for the agency or intermediary institution, such as asset appraisal firms, should be strengthened. The assets appraisal industry standards and the system of selecting agencies need to be perfected. The objectivity and impartiality of evaluating the value of related party transactions should be improved. The last suggestion is about the improvement of the judicial relief mechanism and its effective use, including whether the litigation mechanism of shareholders meeting resolution can be revoked or can be decided to invalid,⁵⁷⁴ including shareholder derived litigation mechanism, the judicial review system of the fairness of connection

before they happen, such as improving the shareholders' voting rights challenge system and the listed company information disclosure system. In addition, improving the internal governance structure, strengthening the controlling shareholders' fiduciary duty and the independent director system, is conducive to the protection of the interests of minority shareholders and creditors. Afterwards relief measures can build a good judicial relief way, in order to regulate related transactions.

⁵⁷⁴ According to Article 22 of Chinese Company Law, specific provision for the resolution of the shareholders' general meeting revocable system has been made. The Article 22 created the resolution of the shareholders meeting revocable system in China, set up a legal basis for the shareholders. Compared with the Company Law 1993, it is an achievement. Shortcomings of the resolution of the shareholders' general meeting revocable system: the resolution without distinction between revocable system and non-litigation relief system, and lack of the judicial practice in the remedy system. Relief method about the shareholders meeting resolution revocable system was divided into non-judicial relief and judicial relief, non-judicial relief to include personnel to attend the shareholders meeting to make the revocable defects, as well as to withdraw and ratify the revocable defective resolution, the judicial relief is an important way of relief of revocable resolution. In China, shareholders only have revocable proceeding method, without the non-litigation relief way. Even in litigation relief way and only the shareholders as the only main body can institute legal proceedings. Chinese Company Law did not regulate to the guarantee system and main body qualification, and provision of the discretion to reject system.

The resolution of the shareholders' general meeting of revocable system in China should be built. First of all, it is more appropriate for Chinese's system of the shareholders meeting resolution revocable system adopts the model--revocable, does not exist, and is invalid. However, the resolution revocable system and the resolution was invalid system, these two types having been provided in current legislation, the type of non-existence of resolution should be given independence status. Second, the non-litigation relief way can effectively maintain trade order, and the company's operating stability, so the construction of non-litigation relief way for the shareholders meeting resolution relief system is urgently needed. Finally, the resolution of the shareholders' general meeting revocable system provides only the lawsuit relief way and the guarantee system, with no clear regulations regarding the above system, the discretion to set aside system should be introduced in China: "Revocation of the resolution of the shareholders' general meeting proceeding, the court may consider the content of the resolution, the company situation and all other circumstances, considers discomfort at the time, can be set aside", in order to achieve the litigation right and prevent the abuse of litigation right of exercise of the right balance.

More discussion about this issue can see Zhang Juan, 2007. "Gudong Dahui Jueyi Ke Chexiao Zhidu Yanjiu", *Master degree thesis of Master of China Excellent Full-text Database*. 04 2007 Pp. 1-51. And see Zhang Lei, 2014. "Gudong Dahui Jueyi Ke Chexiao Zhidu Yanjiu", *Master degree thesis of Master of China Excellent Full-text Database*.

transaction, and the system of disregard of corporate personality.

6.2.2 Perfect the Management System of the State-Owned Equity, Standardize the Scope and Procedure of Government Intervention

The typical patterns of representation of the state-owned shareholders of listed companies in Chinese capital market can be divided into the followings: the first kind of pattern is that the SASAC of local government at all levels is the representative of the state-owned shareholders of listed companies.⁵⁷⁵ The second kind is that the state-owned assets management company established by the government is the representative, such as State Development & Investment Corporate (SDIC)⁵⁷⁶ and China Cheng Tong (CCT)⁵⁷⁷, and the state-owned assets management company which is affiliated to Beijing municipal SASAC. The last kind of representative of the state-owned shareholders of listed company is the SOE Group which is authorized by government, for example, the China National Chemical Corporation.⁵⁷⁸ According to the modern corporate governance theory, the shareholder representative participation in the activities of the listed company is a kind of civil legal action. They need to accept restriction by civil laws and commercial laws, without any special status. However, for the three modes stated above, the status of the state-owned assets management institutions is special. Under the mode of direct holdings of stock, the state-owned assets management institution plays the role of the shareholders, under the mode of

⁵⁷⁵ Such as the two listed companies—Anhui Conch Cement Company Limited (600585) and Wuhu Conch Profiles and Science Company Limited (000619) which belongs to Anhui SASAC Conch Group, Yunnan Yunwei Co.Ltd. (600725) belongs to Yunnan SASAC. GRG Banking Equipment Co. Ltd. (002152) belongs to Guangzhou SASAC, and Chongqing Taiji Industry (Group) Co. Ltd. (600129) Chongqing SASAC.

⁵⁷⁶ See <http://www.sdic.com.cn/cn/index.htm> (accessed on 16 September 17, 2015).

⁵⁷⁷ See http://www.cctgroup.com.cn/wwwroot/c_000000010009/ (accessed on 16 September 17, 2015).

⁵⁷⁸ See <http://www.chemchina.com.cn/portal/index.htm> (accessed on 16 September 17, 2015).

authorized operation; the state-owned assets management institution plays the role of the supervision and administration.

Law of the People's Republic of China on the State-Owned Assets of Enterprises weakens the administrative and supervisory functions of the state-owned assets management institutions.⁵⁷⁹ Moreover, the Chapter VII of Law of the People's Republic of China on the State-Owned Assets of Enterprises, State-owned Assets Supervision, did not state the SASAC's duty of supervision and the state-owned assets investors' duty of supervision, but instead, the supervision of the standing committee of the people's congress at every level,⁵⁸⁰ supervision of the State Council and the local people's government,⁵⁸¹ the supervision of the audit organs⁵⁸² and supervision of the supervision of the general public⁵⁸³ had been emphasized. It is clear that the Law of the People's Republic of China on the State-Owned Assets of Enterprises is deprived of the regulatory functions with administrative function of the state-owned assets supervision and administration institution.

⁵⁷⁹ Law of the People's Republic of China on the State-owned Assets of Enterprises issued by Standing Committee of the National People's Congress on 10-28-2008, Article 6 'the State Council and the local people's governments shall, according to law, perform the contributor's functions, based on the principles of separation of government bodies and enterprises, separation of the administrative functions of public affairs and the functions of the state-owned assets contributor, and non-intervention in the legitimate and independent business operations of enterprises.' the same agreement of state-owned assets investors' duty can be traced into the Report of the Party's Sixteenth Congress and Interim Measures for the Supervision and Administration of State-Owned Assets of the Enterprises issued by State Council on 05-27-2003.

⁵⁸⁰ Ibid. Article 63, the Standing committee of the people's congress at every level shall legally exercise the powers of supervision, though hearing and deliberating the specialized work reports on the performance of the contributors' functions by the corresponding people's government and on the supervision and administration of state-owned assets, organizing the law enforcement inspection on the implementation of this Law, etc.

⁵⁸¹ Ibid. Article 64, the State Council and the local people's governments shall conduct supervision over the performance of functions by the bodies empowered by them to perform the contributors' functions.

⁵⁸² Ibid. Article 65, '...the audit organs conduct audit supervision over the implementation of the state-owned capital operating budgets and the state-invested enterprises falling within the subjects of the audit supervision.'

⁵⁸³ Ibid. Article 66, 'the State Council and the local people's governments shall make available to the public the status of state-owned assets and the information on the state-owned assets supervision and administration, and accept the supervision of the general public...'

Although there are some distinctions for functions of the state-owned assets management institutions, the different functions are still mixed. For example, the functions about management of state-owned assets, personnel decisions, and managing specific affairs are taken at the same time by SASAC. Managing state-owned assets is the civil right and obligation of state shareholders, but the state-owned assets management institutions take responsibility about personnel decisions, and managing specific affairs at the same time will cause the listed company problems about personnel intervention.⁵⁸⁴ Future legislation shall strictly divide the functions of the state-owned assets management institutions, and distinguish the duties of investors and supervisor. The SASAC and other government department shall play the roles of investors and supervisor. The administration commission's scope, content, methods, procedure, and corresponding liability ascertained system of intervention of supervisors to state-owned listed companies shall be defined clearly in the legal system.

6.2.3 Improve the Efficiency of Corporate Governance of State-owned Holding Listed Companies

The predecessor of the state holding listed company decided the particularity and complexity of the internal structure. The Party Committee, staff and workers' congress, trade unions and the board of supervisors of the original SOEs combined together with the corporate governance of the modern enterprises system including meeting of

⁵⁸⁴ See <http://www.bjcx.org.cn/qxweb/n101964c800p2.aspxb> (accessed on 16 September 17, 2015) Li Yining, 2013. "Li Yining : Guoziwei Yao Fangquan Bie Ganshe Guoqi Yunying Taiduo".

shareholders, the board of directors, board of supervisors and managers. These two modes combined and formed the internal governance structure of state holding listed companies with Chinese characteristics. These institutions and functions overlapped, which led to a degree of confusion and division of insider governance.⁵⁸⁵ Some institutions are just taking a necessary external form, but it is hard for them to play their proper role. Therefore, it is necessary for the internal structure of state holding listed company to integrate innovation, streamline institutions, cut costs and enhance the effectiveness of its legal intelligence performance, and further improve the management efficiency of state holding listed companies.

1. To promote a fusion between the Party Committee and the board of directors, and to establish an effective board of directors. In the state holding listed companies, the Party Committee is not only dealing with the ideological and political work of the members of the Communist Party of China, but also participating in the company's business decisions. All the important issues of the reform and development of the state holding listed company had to be discussed, collectively researched and decided by the Party Committee.⁵⁸⁶ The working methods and function of the Party Committee are similar to the board of directors. At present, a relatively effective measure can solve this problem which is to take a mode of mutual part-time, namely, to absorb the main

⁵⁸⁵ More detail of confusion can see Bai Yue, 2012, "Woguo Guoyou Duzi Gongsi Neibu Ge Jiandu Jigou Xianghu Guanxi Yanjiu", Capital University of Economics. And see Dong Baiyi, 2008. "Lun Woguo Duli Dongshi yu Jianshahui de Chongtu yu Xietiao", *Journal of Hebei University (Philosophy and Social Science)*. 05 2008. Pp. 83-86.

⁵⁸⁶ Yang Hua, 2011. *Gongsi Zaizao: Zhongguo Shangshi Gongsi Zhili de Xinlujing*. Beijing: China CITIC Press. P. 90.

members of the Party Committee into the board of directors as internal directors.⁵⁸⁷ In addition, this kind of part-time working would have to meet the qualifications, nomination and election procedures of the state holding listed company.

For effective operation, the board of the directors shall be relatively independent from the controlling shareholders and managers. Controlling shareholders or any insider control over the board of directors will lead to an imbalance of the internal governance structure. In order to guarantee the independence, scientific nature and effectiveness of the board's decision, the following aspects should be strengthened. First of all, the nomination, election and replacement system of directors should be perfected, and a board of director's team with diversified background and knowledge structure need to be established. This system and team should maximize all the parties' interests, and ensure that the board of directors will have independent professional judgment ability. Secondly, independent director management institutions, such as the independent director association, should be established and responsible for the management of the independent directors, and the assessment of salary payment. And the independent director database should be established and improved; controlling shareholders recommended or nominated independent directors should be randomly selected in the database to improve the quality of the independent directors. Thirdly, the relationship between the board of directors and managers should be straightened out. The chairman should be banned from being the general manger at the same time in the same state

⁵⁸⁷ Ibid.

owned listed company. A regular evaluation mechanism of the managers should be established, aiming to realize the separation and checks and balances between the rights of management, decision-making and executive authority.

2. It is necessary to promote the fusion between dispatched supervisors and the board of supervisors, and improve the effectiveness of the supervision of the board of supervisors.⁵⁸⁸ In practice, the SASAC, in order to enhance the monitoring of state holding listed companies, often directly or indirectly through state-owned shareholders, dispatches full-time supervisors to exercise right of supervision. Compared with the supervisors of state holding listed companies, the dispatched supervisors neither receive compensation from state holding listed companies (thus without direct interest relationship with the listed companies), nor are controlled by companies, being relatively independent of major shareholders. However, these dispatched supervisors replicate the functions of listed companies' own supervisors, yet carry with them the staff identity from the SASAC. This situation conflicts with the regulations of the Civil Servant Law of the People's Republic of China that a civil servant shall not undertake or participate in any profit-making activity or hold a concurrent post in an enterprise or any other profit-making organization.⁵⁸⁹ One suggestion to improve the supervision structure of the state holding listed company and reduce the cost of governance is that the SASAC should involve the dispatch of supervisors into the supervision of state holding listed company through proposing candidates, not directly or indirectly through

⁵⁸⁸ Ibid.

⁵⁸⁹ Civil Servant Law of the People's Republic of China issued by Standing Committee of the National People's Congress on 04-27-2005, See Article 42, and Article 53.

state-owned shareholders. The other suggestion includes to establishing and improving the administration system of the dispatch supervisors, making particular specifications on the identity, functions and power, accreditation program and measures of dispatch supervisors, in order to avoid conflicting with the Civil Servant Law, Company Law, the Listed Company Corporate Governance Standards and other related Laws and regulations.

Whether board of supervisors can exercise authority effectively depends on whether the members of the board of supervisors have corresponding independence and ability. At present, most members of board of supervisors for Chinese state owned listed company are supervisors who represent the interests of the major shareholders and employee supervisors. The full time supervisors hired from outside are rare. Before serving as a supervisor, some have worked for the Party Affairs Committee,⁵⁹⁰ discipline inspection committees,⁵⁹¹ and trade unions.⁵⁹² Even after serving as a supervisor, there are some

⁵⁹⁰ According to Chinese Constitution Law, the Company Law and relevant regulations of the Constitution of Communist Party of China (amended and adopted at the Seventeenth National Congress of the Communist Party of China on October 21, 2007), the Party Affairs Committee has the main body qualification to participate in corporate governance of the state holding listed company. This is a feature of CG of the state holding listed company in China. For more discussion about the Party Affairs Committee see Guo Yabing, 2014. "Lun Guoyou Qiye Dangwei Zhengzhi Hexin Zuoyong de Fahui", *New West*, (6) 2014.

⁵⁹¹ Discipline inspection work of state-owned enterprises is an important part of Party Committee of enterprise, which shoulders responsibilities including maintenance the party constitution under the leadership of the Party Committee, rectifying the style of discipline for the Party and cadres, checking the Party's line policies are carried out in the enterprise, and ensuring the sustainable development of the enterprise and its execution. See Han Zhenyang, 2010. "Qiantan Xinshiqi Guoyou Qiye Jijian Jiancha Gongzuo", *Shanxi Development & Reform*. 05 2010. Pp. 44-46. and See Wang Fuyi, 2011. "Ruhe Qianghua Guoyou Qiye Jijian Jiancha Bumen de Zhineng", *Market Modernization*. 4 2011.

⁵⁹² According to Article 7, Trade Union Law of the People's Republic of China, adopted on April 3, 1992 at the 5th Session of the 7th National People's Congress, and amended according to the Decision on Amending the Trade Union Law of the People's Republic of China at the 24th Session of the Standing Committee of the 9th National People's Congress on October 27, 2001. 'Article 7 A trade union shall mobilize and organize the employees to participate in the economic development actively, and to complete the production and work assignments conscientiously, educate the employees to improve their ideological thoughts and ethics, technological and professional, scientific and cultural qualities, and build an employee team with ideals, ethics, education and discipline.' The trade union in the SOEs was appointed by the Party Committee at the higher level. In state-owned enterprises, one of the legal responsibilities of the state-owned enterprise's trade union is to foster the patriotism of employees through education. The trade union's job is to safeguard the rights and interests of workers, and resolve

who take the part-time positions in these departments; some even do the part-time job of managing and operating the company.⁵⁹³ It is difficult to ensure the independence of the supervisors, and it is hard to guarantee that supervisors have enough time and energy to carry out supervision. Therefore, the governance structure of supervisors should be improved; the proportion of external professional supervisors should be increased, especially the proportion of operating personnel who are familiar with the industry or who have professional background including accounting, auditing and legal background. This part of the supervisor's nomination and compensation should be charged by the independent directors, and the power to appoint and dismiss them should be left to the general meeting of shareholders, thus cutting the subordinate relationship between this element of supervisors and the board of directors and senior managers. In addition, the existing board of supervisors system lacks the guiding rules with regard to the specific work of the supervisors,⁵⁹⁴ and because of this lack the rules should be further refined. Manoeuvrability need to be improved, for example, in what issues need to be supervised, and the procedures, measures, information channels, agencies and spending should be explicit.

3. To the workers' congress system should be perfected to ensure that employees can effectively participate in corporate governance. The employee is one of groups which

difficult problems. For more discussion of the trade union see Wang Erfu, 2011. "Gonghui Zai Guoyou Qiye Zhongde Weizhi", *China Urban Economy*. 12 2011. P. 92.

⁵⁹³ There is more detail in these articles, which hold the same opinion: Ma Bo, Wang Xiaoming, 2013. "Qiye Jianzhi Gonghui Ganbu Ruhe Zuohao Gonghui Gongzuo", *Chinese Workers' Movement*. 01 2013. Pp. 53-54. and see Xu Fengyang, 2011. "Xiandai Qiye Fazhan Xuyao Gonghui Zhicheng", *China Co-Operation Economy*, 11 2011.

⁵⁹⁴ Yang Hua, 2011. *Gongsi Zaizao: Zhongguo Shangshi Gongsi Zhili de Xinlujing*. Beijing: China CITIC Press. P. 91.

are closely related to corporate interests. The company's business situation is directly related with the interests of the employee. Compared with public shareholders, creditors and other stakeholders for state owned listed company, employee are familiar with the operation of the company, and the relationship between the company and employee is more durable. Therefore, the employee can gain a certain degree of decision-making participation and supervision. The method and procedures for employees to participate in corporate governance should be regulated, in order to improve the employee's interests and the effectiveness of corporate governance. According to the provisions of the Company Law about listed company employee representatives,⁵⁹⁵ the key for the employee to effectively participate in corporate governance is whether the workers' congress can play its proper role.

The workers' congress system is a traditional and effective organisational form for SOEs' workers to participate in a democratic management. According to the requirements of the modern enterprises system, '*Xin Sanhui*', as a new governance structure, had been established after the corporate reform of SOEs. The workers' congress basically lost its original important position. Although the Company Law still retains the workers' congress system for strengthening the protection of workers' legitimate rights and interests, the legal status and specific rights and procedures had not been defined in the Company Law. It is obvious that although Chinese law gives the rights to employees to take part in corporate governance, the right is falsified, and the

⁵⁹⁵ Article 18, 44, and 70 of the Chinese Company Law.

corresponding security conditions which can guarantee the rights are not enough. To solve the problem, the workers' congress needs to be further improved by the specific measures including: to make clear the checks and balances relationship and the mutual coordination relationship between workers congress and other parts (general meeting of shareholders, board of directors, and board of supervisors), to ensure that the workers can truly elect their own representatives – workers directors and workers supervisors -and to participate in the operation and management of the company.

6.2.4 Strengthen the Supervision of Insider Information Sources

The state holding listed companies may submit non-public information to the controlling shareholders and actual controllers, and this will cause insider trading. To solve this problem since 2007, the CSRC started in some jurisdictions - area under administration - to implement an insider information source registration system that requires listed companies to report to the securities regulatory bureau about the lists of listed companies, controlling shareholders and actual controllers, and other insiders, before they submit the non-public information. To put term “insiders “in context: for any major event being planned that may affect the stock price of the company, the listed company and its directors, supervisors, senior managers, trading counterparts, related parties, and directors, supervisors, senior managers or main principals of its trading counterparts, professional institutions and handlers it has hired, relevant institutions and persons participating in the formulation, demonstration, examination and approval

to other relevant links, as well as the relevant institutions and persons that have the access or may have the access to the major event due to business contacts.”⁵⁹⁶ This system will bring more regulatory pressures to listed companies, controlling shareholders and actual controllers. Moreover, this system will provide important clues and evidence for investigation and punishment of insider trading. It plays a key role for providing advance warning, timely monitoring and solidification of evidence, and it is helpful to check the leakage of inside information and insider trading. The market parties have accepted this system, but have not yet become a mandatory provision. In the actual execution, parts of insider cannot be included in the scope of registration, such as controlling shareholders and actual controllers, and staff of the relevant competent department in charge. The scope of registration and the pilot range of the system should be expanded in future, and the insider information source registration should be made a legal obligation for listed companies and its insiders.

6.2.5 Improve the State-owned Equity Transfer System

The corporate control market is the main part of the corporate governance of listed company,⁵⁹⁷ and plays a key role to optimise resources allocation and industrial distribution. Its functions of management and punishment and shareholder governance are the important external mechanisms to constrain managers and control shareholders’

⁵⁹⁶ Notice of China Securities Regulatory Commission on Regulating the Information Disclosure of Listed Companies and the Acts of All the Related Parties issued by CSRC on 08-15-2007, see III.

⁵⁹⁷ The importance of corporate control market had been stated in Notice of China Securities Regulatory Commission on the Relevant Issues concerning the Regulation of Acts of Transferring Actual Controlling Rights of Listed Companies issued by CSRC on 09-01-2006, now expired. The corporate control market for listed companies has developed further, and the takeover of listed companies is more transparent and standardizing. All this has accelerated the innovation of the merger and acquisition market. The transfer of the actual controlling right of listed companies concerns the sound management, sustainable development and the rights and interests of the wide minority shareholders, and touches the normal order of the securities market...’

behaviour. With the completion of non-tradable share reform, the state-owned equity transfer system, environment and trading partners have gone through great changes. The traditional methods - the original pricing method which is on the basis of the net assets - and the original transfer method which is negotiating transfer are no longer suitable for the development of the capital market.⁵⁹⁸ Therefore, it is necessary to build a mature, effective corporate control market, to realise the transition of state-owned equity transfer of listed companies, to make the state-owned capital achieve efficient configuration through capital market platform, and to perfect corporate governance of a listed company.

First of all, the current laws and regulations on state-owned equity transfer need to be improved; a good legal and market environment should be established. The transfer of the state-owned equity of listed companies involves many aspects. In order to promote state-owned equity transfer, the detailed rules should be formulated, the specific rules should be refined, and the approval procedures should be simplified.⁵⁹⁹ The state-owned equity transfer should be treated differently between industries involved in

⁵⁹⁸ Yang Hua, 2011. *Gongsi Zaizao: Zhongguo Shangshi Gongsi Zhili de Xinlujing*. Beijing: China CITIC Press. P. 93.

⁵⁹⁹ With the development of social economy since the reform and opening up, the traditional SOEs experienced a shareholding system reform, and a large number of state-owned property rights transferred into state-owned equity. At the beginning of the SOEs restructuring, state-owned equity transfer had been limited strictly by the policy in China to effectively prevent the loss of state-owned assets. However, under strict policy control, state-owned equity is difficult in realising the value of its diversity. Starting with the 1990s, the government gradually eased restrictions on state-owned equity transfer. When we look back through history, many policies and regulations about the transfer of state-owned equity have been formulated in different periods. At present, the management of the listed companies of state-owned equity transfer is "one case by one case has been handled by one institution for examination and approval". With frequent acquisition restructuring of listed companies, the cumbersome approval process is inefficient, such as multidisciplinary departments' examination and approval for change to the comprehensive examination and approval. More discussion about this issue can be seen in Zhang Xiaozhe, 2004. "Shangshi Gongsi Guoyou Guquan Zhuanrang Shenpi Guanli de Youguan Wenti", *Contemporary Economics*. 02 2004. Pp. 60-61. and see Zhao Deming, 2005. "Waizi Shougou Shangshi Gongsi Guoyougu de Chengxu Yinggai Jianhua", *Capital Shanghai*. 06 2005. P. 73. and see Mei Yi, 2013. "Woguo Guoyou Guquan Zhuanrang de Falv Wenti Yanjiu", *Master degree thesis of Master of China Excellent Full-text Database*, 07 2013. Pp. 1-35.

the national economy and general competitive industries; and the state-owned equity transfer of listed company should be classified, managed and monitored.⁶⁰⁰

Secondly, a more transparent information disclosure mechanism should be established, and the transparency of state-owned equity transfer should be increased. Contract transfer is the traditional method for transfer of the state-owned equity of a Chinese listed company.⁶⁰¹ Moreover, the auction after the judicial action is the result of private bargaining.⁶⁰² Therefore, asymmetric information in the process of transfer is a common problem, and establishment of a market-oriented pricing mechanism may solve this issue better. In the state-owned equity transfer of state holding listed companies, especially involving state-owned equity transfer into non-state-owned equity, buyers should be found through market information disclosure, and public bidding in the market, or transfer through property rights trading centre, in order to ensure transparency of the state-owned equity transfer and the rationality of pricing.

Moreover, the controlling shareholders' duty needs to be strengthened, likewise the protection of minority shareholders' interests. Today, the main method of state holding listed company equity transfer is still negotiating transfer. Therefore, it is necessary to strengthen the duty of care and duty of loyalty of controlling shareholders in the process

⁶⁰⁰ Since strategic adjustment of state-owned economy had been appointed on the Fifth Plenary Session of 14th Central Committee, state-owned economy gradually exited from competitive fields, and focused on matters related to the national security, natural monopoly, public services, such as telecommunications, petroleum, aerospace, steel, coal gas, war industry. See Bai Jinfu, 2006. "Striking Problems in Current State-Owned Enterprises Reform", *Academic Exchange*, (9) 2006. and see Gu Shen, 2012. "Xinxing Guoyou Zichan Jingying Gongsi Yanjiu", *Master degree thesis of Master of China Excellent Full-text Database*. Pp.44-73.

⁶⁰¹ Yang, *supra* note 486, at 94.

⁶⁰² *Ibid.*

of transfer. And the equity transfer should follow the principles of marketization, standardisation and transparency to protect the interests of minority shareholders. The money income and purpose of state-owned equity transfer should be announced to the public. The supervision measures should be formulated as soon as possible to achieve the goal of unified management for the funds of the state-owned equity transfer.

Finally, it is necessary to strengthen the real-time monitoring of secondary market trading, increase punishment, crack down on insider trading and market manipulation. Securities regulators should focus on abnormal price and volume movements in the process of the state-owned equity transfer, and on strengthening supervision coordination with the relevant government departments. For insider trading and market manipulation, early intervention should take place when necessary.⁶⁰³ And the punishment of the company and the punishment of the responsible person should be combined.

⁶⁰³ The term “early intervention” refers to a special kind of work method in criminal litigation that mean the disciplinary inspection and supervision organs of trial department accepts the cases which form the disciplinary and supervisory organs at the same level. When the case of inspection goes to a certain phase, a preliminary trial will be conducted, and the case should be transferred to the department after all inspection has been done. See Zhang Wei, Xu Fangu, 1995. “Tantan Anshen Gongzuo de Tiqian Jieru”, *Honesty Outlook*. 02 1995. Pp. 10-11. In China, early intervention was originally produced in a period of taking severe measures against grave illegal and criminal activities in 1983, and then gradually carried out by some local People's Procuratorate or the People's Court as an important method to deal with major cases or hard cases as soon as possible. See Liu Jiahu, 2012. “Tiqian Jieru shi zai Teshu Qingkuang Xia Caiqu de Gongzuo Fangfa”, *Jiang Huai Fa Zhi*, (03) 2012.” And see Zhang Zhonglin, Fu Kuanzhi, 1991. “Guanyu Tiqian Jieru de Sikao”, *Chinese Journal of Law*, 03 1991. The term “necessary” refers to the cases which found major violations of discipline problems by the audit department, so that the bureau of supervision of municipality can master the details on time. See Audit Office of Qingdao City in Shandong Province, “Shandong Qingdao Dazao Shenji Jiancha Xiezuo Peihe Pingtai”, *Audit Monthly*. 11 2012. p. 59.

Conclusion

Under the background of the reform and open policy, the SOEs experienced expanded autonomy and the period of the responsibility contract system. Then the interests' status of the SOEs had been further established. In addition, the SOEs' structure had been readjusted through the projects about: grasping the large, releasing the small, mergers, and standardizing bankruptcy procedures, laid-off employees, and re-employment. Large-sized SOEs established MES; small and medium sized SOEs completed further development through restructure, partnership, mergers and acquisitions, leasing, contract operation, the joint stock cooperation and sale. After 2003, with the establishment of the SASAC, the central and local state-owned assets supervision institutions were established, and regulations gradually implemented. According to the government's administrative rights, Chinese SOEs can be classified into the central enterprises and local SOEs. The total number of central enterprise was 196 at the beginning of the establishment of SASAC in 2003, and then reduced to 110 by the end of September 2015 through mergers and reorganization.⁶⁰⁴

Due to the state-owned assets being very active in the stock market, the government paid more attention to the securities markets. The problems of CG in Chinese state-owned listed companies are representative and universal in China's securities market. Therefore, this situation determines that China's legal framework for corporate governance, in fact, is to seek a balance between maintaining and increasing the value

⁶⁰⁴ See the list of Chinese central enterprises from SASAC, <http://www.sasac.gov.cn/n86114/n86137/c1725422/content.html> (accessed on September 30, 2015).

of state-owned assets and protecting the interests of the stakeholders. In some cases, the public welfare goal of the state-owned equity is more important than the profit-making goal.

The system construction and practice of CG for Chinese state-owned listed companies have created remarkable achievements. The revision of the current Chinese Company Law and Securities Law consolidate the legal basis for the CG. The listed company governance principles, the listed company equity incentive measures for the administration of the listed company's articles of association, and the listed company information disclosure management method have established a basic framework for the CG of listed companies. From the point of view of practice, performance appraisal, market-oriented employment executives, the overall listing, construction of enterprise culture have accumulated rich experience.

Although some achievements in CG had been made, the unique position of state-owned stake for the equity structure of listed companies still determines the status of the state-owned equity in the market for corporate control, thus leading to a series of issues about the Chinese characteristics of the CG of listed company. For example, on the one hand, listed company and the controlling shareholders of listed companies are closer to dealing with the issues about personnel, assets, finance, and management, whereby the listed company listed is the independent legal person nominally, it actually lacks of independence. On the other hand, there is a common phenomenon is that the

state-owned shares have a dominant status in a state-owned listed company; therefore, the CG cannot restrict the behaviours of majority shareholders - state-owned shares. The majority shareholders can easily use its advantageous status to seize the minority shareholders' interests. To solve these problems, this thesis puts forward suggestions and the theory and methods with the features of the localization research concerning the CG of Chinese SOEs.

Appendix I

Table 4-1 the Main Corporate Governance Evaluation System

Corporate Governance Evaluation Organizations or Individuals	The Content of Evaluation
Jackson del Martin	1.Social contribution,
	2.Service for Shareholders
	3.The board performance,
	4.The company’s financial policy
S&P	1.Ownership Structure
	2.The rights of Stakeholders and mutual relations
	3.Financial transparency and disclosure
	4.The board of directors structure and procedure
Deminor	1.Shareholder’s rights and obligations
	2.To take over the scope of defence
	3.Information, disclosure, transparency
	4.The board of directors structure
ISS	1.The structure and composition of the board and main committee

	2.The company's articles of association
	3.The law of the company belongs to state
	4.The salary and compensation of manager and board members
	5. Financial performance
	6.Governance practice
	7.Executive shareholders
	8.Director's education(background)
DVFA	1.the rights of Shareholders
	2.the governance committee
	3.transparency
	4.the management of company
	5.Audit
Brunswick Warburg	1.transparency
	2.transfer of assets/costs
	3.Equity dispersion degree
	4.Megers and reorganization
	5.bankruptcy
	6.Bid and ownership restrictions
	7.The Attitude for external personnel
	8.The nature of register

ICLCG	1.Information disclosure
	2.owerships structure
	3.The board of directors and manager’s structures
	4.the rights of shareholders
	5.the risk of misappropriation
	6.the history of corporate governance
ICRA	1.ownership structure
	2.management structure
	3.the quality of financial report and other disclosure
	4.The satisfaction of the interests of the shareholders
CGS	1.the rights of shareholders
	2.the quality of directors
	3.the effectiveness of internal control
Thailand	1.rights of shareholders
	2.the quality of directors
	3.the effectiveness of internal control
South Korea	1.rights of shareholders
	2.the structures of the board of directors and committee
	3.procedures of the board of directors and committee
	4.Disclosed to investors and equality ownership
City University of Hong Kong	1.the board of directors structure
	2.independence and responsibility
	3.minority shareholders’ treatment

	<ul style="list-style-type: none"> 4.transparency and information disclosure 5.stakeholders 6.Rights and human relations 7.the rights of shareholders
Taiwan FuJen University	<ul style="list-style-type: none"> 1.the compositions of the board of directions and supervision 2.ownership structure 3.participation in the management and major shareholders 4.Ownership structure and concentration 5.the major shareholders in supermarket
GMI	<ul style="list-style-type: none"> 1.transparency and disclosure 2.the accountability of the board of directors 3.the social responsibility 4.Ownership structure and concentration 5.the rights of shareholders 6.salary of managers 7.corporate behaviour
The world Bank	<ul style="list-style-type: none"> 1.The promise of corporate governance 2.the Result and Functions of the board of directors 3.Control environment and procedure 4.transparency and information disclosure 5.treatment of minority
Institute of World Economics and Politics Chinese Academy of Social Sciences	<ul style="list-style-type: none"> 1.the rights of shareholders 2.Equal treatment to the shareholders 3.stakeholders 4.transparecy and information disclosure 5.Duty of the board of directors 6.Duty of the board of supervision

Table 4-2 the Evaluation System of Corporate Governance of Chinese Listed Company

Evaluation	Factors
Shareholder	<ul style="list-style-type: none"> 1. independence of listed company 2. related party transaction 3. protection of the rights and interests of minority shareholders
The board of directors	<ul style="list-style-type: none"> 1. rights and obligations 2. operational efficiency 3. the structure of the organization 4. the salary and compensation of directors 5. the independent director
The board of supervisors	<ul style="list-style-type: none"> 1. running status 2. size and structure 3. competence
The manager	<ul style="list-style-type: none"> 1. the appointment system

	<ol style="list-style-type: none"> 2. implementation supporting system 3. incentive constraint
Information Disclosure	<ol style="list-style-type: none"> 1. reliability 2. relevance 3. timeliness
The Stakeholders	<ol style="list-style-type: none"> 1. the participation 2. the coordination

Table 4-3 The Evaluation System of shareholders Governance of listed Companies

Main Factors	Elements	The Content of Evaluation
Independence	The directors and the controlling shareholders	<ol style="list-style-type: none"> 1. whether the directors of listed company are the controlling shareholders in the same company 2. the independence of policy makers and controlling shareholders 3. whether the directors can keep a balance when dealing with the conflicts of interest between shareholders
	Inter-industry competition; horizontal competition; congener	Whether the main business of listed company and main business shareholders Company are the same or the parts of same
	The controlling chain between ultimate controllers and listed company	The degree of the divergence between the control rights and cash-flow rights of the firm's ultimate controllers to estimate the independence of listed companies. The controlling chain is longer , the ultimate controllers are more likely to be vulnerable to management risks, especially financial risks, reduce the interest of minority shareholders through a pyramid-style ownerships structure
	Overall listing	Avoid horizontal competition, congener competition or inter-industry competition, reduce the connected transaction
Protection of the rights and interests of minority shareholders	Shareholders voting system	Establish cumulative voting, adopt online vote
	Participation of the shareholders	
	Raise money	<ol style="list-style-type: none"> 1. whether there is abuse to raise money 2. observes listed company whether to charge the raise funds, 3. Whether the charge procedure is

	approved by the shareholders meeting.
Cash dividend payments	Cash dividend payments scale and continuity

Table 4-4 The Evaluation System of the Board of Directors Governance of listed company

Main Factor	Elements	The content of Evaluation
The rights and obligations of directors	Rights and obligations	The responsibility of directors
	The number of training	Liability of directors
	Compensation system	Duty of the directors
	D&O liability insurance	Obligations of the directors
	Age	
	Shareholder directors proportion	The proportion of shareholders in the board of directors
	The wording status of directors in other company	The time guarantee to execute the directors' obligation
Efficiency of the directors	Scale of directors	
	Whether the chairman and manager are separate	The part-time working status for the chairman and general manager
	The overlap positions between the directors and executive	The part-time working status
	Gender composition of members of the board of directors	Female proportion
	The procedures for the board of directors meeting	The legitimacy of the procedures
	The status of the meeting	Efficiency
	The structure of the board of directors	Strategy committee
Audit committee		
Remuneration and appraisal committee		
Nomination committee		
Other professional committee		
Compensation and salary system	Compensation and salary level	
	Compensation structure and forms	
	Performance evaluation standards	
Independent director system	The professional background of the independent director	
	The part-time working status	The working situation of independent director in other working place

Proportion of independent directors	
Incentive system	Cash/equity
Duty	Supervision and advisory

Table 4-5 The Evaluation system of the Board of Supervisory of Chinese Listed Company

Main Factors	Elements	Inspection Items
Running Status Or Operation Conditions	Whether a meeting is held and the times of the meeting	Basic Status of Completion of work
Size and Structure	1.Number of Members 2.employee supervisory	1.the performance of the supervisory 2.the situation of the board of supervisors on behalf of the employee supervised the company
Competence	1.professional working background of the chairman 2.the Degree qualification of the chairman 3.Age of the chairman 4.shareholding allocation of the chairman 5.professional working background of other supervisors 6.Degree of other supervisors 7.Age of other supervisors 8.shareholding allocation of other supervisors	The relationship between elements and competence

Table 4-6 the Evaluation System of the Managers Governance of Chinese Listed Company

Main Factors	Elements	Inspection Items
The Appointment System	Senior Manager	The hiring of the managers and other managers
	The Chairman and general manager	Part time working status
	Stability of senior manager	The charges of manager
Implementation Supporting System	Executives' constitute	Education background
	The Dual representation	Members of managers' part time status
	CEO	The CEO's setting

Incentive and restrains mechanisms	Salary level	Salary incentive system
	Salary structure	The dynamic incentive system
	Equity ratio	Long-term incentive status

Table 4-7 The Evaluation System of the Information Disclosure Governance of listed Companies

Main Factor	Elements	The content of Evaluation
Reliability of the information disclosure	Whether be issued a modified unqualified report	The legitimacy and fairness of financial report
	Irregularities of company	Irregularities of company in nearly three years.
	The negative reports of company	
Timeliness of information disclosure		Whether the information has been provided to decision maker before the information loses its ability to influence on decisions
The correlation of information disclosure	Corporation strategy	
	Governance structure	
	The competitive environment	
	Product and service market	
	The profit forecast information	
	Empirical risk and financial risk	
	Social responsibilities	
	Employee training plans and costs	
	Foreign investment projects	
	The distribution of business	
	The business status of holding company and taking a stake in the company	
	Related party transactions and events occurring after the data of the balance sheet	

Table 4-8 The Evaluation System of the Stakeholders' Governance for Chinese Listed Company

Main Factors	Elements	Inspection Items
The participation of stakeholders	Employees participation	Employee holding the company's stock
	Participate in and protection of the rights and interests of minority shareholders	
	Management of investor relations	Establishment of the web, and the management system of investor relations' status
The coordination of stakeholder	Social responsibility	1.social responsibility 2.disclosure 3.the attitude and protection for natural environment
	The relationship between company and supervisory and administration department	The relationship between listed company and the part of stake holders
	Litigation and arbitration	

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