

Political Determinants of Corporate Governance: Evidence from Chinese State-controlled Listed Companies

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Abstract

The reform of corporate governance has already been on the agenda worldwide. A group of scholars argue that competition will lead to the result that the corporate governance of listed companies will converge toward the shareholder-oriented model. Some others insist that politics is the key force to push the evolution of the corporate governance of listed companies. Existing evidence demonstrates that the theory of politics is much closer to the reality than the competition one in major developed economies. With the proof from the evolutionary process of the corporate governance of Chinese State-controlled Listed Companies (SCLCs), it is found out that the theory of politics is also applicable to emerging and socialist China in this regard. The implication of this research is that the improvement of the corporate governance of the SCLCs cannot be separate from the Chinese political reform.

Key Words: Political Determinants, Corporate Governance, SCLCs

I. Introduction

The reform of the corporate governance of listed companies has already been an issue under the limelight since the occurrence of the devastating Asian financial crisis.¹ In terms of their different standpoints on the reform approaches, corporate law scholars can be roughly divided into two groups. One group argues that competition will lead to the result that the corporate governance of listed companies will converge toward the shareholder-oriented model.² The other group insists that politics is the key force to push the evolution of the corporate governance of listed companies in each jurisdiction³ and in turn convergence will not spontaneously and substantively occur without the support of political reforms.⁴ In order to prove that the path advanced by it is closer to the reality, each group has displayed a number of evidence in its publications. For example, Professor Henry Hansmann in the “competition” group argues that due to the force of competition, ideological convergence toward the shareholder-oriented model has been achieved in major developed economies.⁵ On the contrary, by showcasing the evidence

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1. For instance, the government of South Korea has taken a series of steps to reform the corporate governance of the Chaebol since 1998. The Organization of Economic Cooperation and Development (OECD) also released “OECD Principles of Corporate Governance” in 1999 in order to provide member and non-member countries with specific guidelines in improving the legal, institutional and regulatory framework that underpins corporate governance. OECD, *Principles of Corporate Governance* (2004), available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf>. (Since its first issuance, this document was revised in 2003 and 2004. The above hyperlink leads to the 2004 revised version.) In addition, intermediaries, such as McKinsey & Company, are also urging the overhaul of corporate governance in emerging and transitional economies. McKinsey & Company, *Corporate Governance Develops in Emerging Markets*, in *McKinsey on Finance* 3, 15-18 (2002). See Barry Metzger, Bernard S. Black, Timothy O’Brien & Young Moo Shin, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 *J. CORP. L.* 537-608 (2001). In this report, with the request of the South Korean government, Professor Black and his colleagues proposed a systematic legal reform framework to the Ministry of Justice of South Korea for the purpose of improving the porous governance structure of the Chaebol.
 2. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 *GEO. L.J.* 439 (2001).
 3. Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 *STAN. L. REV.* 127 (1999).
 4. *Id.*
 5. See Hansmann, *supra* note 2.

from Germany, Japan, the UK and the US, Mark Roe in the “politics” group points out that politics has been the crucial factor for the formation and evolution of the corporate governance of listed companies.⁶ Likewise, Professor Kap-Young Jeong and Professor Jongryn Mo demonstrate that politics has also been the key driving force to push the reform on the corporate governance of Korea companies including listed ones since the middle of the 1990s.⁷ By comparing their arguments and evidence, it is believed that the path advanced by the “politics” group is closer to the reality of major developed economies than that of the “competition” group. But whether or not the path of political determinants can also be compatible with the evolution of the corporate governance of listed companies in emerging economies, especially under the socialist regime, is still a research gap to be filled. In terms of this understanding, the research intends to partly fill the gap by means of the evidence from the SCLCs in China.

The reason for selecting the SCLCs as the sample lies in the fact that they are the results of conversion from traditional state-owned enterprises (SOEs) to corporatized entities with western governance institutions which have been designed to increase the legitimate interests of all shareholders. Therefore, through analyzing their performance in the aspect of corporate governance, we can find out whether or not the evolution of the corporate governance of the SCLCs has been economically driven or politically determined. In turn, this finding will provide proofs for us to measure the application scope of the theory of political determinants and to further identify its legitimacy for guiding the futuristic motion to reform the corporate governance of the SCLCs.

The article consists of five parts. Part two describes the politically-driven governance models of SOEs before corporatization. Part three proves that due to political factors, the corporate governance of the SCLCs is in essence same with that of traditional SOEs even if they have been formally equipped with western governance institutions. Part four demonstrates that the changes of the ownership structure of the SCLCs in recent years which would at least theoretically exert positive impacts on the performance of their corporate

6. MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2006).

7. Kap-Young Jeong & Jongryn Mo, *The Political Economy of Corporate Governance Reform in Korea*, 26(3) GLOBAL ECON. REV. 59 (1997).

governance are also the product of politics. The last part is conclusions.

II. A Historical Perspective: Revisiting SOEs

Before the economic reforms which started in 1978, SOEs occupied a near-total monopoly position over the means of production in China. Prior to the corporatization of SOEs after the first company law of China was enacted in 1993, the governance systems of SOEs had evolved from a traditional model in which the state was the sole owner of all assets and managerial rights to a contracting model which conferred the legal person status on SOEs and provided economic incentives for them.⁸ Next, the salient features of the two models are described in order.

A. Traditional Model (1950s-1984)

When the PRC was established in 1949, the dominating business organization in industrial and commercial sectors was private enterprises. In order to achieve socialism in the economic field, on the basis of the public ownership theory of Marxism and the socialist practice of the former Soviet Union, the new regime led by the Communist Party of China (CPC) launched the movement to purchase private enterprises by the state and then convert them into SOEs at the very beginning of the 1950s. In 1956, the state successfully completed the transformative process of private enterprises and state ownership and SOEs obtained absolute monopolistic power in the industry and commerce of China.⁹ The rationale behind this economic metamorphosis was that state ownership represented the most advanced ownership form and correspondingly should be the only legal one in any socialist regime.¹⁰

The presence of SOEs and their monopolistic position provided justification for the CPC and the Chinese central government to adopt the centrally

8. With regard to the classification of governance models of SOEs and their respective valid periods in China, this article makes reference to the article authored by Cindy A. Schipani and Junhai Liu. *See infra* note 12.

9. Available at <http://cpc.people.com.cn/BIG5/33837/2534775.html>.

10. Jue Wang, *Reform on Chinese Economic Framework and the Institutional Innovation of SOEs*, available at http://www.chuangxinzhe.com/show_hdr.php?xname=HSN9321&dna me=MS28F21&xpos=28.

planned economy which was accepted by the former Soviet Union.¹¹ Under this economic system, state planners required authorities to set production demands and distribute human and financial resources. Consequently, at that time, SOEs were not real business entities. They were just the affiliates of the state for the purpose of implementing its economic and social policies. Line departments of governments determined what products and how many an SOE was permitted to produce and how many resources it could acquire.¹² In addition, SOE executives were also appointed and fired by government agencies. They were called “state cadres” whose duties were to fulfil the production demands assigned by government planners and guarantee the implementation of other state policies in their enterprises. These SOE managers were responsible to government agencies because they were also an integral layer of governmental hierarchy and “enjoyed the same economic and political treatments as government officials”.¹³

With their complete ownership and governance, the state not only deemed SOEs to be units for production activities, but also a tool to arrange employment and maintain social stability. In the age of a centrally planned economy, if a person was recruited by an SOE, it meant that he would obtain a so-called “ironclad bowl” which could be kept for his lifetime and insured his “salary, housing, medical treatment, and pension”.¹⁴ In a word, during the reign of the traditional model, the state firmly gripped governance power over SOEs. Unfortunately, “most SOEs were static and uncompetitive”.¹⁵

B. Traditional Model (1984-1993)

The transitional governance model of SOEs is referred to as the contracting model as well.¹⁶ With the long-term misleading nature of the centrally planned economy and devastating effects of the Cultural Revolution, most SOEs were on the brink of going bankrupt in the late 1970s.¹⁷ Under the cir-

11. Changgeng Liu, *Exploring the Process from the Centrally Planned Economy to the Market Economy in China*, 5 *ECON. & SOC. DEV.* 8 (2007).

12. Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 2002 *COLUM. BUS. L. REV.* 1, 8 (2002).

13. *Id.*

14. *Id.* at 9.

15. Schipani, *supra* note 12.

16. Shutang Gu & Siqun Xie, *Revisiting the Reform Process of SOEs*, 9 *ECON. REV.* 2-3 (2002).

17. *Id.* at 2.

cumstances, the reform to SOEs had been put on the agenda of the CPC and the Chinese central government since 1978.¹⁸ The strategy adopted by Chinese leaders was to change the rigid planned mechanism and allocate management rights to SOEs and their executives to a limited degree. At the initial stage of this reform, policy makers held a very cautious attitude and they only conducted pilot experiments in several carefully selected SOEs with this new tactic.¹⁹ Consequently, the contracting model did not become pervasive in the process of Chinese SOE reform until the twelfth CPC Central Committee passed the breakthrough platform entitled “The Decision of the CPC Central Committee on the Reform of the Economic System” in 1984.²⁰

With regard to the governance features of the contracting model, they were systematically introduced by the State-owned Industrial Enterprise Law of the People’s Republic of China (SOEs Law of the PRC) which was adopted in 1988 for the purpose of achieving the above reform objective. In the light of the SOEs Law of the PRC, the state retained ownership of all of SOEs’ property. SOEs were transformed into legal persons who were responsible for their own profits and losses. Instead of the CPC secretaries in the traditional model, the directors of SOEs occupied the central leadership in enterprises. They assumed the overall managerial responsibilities for those firms.²¹ The

18. Hongbo Xie, *From the Planned Economy to the Market Economy - The Transformation of the Economic Framework in China*, 5 *MACROECON. MGMT.* 23 (2008).

19. See Gu, *supra* note 16, at 2.

20. 12th Central Committee of the Communist Party of China, *Decision on the Reform of the Economic System*, available at http://news.xinhuanet.com/ziliao/2005-02/07/content_2558000.htm. After this Decision was published in 1984, the slogan of “separation between the state ownership and the SOE management authority” and the phrase “legal person” became popular among the Chinese.

21. Article 2 of the SOEs Law of the PRC stated that “an industrial enterprise owned by the whole people shall be a socialist commodity production and operation unit which shall, in accordance with law, make its own managerial decisions, take full responsibility for its profits and losses and practice 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. The enterprise shall obtain the status of a legal person in accordance with law and bear civil liability with the property which the state has authorized it to operate and manage”. Article 45 of the SOEs Law of the PRC stipulated that “the factory director shall be the legal representative of the enterprise. The enterprise shall establish a system of production, operation and management headed by the factory director. The factory director shall occupy the central position in the enterprise and assume overall responsibility for building up a materially developed and culturally and ideologically advanced enterprise”.

theory behind this reform was “separation between the state ownership and the SOE management rights”.²² Although the contracting model allocated some autonomous rights in the aspect of management to SOEs and their directors, it did not substantially reduce the state’s control of these entities and changed their nature of implementing policies. In other words, the transitional governance model was still operated on the basis of state control which could be proved by the following three pieces of evidence.

First, in terms of the SOEs Law of the PRC, the mandatory production plans required by governments were not completely eliminated from SOEs. They still had to finish a portion of bureaucratic production demands.²³ In addition, even though the SOEs Law of the PRC stipulated that SOEs should be responsible for their own profits and losses, in practice, they only retained their due profits and governments indemnified their losses with the so-called “soft budgets”.²⁴ Therefore, governmental intervention in the production activities of SOEs was still substantial.

Second, according to the SOEs Law of the PRC, the competent departments of governments were responsible for the appointment of SOEs’ directors.²⁵ Although the workers congresses of SOEs were entitled to recommend director candidates to governments, governments approved their recommendation in the form of official documents only if the CPC committees

22. *Id.*

23. Article 35 of the SOEs Law of the PRC declared that “the enterprise must fulfill the mandatory plans”.

24. *See Gu, supra* note 16, at 3.

25. Article 44 of the SOEs Law of the PRC provided that “except as otherwise stipulated by the State Council, the selection of the factory director shall be made by the competent department of the government in the light of the specific conditions of the enterprise by one of the following methods: (1) appointment by the competent department of the government or choice of an applicant on a competitive basis by the same department; or (2) election by the staff and workers’ congress of the enterprise. With respect to the person to be appointed or the applicant to be chosen as factory director by the competent department of the government, the opinions of the staff and workers shall be solicited, with respect to the person elected as factory director by the staff and workers’ congress of the enterprise, his appointment shall be reported to the competent department of the government for approval. The removal or dismissal of the factory director appointed or chosen from applicants by the competent department of the government shall be decided upon by such department, while the opinions of representatives of the staff and workers shall be solicited; the recall of the factory director elected by the staff and workers’ congress of the enterprise shall be decided by such congress and reported to the competent department of the government for approval”.

also appreciated these candidates.²⁶ In other words, the CPC still made the final decisions on the personnel arrangements of SOEs as it determined state cadres. It guaranteed that the executives of SOEs were in line with the requirements of the state.

Third, the SOEs Law of the PRC provided that the local organizations of the CPC assured and supervised the implementation of the Party's and the state's guidelines and policies.²⁷ That meant that SOEs were more policy-implementation tools than independent business entities.

To sum up, the transitional governance model did not significantly diminish the power and intervention of the state in relation to SOEs. Even though its objective and slogan was "separation between the state ownership and the SOE management rights",²⁸ governmental acts and production activities still mingled with each other. Moreover, SOEs bore the heavy burden of carrying out different kinds of policies and did not concentrate on the maximization of profits. Therefore, the contracting model failed to provide much in the process of SOE reform.

III. Modern Corporate Model (1993-Present): A Substantial Transformation of SOEs

The failure of the contracting model induced the national debate on the transformation and diversification of public ownership of SOEs into different forms at the end of the 1980s.²⁹ However, this move was halted by the Tiananmen Square protests in 1989. In the following three years after this demonstration, the speed of SOE reform was slowed down and the voice for a restoration of the centrally planned economy resurged.³⁰ Confronted with the circumstances, Mr. Xiaoping Deng called for the CPC and the whole na-

26. Zongguo Sun, Tingting Feng & Guangshan Zhao, *The Role of Governments in the Reform Process of SOEs*, 8 MOD. BUS. 215 (2008).

27. Article 8 of the SOEs Law of the PRC provided that "the local organization of the Chinese Communist Party shall guarantee and supervise the implementation of the guiding principles and policies of the Party and the state in the enterprise."

28. *See supra* note 21.

29. *See Gu, supra* note 16, at 3.

30. *See Xie, supra* note 18, at 24.

tion to further emancipate their minds and put forward the economic reform with great courage during his inspection trip to South China in 1992.³¹ Under his theory, the market economy did not solely belong to capitalism and it was compatible with the needs of socialist economic division and productions.³² The support from Mr. Xiaoping Deng provided fresh political impetus to the transformation of SOEs in China. In late 1992, the Fourteenth National Congress of the CPC put the establishment of the market economy into its charter.³³ Soon afterwards, the Fourteenth CPC Central Committee passed the “Decisions on the Establishment of the Socialist Market Economy” in 1993 in which the setting up of a modern corporate system in relation to SOEs was an urgent and important objective.³⁴ A series of policy signals for the corporatization of SOEs from the CPC and its paramount leaders promoted the enactment of the first Company Law of the PRC at the end of 1993 (Company Law 1993). After that, on the legal foundation laid by the Company Law 1993, two new approaches were put into practice for the reform of SOEs. First, small and less important SOEs were privatized and diversified into other business forms. The overall amount of SOEs has drastically diminished.³⁵ Second, recapitalization with the governance system of modern corporations was encouraged for big and key SOEs instead of total privatization.³⁶ Some of them were listed on the emerging domestic stock market in order to raise as much money as possible.³⁷ These listed companies whose predecessors were the traditional SOEs have constituted the cornerstone of the whole state-owned economy in China. According to published statistics, there were 144,700 SOEs with the total assets of RMB 8.537 billion by the

31. Xiaoping Deng, *The Comments Made by Deng Xiaoping During His Inspection Tour to South China*, available at <http://cpc.people.com.cn/GB/33837//2535034.html>.

32. *Id.*

33. Available at http://news.xinhuanet.com/ziliao/2003-01/20/content_697129.htm.

34. 14th Central Committee of the Communist Party of China, *Decisions on the Establishment of the Socialist Market Economy*, available at <http://www.people.com.cn/GB/shizheng/252/5089/5106/5179/20010430/456592.html>.

35. BIN LIANG, *THE CHANGING CHINESE LEGAL SYSTEM, 1978 – PRESENT: CENTRALIZATION OF POWER AND RATIONALIZATION OF THE LEGAL SYSTEM* 30 (2007).

36. *Id.*

37. These enterprises are generally called “SCLCs” in official documents and academic literature in China.

end of 2011.³⁸ Meanwhile, there were 953 SCLCs with the total capitalization of RMB 1.371 billion.³⁹ On the basis of the statistics and the traditional policy-implementation orientation to SOEs which has been analyzed in the above section, it is presumed that the state must tightly control these pivotal listed companies through the specific governance institutions which have been stipulated by the Company Law of the PRC.⁴⁰ In other words, the corporate governance of the SCLCs is still the control-based model as traditional SOEs, which is the result of path dependence. Next, this model will be illustrated from the aspects of three principal corporate governance institutions applied in China - the shareholder meeting, the board of directors and the supervisory committee.

A. The Shareholder Meeting

In China, the shareholder meeting which is viewed as a supreme power organ of a corporation occupies the central position in corporate governance.⁴¹ In terms of the latest Company Law of the PRC which came into effect in 2006 (Company Law 2006), the shareholder meeting holds the following comprehensive decision-making powers: (1) to determine corporate operation guidelines and investment plans; (2) to elect and replace directors and shareholder supervisors and determine their remunerations; (3) to review and approve the reports submitted by the board of directors; (4) to review and approve the reports submitted by the supervisory committee; (5) to review and approve the corporate fiscal budgets and final account reports on an annual basis; (6) to review and approve the corporate plans regarding allocating profits and making up for losses; (7) to determine the increase and decrease of the corporation's registered capital; (8) to determine the issuance

38. Yong Wang, *Report on the Reform and Development of SOEs*, available at http://www.npc.gov.cn/npc/xinwen/2012-10/26/content_1740994.htm.

39. *SCLCs Account for Half of Shares*, PEOPLE'S DAILY ONLINE, available at http://www.gov.cn/jrzq/2013-01/11/content_2309490.htm.

40. The Company Law 1993 was revised in 2005 and the latest Company Law came into effect in 2006. However, its overall structure with the three main sections of the shareholder meeting, the board of directors and the supervisory committee has remained in the new Company Law to which the author will make reference in the following analysis.

41. Lin Ye, *The Distribution of Corporate Powers*, available at <http://www.civillaw.com.cn/article/default.asp?id=37502>.

of corporate bonds; (9) to make decisions regarding corporate mergers, divisions, dissolution and liquidation; and (10) to amend the Articles of Incorporation.⁴² By this enumeration, we can see that the shareholder meeting of a corporation in China keeps substantial managerial powers, some of which are reserved to the board of directors in the United States and other western countries. This arrangement has given rise to the probability that the majority shareholder can control the operation of the corporation to considerable degrees through the governance institution of the shareholder meeting in China.

As mentioned above, the SCLCs are the transformative result of traditional SOEs. Even though they have privatized a portion of shares to the public during the process of corporatization, the ownership structure of these enterprises still characterizes the substantial concentration of the state shares. Given the limited availability of data, I am not able to show the ownership constitution of each SCLC to prove the above proposition. However, Table 15 provides the empirical evidence regarding the biggest shareholders of the SCLCs in the sector of steel. It is believed that these enterprises can be used as a sample to reflect the concentrated state shares in this kind of listed company in China to a large extent. In light of the data in Table 15, all of the biggest shareholders of the 12 listed companies producing steel and iron were state holding corporations which are solely held by the state.⁴³ The appointments to the top-tier corporate leadership positions in these state holding corporations are made by state-owned asset management commissions and CPC committees.⁴⁴ Moreover, almost all of the candidates for these positions have the background of working in related government agencies.⁴⁵ Therefore, state holding corporation leaders are seldom held accountable for the economic performance of the enterprises and its subsidiaries as long as their performance does not deteriorate massively.⁴⁶ Their obligations are to guarantee the implementation of state and local policies in those entities. With the level of state holding corporations as their biggest shareholders, the state has tightly gripped the SCLCs through the shareholder meeting. Even though

42. Article 38 of the Company Law 2006.

43. Christopher A. McNally, *Strange Bedfellows: Communist Party Institutions and New Governance Mechanisms in Chinese State Holding Corporations*, 4(1) *BUS. & POL.* 91 (2002).

44. Can Yin & Yumin Zhang, *Research on the Corporate Governance of Wholly State-owned Corporations*, 7 *J. SW. U. NATIONALITIES* 86 (2007).

45. *See infra* note 49, at 104.

46. *See infra* note 49, at 102.

the equity division reform in 2005 made state shares tradable on the secondary market, it has not shaken the state's position in the SCLCs as the largest shareholders due to the hampering from political considerations and vested interests.⁴⁷

Table 15: The Biggest Shareholders in the SCLCs in the Sector of Steel in China in 2009

Corporation Name	Name of the Biggest Shareholder	Amount of Shares Held by the Biggest Shareholder	Ratio to the Total Shares (%)
Anyang Iron and Steel Incorporated	Anyang Iron and Steel Group Corporation Limited	1,438,934,489	60.11
Baoshan Iron and Steel Incorporated	Bao Steel Group Corporation	12,953,517,441	73.97
Guangzhou Iron and Steel Incorporated	Guangzhou Iron and Steel Group Corporation Limited	291,104,974	38.18
Handan Iron and Steel Incorporated	Handan Iron and Steel Group Corporation Limited	1,060,810,380	37.66
Hangzhou Iron and Steel Incorporated	Hang Steel Group Corporation	545,892,750	65.07
Hongxing Iron and Steel Incorporated	Jiuquan Steel Group Corporation Limited	1,712,955,075	83.74
Laiwu Iron and Steel Incorporated	Laiwu Iron and Steel Group Corporation	688,503,152	74.65
Lingyuan Iron and Steel Incorporated	Lingyuan Group Corporation	431,473,247	53.67
Ma Anshan Iron and Steel Incorporated	Ma Steel (Group) Holding Corporation	3,886,423,927	50.47
Nanjing Iron and Steel Incorporated	Nanjing Iron and Steel Group Corporation Limited	1,056,120,000	62.69
Hebei Iron and Steel Incorporated	Tangshan Iron and Steel Group Corporation Limited	1,853,409,753	51.11
Wuhan Iron and Steel Incorporated	Wuhan Steel Group Corporation	5,072,021,816	64.71

Source: The Annual Reports Released by the Above Sample Companies in 2009⁴⁸

47. See *infra* note 49.

48. Available at http://static.sse.com.cn/sseportal/ps/zhs/ggts/ssgsggqw_full.shtml; also available at <http://disclosure.szse.cn/m/drsgg.htm>.

B. The Board of Directors

According to the stipulation of the Company Law 2006, the board of directors plays the role as the executive branch of the shareholder meeting in a corporation. It is mainly responsible for the enforcement of the operation decisions made by the latter.⁴⁹ The state has achieved its control over the board of directors by means of personnel arrangements. Generally speaking, the chairman and the vice chairman of the board of directors and the director who is concurrently the chief executive in a SCLC are actually determined by local CPC committees.⁵⁰ After that, this decision is forwarded to local governments and their state-owned asset management commissions.⁵¹ Next, state-owned asset management commissions require state holding corporations who are the biggest shareholders to convene the shareholding of the SCLCs and appoint the candidates on the shortlist.⁵² Moreover, in terms of local government regulations, it is a prevalent requirement that the chairman of the board of directors should act as vice CPC secretary and then the vice chairman should act as CPC secretary in this sort of listed company.⁵³ In addition, a large portion of directors in a SCLC are former officials in disbanded component government departments.⁵⁴

With regard to the independent directors in the SCLCs, they also represent the voice of the state. In the light of the “Guidelines on the Establishment of the Institution of Independent Directors in Listed Companies” (the Guidelines on Independent Directors 2001) issued by the CSRC in 2001, independent

49. Article 47 of the Company Law 2006.

50. Liaoning Securities Supervisory Bureau, *Analysis on the Behavioral Changes of the Majority Shareholders and the De Facto Controllers of Listed Companies and the Corresponding Supervisory Approaches After the Equity Division Reform*, available at <http://www.csrc.gov.cn/n575458/n870331/n10217417/10264959.html>; *Behind the Dismissal of Qiao Hong: No Contest for the Successor of Maotai*, PEOPLE'S DAILY ONLINE, available at <http://finance.people.com.cn/GB/67815/71134/5870908.html>. The appointment procedure is also applicable to the listed companies invested in by the central government which are the minority of all SCLCs.

51. *Id.*

52. *Id.*

53. See *supra* note 49, at 105. In practice, it is also common that the chairman of the board of directors act as that corporation's party secretary.

54. *Black Record of Chinese Listed Companies in 2005*, XINHUANET, available at http://news.xinhuanet.com/stock/2006-01/06/content_4015864.htm.

directors are elected by the shareholding meeting.⁵⁵ Therefore, in the SCLCs, the state is the largest shareholder, although the level of state holding corporations actually dominates the selection of their independent directors.⁵⁶ Consequently, independent directors keep tight ties with governments and act on behalf of them.

C. The Supervisory Committee

In China, the principal function of the supervisory committee in a corporation is to monitor the behaviour of directors and managers in the interests of shareholders.⁵⁷ The members of the supervisory committee in the SCLCs tend to be drawn from two sources. First, state holding corporations as the largest shareholders select external shareholder supervisors through the shareholder meeting.⁵⁸ Generally, these external shareholder supervisors are retired government officials, famous economists and accountants who have close relationships with the authorities. Second, within corporations, the secretaries of corporations' disciplinary committees of the CPC and worker representatives constitute internal shareholder supervisors.⁵⁹

The two sources clearly convey the two main purposes of the supervisory committees of the SCLCs. First, the committee is applied to further internalize the oversight of competent government departments over how the SCLCs are operated, thus assuring the maintenance and increase of state assets and the implementation of state policies.⁶⁰ Second, the disciplinary committees of the CPC within corporations can play the traditional role as the primary organs of managerial discipline through their personnel overlap with the

55. Article 4 of the Guidelines on Independent Directors 2001.

56. Jianmin Su, Yanbin Yao & Yuehui Su, *Analysis on the Problems of Independent Directors in China*, 14 FIN. & ECON. 79 (2007); Xiangping Cao, *Reasons for the Dysfunction of Independent Directors in China*, 1 CHINA NAT'L CONDITIONS & STRENGTH 47 (2008).

57. Article 54 of the Company Law 2006.

58. Jian Zhao, *Consideration on the Improvements of the Supervisory Committee of Chinese Listed Companies*, 11 CHINA ECONOMISTS 113 (2003); Jianwei Li, *On the Improvements of the Supervisory Committee of Chinese Listed Companies Through the Perspective of Its Relationship with Independent Directors*, 2 L. SCI. 76 (2004).

59. Linqing Wang, *The Tragedy of the Supervisory Committee of Chinese Listed Companies: Curious Performance in the Past Eleven Years*, available at <http://www.civillaw.com.cn/article/default.asp?id=25935>.

60. See *supra* note 49, at 106.

supervisory committees.⁶¹ Therefore, this corporate institution in charge of management supervision in the SCLCs is also firmly held by the state.

IV. The Changes of the Ownership Structure of the SCLCs: A Political Explanation

In China, there exist two types of SCLCs. One type refers to those listed companies which are in the charge of the State-owned Assets Supervision and Administration Commission (SASAC) of the Chinese central government and are accordingly called central SCLCs. The other type refers to those which are administered by the local SASACs of Chinese local governments and are correspondingly dubbed local SCLCs. In terms of their respective scales, central SCLCs are generally much larger than local ones. In the light of business, central SCLCs are usually engaged in infrastructures and the industries in close relation to national security, such as the invention of sophisticated weapons, while local ones regularly operate in more competitive industries. As for the amounts, 998 local SCLCs and 194 central ones existed in the Chinese domestic stock market by the end of 2006.⁶²

Given the very important role played by these companies in the stable reign of the CPC in China, leaders of the SASAC of the Chinese central government repeatedly stress on different occasions that the majority blocks of shares held by the state will never be significantly decreased in central SCLCs in the future.⁶³ Thus, it is almost undoubted that the concentrated ownership of central SCLCs will not be substantively dispersed at least within a short term. To the contrary, the ownership of local SCLCs has really been occurring in recent years principally due to political reasons. Next is a discussion to this trend.

At the end of 1993, the CPC and Chinese central government launched

61. See *supra* note 49.

62. Bin Chen, Jian She, Xiaojin Wang & Jianqing Lai, *Positive Research on the Development of Chinese Privately-held Listed Companies* (2008), available at <http://www.szse.cn/main/files/2008/02/25/091811911155.pdf>; China Development Gateway, *Overhaul of SOEs*, available at http://cn.chinagate.cn/reports/2007-03/13/content_2369560.htm.

63. Available at <http://finance.sina.com.cn/stock/y/20080811/07055185859.shtml>.

a tax-revenue-division program.⁶⁴ According to the program, China's annual tax revenue has been split between the central government and local ones with a new set of criterion. The implementation of this program has fundamentally changed the respective fiscal abilities of Chinese central and local governments. As statistics show, the ratio of fiscal income of the Chinese central government to that of local ones was 22/78 and the ratio of fiscal expense of them was 28/72 in 1993. In 2008, the two ratios have changed to 53/47 and 21/79.⁶⁵ Clearly, the two sets of data indicate that, after the tax-revenue-division reform, Chinese local governments have been given a smaller piece of the tax-revenue cake, but have had to contribute more strength to make the cake bigger. Besides this unfavorable factor, the one-veto-all criteria of China's official promotion system which means that a government leader can never get promoted if he fails to fulfill even one task assigned by superior governments also puts huge tensions on local governmental seniors. Consequently, the combination of the two factors has provided local senior officials with strong incentives to search alternative ways to substantially increase local fiscal income so as to successfully complete heavy tasks saddled by superior governments. Sales of state shares of local SCLCs, among other ones, is such an alternative way which are well applied by Chinese local governmental heads to raise fiscal funds in a rapid manner. Even though the statistics regarding it in China is not available for the time being, some high-profile cases can indeed demonstrate the existence of this practice. Subsequently, the case of Huaxin Cement Corporation will be taken out from a group of such cases as an example.⁶⁶

Huaxin Cement Corporation is a cement manufacturer who is headquartered at Huangshi city of Hubei province and has been listed on the Shanghai Stock Exchange since 1994. The biggest shareholder of Huaxin Cement Corporation is Huaxin Group Corporation who is wholly owned by the SASAC of Huangshi city. On 6 June, 2011, Huaxin Cement Corporation issued a notice to the public to announce that Huaxin Group Corporation as the biggest shareholder had sold out the stocks of Huaxin Cement

64. State Council of the People's Republic of China, *Decision on the Implementation of the Tax-Revenue-Division Program*, available at http://news.xinhuanet.com/ziliao/2005-03/17/content_2709622.htm.

65. Available at <http://finance.sina.com.cn/roll/20100724/01588356765.shtml>.

66. Xiaojie Liu, *The SASAC of Huangshi Sold Stocks for Security Houses*, available at <http://www.nbd.com.cn/articles/2011-06-23/577559.html>.

Corporation in its hands by 2.28% since 24 May, 2011. The money raised through the sold-out would be made use of by the Huangshi municipal government to build social security houses for the poor living in the city.

The building of 26,309 social security houses was assigned to the Huangshi municipal government as a political task by the Hubei provincial government at the beginning of 2011. After accepting the task, the Huangshi municipal government made a promise to the Hubei provincial government that all the houses would be put under construction by the end of June, 2011. Unfortunately, the Huangshi municipal government did not have sufficient fiscal reserves to keep the promise when it was made. Therefore, it subsequently sold out the shares of Huaxin Cement Corporation to mitigate its shortage of money so as to guarantee the on-time construction of those houses.

To a large degree, the case of Huaxin Cement Corporation has plausibly demonstrated that it is real that local governments are indeed selling out state shares of local SCLCs in China in order to lift their fiscal abilities. An effect of this practice is that the concentrated ownership of local SCLCs has been somehow dispersed. Particularly under the circumstances that the sales of state-owned land and use of governmental debts have been increasingly constrained by the Chinese central government nowadays,⁶⁷ the financial significance of the sales of state shares of local SCLCs for local government will be enlarged. Accordingly, the concentrated ownership structures of local SCLCs will continue to be scattered, which would at least theoretically exert positive impacts on the performance of their corporate governance.

V. Conclusions

Just as Donald Clarke claimed “China’s legal system cannot be understood apart from its history and that history—whether imperial or modern— is overwhelmingly a story of centrality of the state”,⁶⁸ it is also applicable to the corporate governance of the SCLCs. Through the retrospect to the gov-

67. State Council of the People’s Republic of China, *Notice on Regulating the Fundraising Companies of Local Governments*, available at http://www.gov.cn/zwgk/2010-06/13/content_1627195.htm.

68. Donald C. Clarke, *Lost in Translation? Corporate Legal Transplants in China*, GEO. WASH. L. FAC. PUBL’N 1068 (2006).

ernance structures of their predecessors, we are able to truly understand why the corporate governance of the SCLCs is a control-based model and why the recent dispersion of their ownership is also driven by political factors. In other words, without looking back to the historical path, it is not explicable that “the policy of corporatization does not involve a renunciation by the state of its ambition to remain the direct owner of enterprises in a number of sectors”⁶⁹ because “this ambition makes no sense if profits are the only objective.”⁷⁰ With the evidence from the SCLCs, it is obvious that the theory of politics is also applicable in emerging and socialist China. Therefore, the improvement of the corporate governance of the SCLCs cannot be separated from the Chinese political reform since political determinants have hampered its convergence toward the shareholder-oriented standard.

69. Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494 (2003). In the cited article, Professor Clarke questions the legitimacy and competency of governments' keeping ownership in enterprises. This research agrees with the stance advanced by Professor Clarke.

70. *Id.*

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