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## Transforming Corporate Governance in Chinese Corporations: A Journey, Not a Destination

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# Transforming Corporate Governance in Chinese Corporations: A Journey, Not a Destination

*Andrew Keay\* and Jingchen Zhao\*\**

*Abstract: The article offers a systemic, historical, and rigorous study of the transformation of Chinese corporate governance, focusing on its development from a totally administrative model, being one which relies on government and administrative power and imposes on corporations' controllers administrative duties and objectives, to a hybrid model which has both administrative and economic governance characteristics. The article assesses whether administrative power will hinder corporate governance transformation in China on its journey towards a sound and sustainable model. We opine that the government continues to have a key role to play in corporate governance in China which makes administrative interference and power something that is embedded in corporate governance regimes through public and political policies, law enforcement, and strategic management policies for corporations. The administrative involvement might sacrifice efficiency, and effective market and corporate responses. However, it is observed that it may bring comparative advantages for Chinese corporate governance in terms of supporting long term strategic planning and the setting of multiple goals for State Owned Enterprises (SOEs, hereinafter), with government interference producing immediate action in order to prevent market failure.*

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|  |     |
|--|-----|
| I.Introduction.....  | 189 |
| II.Introduction to Economic and Administrative Corporate Governance .                                    | 194 |
| III.Historical Progress of Corporate Governance Transition in China.....                                 | 198 |
| Pre-1978.....  | 198 |
| 1978 to 1986 .....   | 199 |
| 1987-1992 .....  | 200 |
| Modern Enterprise System after 1992 .....  | 201 |
| IV.Reasons for Transition .....  | 204 |
| Corporatization .....  | 204 |
| Foreign Investment and Entering into the WTO.....  | 206 |
| Corporate Governance Guidelines and Internationally<br>Recognized Guidelines.....                        | 207 |
| Cross-listing of Chinese Corporations .....  | 208 |
| V.Advantages of Administrative Aspects of Corporate Governance.....                                      | 210 |
| A Critical but Accepting Attitudes towards Administrative<br>Governance .....                            | 210 |
| Long Term Strategic Planning and Multiple Goals of SOEs..  | 212 |
| Effectiveness of Government Interference .....   | 216 |
| VI.Characteristics and Impact of Administrative Governance in the<br>Transformation Process.....         | 218 |
| Administrative Power and Corporate Governance in China...  | 219 |
| Government Interference and Influence in China.....  | 221 |
| Are Administrative Factors Hindering the Development of<br>Efficient Chinese Corporate Governance? ..... | 225 |
| No Universal Path for Transition.....  | 227 |
| VII.Conclusion.....  | 231 |

## I. INTRODUCTION

China has achieved unprecedented economic growth since 1980, with per capita GDP increasing from one of the lowest in the world to a level that is firmly in the middle of the international ranks.<sup>1</sup> China has seen the advent of economic miracles since opening up policies and reforms that were introduced by it in the late 1970s; it has become a global economic powerhouse at an incredible speed and has changed international trade and investment patterns. The success of China to date has come about without key elements that are regarded by Western scholars as essential for long-term success, such as a well-functioning market, private property rights, an efficient and impartial legal system and a shareholder-centred economic corporate governance.<sup>2</sup> In 1992 the Chinese central government altered its policy from seeking to have a “combined planned and market economy” to having a “market economy with Chinese characteristics.”<sup>3</sup> If the adjective “socialist” characterises the political system, the term “market economy” clearly guides the direction of the reform goals in China.<sup>4</sup> These reforms have significantly increased and enhanced the scope of the market, while a shift can be seen from central planning to market regulation. It has been argued that enterprise and economic reform in China since the 1980s has been a process that is aimed at establishing a suitable corporate governance mechanism.<sup>5</sup> A suitable and ideal corporate governance model has not yet been developed despite innovative reforms and the undertaking of a variety of comparative studies and some empirical research.<sup>6</sup>

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<sup>1</sup> See *GDP per Capita (Current US\$) 1980–1984 to 2010–2014*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?page=6> (last visited November 1, 2017).

<sup>2</sup> Randall Morck & Bernard Yin Yeung, *Corporate Governance in China*, 26 J. APPLIED CORP. FIN. 20, 20 (2014).

<sup>3</sup> This is a model with a competitive market system in which public ownership predominates.

<sup>4</sup> In addition to this fundamental change, the rapid growth of the private economy, joint ventures, wholly foreign-owned enterprises, collectively-owned enterprises, farmers’ special cooperatives and the corporatisation and reconstruction of state-owned enterprises have meant that Chinese business organisations are very diverse, forming a truly “mixed ownership economy”. See GUOLI LIU, *The Dialectic Relationship between Peaceful Development and China’s Deep Reform*, CHINA’S “PEACEFUL RISE” IN THE 21<sup>ST</sup> CENTURY: DOMESTIC AND INTERNATIONAL CONDITIONS 1, 23 (Sujian Guo ed., 2006).

<sup>5</sup> PENG FEI YANG, *The Two Models of Corporate Governance and the Institutional Reform of Chinese Enterprise*, in CHANGING CORPORATE GOVERNANCE PRACTICES IN CHINA AND JAPAN: ADAPTIONS OF ANGLO-AMERICAN PRACTICES 15 (Masao Nakamura ed., 2008).

<sup>6</sup> See, e.g., Fuxiu Jiang & Kenneth A. Kim, *Corporate Governance in China: A Modern Perspective*, 32 J. CORP. FIN. 190 (2015); Wei Shen, Qiong Zhou & Chung-Ming Lau, *Empirical Research on Corporate Governance in China: A Review and New Directions for the Future*, 12 MGMT. & ORG. REV. 41 (2016); Stijn Claessens & Joseph P.H. Fan, *Corporate Governance in Asia: A Survey*, 3 INT’L REV. FIN. 71 (2002); Guy S. Liu, *Comparative Corporate Governance: The Experience between China and the UK*, 13 CORP. GOVERNANCE: INT’L

Chinese corporate governance is clearly distinct from the German-Japanese insider model, the Anglo-American outsider model or the south-east/west Asian family-oriented corporate model,<sup>7</sup> having moved on from learning lessons from the German experience of corporate governance with strong employee participation and two-tier boards in the 1980s, to learning from the American experience in developing a strong stock market, introducing a system of independent directors in the 1990s<sup>8</sup> and the reform was put in force in 2014 with minimum paid-in thresholds completely discarded.<sup>9</sup> The transition process of the Chinese corporate governance model is one that is ongoing, and is constituted by a hybrid model which has both administrative and economic dimensions.<sup>10</sup> Both elements of governance are expected to coexist and develop to provide an equilibrium in China over a long period, during which there will inevitably be various institutional and ideological obstacles to be overcome.<sup>11</sup> This hybrid model continually changes and does so in line with economic growth and the initiation and development of a series of reform attempts, primarily dominated by corporatization and transformation of the role played by the government and the Communist Party. It is unlikely that the transition of the corporate governance model will ultimately lead to a full economic model due to the political system which is dominated by a very powerful Communist Party (hereinafter, the Party) and deeply-rooted traditional factors including the devotion to a business regulatory culture, the influence of a dominant ideol-

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REV. 1 (2005); Saul Estrin & Martha Prevezer, *The Role of Informal Institutions in Corporate Governance: Brazil, Russia, India, and China Compared*, 28 ASIA PAC. J. MGMT. 41 (2011); Ruth V. Aguilera & Gregory Jackson, *Comparative and International Corporate Governance*, 4 ACAD. MGMT. ANNALS 485 (2010).

<sup>7</sup> Weian Li, Aaichao Qiu & Zhihui Gu, *Dual Corporate Governance Environment, Political Connections Preference and Firm Performance—Study on Governance Transition of China's Listed Firms (Shuangchong Gongsi Zhili Guanling, Zhengzhi Lianxi Pianhao Yu Gongsi Jixiao)*, 267 CHINA INDUS. ECON. 85, 85-86 (2010).

<sup>8</sup> PENG FEI YANG, *The Two Models of Corporate Governance and the Institutional Reform of Chinese Enterprise*, in CHANGING CORPORATE GOVERNANCE PRACTICES IN CHINA AND JAPAN: ADAPTIONS OF ANGLO-AMERICAN PRACTICES 15 (Masao Nakamura ed., 2008).

<sup>9</sup> Chinese Company Law 2006, promulgated by The Standing Committee of the National People's Congress, December 28, 2013, Article 27; Company Law 2005, art. 29, now removed by the Company Law put in force in 2014; see also Shuangge Wen & Jingchen Zhao, *Contextualizing Legal Norms: A Multi-Dimensional View of the 2014 Legal Capital Reform in China*, 19 EUR. BUS. ORG. LAW REV. (forthcoming).

<sup>10</sup> For discussions on the hybrid corporate governance model see Jingchen Zhao, *The Emerging Third Way in the Corporate Objective Debate in Company Law*, 62 N. IR. LEGAL Q. 361(2011); Ji-Yong Lee, *Hybrid Corporate Governance: The Case of Asia*, 3 REV. CONTEMP. BUS. RES. 21 (2014); ABDUL A. RASHEED & TORU YOSHIKAWA, THE CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS (Abdul A. Rasheed & Toru Yoshikawa eds., 2012).

<sup>11</sup> See WEIAN LI, XIAOHONG CHEN & QINGHONG YUAN, CHINESE CORPORATE GOVERNANCE: ROAD TO TRANSITION AND PERFECTION (ZHONGGUO GONGSI ZHILI: ZHUANXING YU WANSHAN ZHILU 中国公司治理：转型与完善之路) 140 (2012).

ogy, and China's long-term preoccupation with state ownership of property with its cautious embrace of capitalism accompanied by ownership that involves Chinese characteristics, including a Chinese top-down regulatory system.<sup>12</sup>

There is evidence that suggests that good corporate governance mitigates agency problems, and this is especially needed, in a unique way, in the case of China which has double agency problems, namely conflicts between boards of directors and shareholders and conflicts between controlling and minority shareholders. The latter kind of problem can well involve state and government agencies.<sup>13</sup> These agencies often are the controlling shareholders and decision makers as part of their role as representatives of the State. They tend to dominate corporate boards in SOEs, and the regulators of corporations and corporate actions. Therefore, discussions of the history, nature, problems and future of administrative corporate governance are particularly important in order to offer a true picture of corporate governance. This picture reflects stages of economic development, political policies, social needs, international policies, shareholding structure, market conditions, financial systems and foreign policies, all of which have had an impact on the Chinese economy.<sup>14</sup>

China's economic success and the unique Chinese characteristics of its economic development make its transition path an insightful subject with a profound impact for researchers, and with, as far as corporate governance development is concerned, potential effect for other jurisdictions that have emerging markets or even those with mature markets where there is government interference in the content and process of the corporate governance scheme. There have been a number of studies addressing the improvement of corporate governance in response to problems and troublesome practices in China, with many suggestions and recommendations made in order to improve effectiveness, accountability, transparency and efficacy of corporate governance.<sup>15</sup> Chinese corporate governance has been described in dif-

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<sup>12</sup> CHENXIA SHI, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE IN CHINA* 18-19 (2012).

<sup>13</sup> See Qingxiang Yang, *On Governance Control of Corporation*, WUHAN U. J. (PHIL. & SOC. SCI.) 38 (2008); see also YONG ZHANG, *LARGE CHINESE STATE-OWNED ENTERPRISES: CORPORATIZATION AND STRATEGIC DEVELOPMENT* (2007).

<sup>14</sup> This unique nature does not only compromise the independence of corporate boards and the efficiency of corporate governance. It may also have positive effects in a jurisdiction like China because of its unique economic and historical development and the profound impact of culture on governance, such as a mitigation of the serious information problems faced by investors and regulators.

<sup>15</sup> See, e.g., Qiao Liu, *Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants*, 52 CESIFO ECON. STUD. 415 (2006); Lay-Hong Tan & Jiangyu Wang, *Modeling an Efficient Corporate Governance System for China's Listed State-Owned Enterprises: Issues and Challenges in a Transitional Economy*, 7 J. CORP. L. STUD. 143 (2007); Yongqiang Gao, *Corporate Social Performance in China: Evidence from*

ferent ways and based on various foci and classifications. This article examines the transition of corporate governance in China, with a special focus on the nature, problems and necessity of administrative governance. It assesses whether administrative power will hinder corporate governance transformation in China on its journey towards a sound and sustainable model. If there are unavoidable barriers which reflect deeply rooted views within China's political system, as well as China's culture, history and shareholding structure, should administrative governance be seen as a positive advantage that is useful, necessary and functional under the current economic development stage in China? In order to be able to do this, we offer an in-depth analysis of corporate governance transition in China on its route from an administrative governance model to a hybrid one with elements of both administrative and economic governance, and a critical examination of the role played by administrative power that has been wielded by the government in shaping corporate governance. The article aims to address the following questions to construct a coherent assessment. What are the characteristics and nature of administrative power in relation to the development of Chinese corporate governance? What is the role of administrative governance historically in the transformation of corporate governance and what are the reasons for this transformation? And finally, in what way could corporate governance in China take advantage of administrative governance if it were to coexist with market forces in China indefinitely? To address these questions, historical and doctrinal methods will be used to scrutinize and explain administrative factors shaping the path of corporate governance in China.

This article includes an exploration of the nature and function of administrative governance as far as it relates to the "Beijing Consensus."<sup>16</sup> The Consensus is also referred to as the "China Model" and is regarded as the political and economic policies of China and the concept alludes to the

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*Large Companies*, 89 J. BUS. ETHICS 23 (2009); HENRY WAI-CHUNG YEUNG, CHINESE CAPITALISM IN A GLOBAL ERA: TOWARDS HYBRID CAPITALISM (2004); Kun Luen Alex Lau & Angus Young, *Why China Shall Not Completely Transit from a Relation Based to a Rule Based Governance Regime: A Chinese Perspective*, 21 CORP. GOVERNANCE: INT'L REV. 577 (2013); RICHARD MEAD, INTERNATIONAL MANAGEMENT: CROSS-CULTURAL DIMENSIONS (2005); Randall Morck & Bernard Yeung, *Corporate Governance in China*, 26 J. CORP. FIN. 20 (2014); Jingjing Yang, Jing Chi, & Martin Young, *A Review of Corporate Governance in China*, 25 ASIAN-PAC. ECON. LIT. 15 (2011).

<sup>16</sup> See S. PHILIP HSU, YU-SHAN WU & SUISHENG ZHAO, IN SEARCH OF CHINA'S DEVELOPMENT MODEL: BEYOND THE BEIJING CONSENSUS (2011); Scott Kennedy, *The Myth of the Beijing Consensus*, 19 J. CONTEMP. CHINA 461 (2010); Shaun Breslin, *The 'China Model' and the Global Crisis: From Friedrich List to a Chinese Mode of Governance?*, 87 INT'L AFF. 1323 (2011); Barry Naughton, *China's Distinctive System: Can it Be a Model for Others?*, 19 J. CONTEMP. CHINA 437 (2010); see also QIAO LIU, CORPORATE CHINA 2.0: THE GATE SHAKEUP (2016); Randall Peerenboom, *A New China Model for the Era Post Global Financial Crisis: Legal Dimensions*, in ROUTLEDGE HANDBOOK OF ASIAN LAW 54 (Christoph Antons ed., 2017).

putative generalizability of the defining characteristics drawn from China's overall development experience. The notion has attracted many admirers and led to numerous debates in recent years. The article goes beyond current discussions on corporate governance in China which tend to focus on the ineffectiveness and inefficiency of the current model and the possibilities of adopting the experiences of Anglo-American or German-Japanese models in order to reform SOEs, corporate law and government policy. The research has significant implications for policy makers both within and beyond the Asia-Pacific region and to enable us to better understand and deal with a globalized, value-pluralised model. An in-depth analysis of the administrative power will significantly aid policy makers in assessing the appropriateness of existing regulatory methods in relation to administrative governance; and shaping new regulatory trajectories, and how to apply administrative governance more effectively and fairly in China.

The economic development in China has been, and continues to be, one of the most significant developments in the world. An in-depth understanding of the nature of administrative corporate governance is important and should be essential for a broad range of people and including legal practitioners, in-house counsel who have to deal with corporate governance, and legal and business theorists who should realize the development of corporate governance in China is a journey with an uncertain direction. The research should be relevant not only to Chinese corporations, and especially listed ones, but also to foreign corporations wishing to engage in business relations with Chinese corporations to enable them to better understand and, possibly, accommodate administrative influence on corporate governance and thus equip them to do business in China in a fairer and more efficient manner. The focus of the article, administrative and government involvement and interference, is difficult to understand and even appears mysterious to western readers. The research aims to fill the gap so that board members, legal practitioners, academics and directors are aware of the functions, challenges and risks of administrative governance in a contemporary context rather than just simply linking those elements to the planned economy or government control of corporate decisions. The research will also help to determine how an appropriate corporate governance mechanism should be structured and developed and how it would tie in with current government policies and parties' plans.

The article proceeds as follows. In Section 2 we offer important background in the form of introductory discussions on economic and administrative corporate governance. In Section 3 and Section 4 we undertake a critical analysis of the history of China's transformation since economic reform which commenced in 1979, and this includes consideration of some internal and external pressures leading to this transition. Section 5 explores the opportunities of taking advantages of inevitable administrative governance, which may have wider implication for and impact on other jurisdictions



which have emerging markets.<sup>17</sup> Section 6 explores the features unique to the Chinese hybrid corporate governance model, the focus being on an analysis of administrative involvement in this system. Finally, there are some concluding remarks.

## II. INTRODUCTION TO ECONOMIC AND ADMINISTRATIVE CORPORATE GOVERNANCE

Economic corporate governance involves governance that is rooted in economic considerations. The central idea remains constant—the primacy of private and contractual solutions for reducing agency costs. For instance, in Anglo-American systems there tend to be a focus on the economic power of corporations, and as far as many corporations are concerned, this involves the directors running the corporation so that it can make as much profit as possible, and in such a way as to lead to the maximization of the shareholder wealth. The corporation is viewed as a contractually-based, profit-maximizing entity founded on this norm. Therefore, traditionally in these jurisdictions directors' duties are exclusively owed to the corporation, and the maximization of the wealth of the shareholders is the fundamental purpose of their fiduciary duties.<sup>18</sup> According to efficiency theory, it is more efficient if directors run corporations with the aim of maximising shareholder wealth since the least cost is expended in doing this. The directors can work more efficiently if they are focused on one objective only,<sup>19</sup> with-

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<sup>17</sup> See Stijn Claessens & B. Burcin Yurtoglu, *Corporate Governance in Emerging Markets: A Survey*, 15 EMERGING MKT. REV. 1 (2013); Joseph P.H. Fan, K.C. John Wei & Xinzhong Xu, *Corporate Finance and Governance in Emerging Markets: A Selective Review and an Agenda for Future Research*, 17 J. CORP. FIN. 207 (2011); Jingchen Zhao, *Promoting a More Efficient Corporate Governance Model in Emerging Markets through Corporate Law*, 15 WASH. U. GLOB. STUD. L. REV. 447 (2016).

<sup>18</sup> Jill E. Fisch, *Measuring Efficiency in Corporate Law: the Role of Shareholder Primacy*, J. CORP. L. 637 (2006); Stephen M. Bainbridge, *Director Primacy: the Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *In Defence of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); William Lazonick & Mary O'Sullivan, *Maximizing Shareholder Value: A New Ideology for Corporate Governance*, 29 ECON. & SOC'Y 13 (2000); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001); SHUANGGE WEN, *SHAREHOLDER PRIMACY AND CORPORATE GOVERNANCE: LEGAL ASPECTS, PRACTICES AND FUTURE DIRECTIONS* (2013).

<sup>19</sup> Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 56–57 (1996); see also Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8 (2001); Robert Daines, *Does Delaware Law Improve Firm Value?* J. FIN. ECON. 525 (2001); Guhan Subramanian, *The Disappearing Delaware Effect*, 20 J. L. ECON. & ORG. 32 (2004); Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775 (2002); Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and*

out any unpoliced managerial discretion.<sup>20</sup> Besides, in contractarian theory, which arguably underpins the nature of the corporation in Anglo-American jurisdictions, the contracts between the firm and its shareholders are implicit as all these contracts simply amount to a claim on the corporation's residual cash flow.<sup>21</sup> In Anglo-American corporations, there is now arguably a greater concern over corporate social responsibility (CSR) issues. Consideration is also given to the social, environmental, as well as the economic, often known as "the triple bottom line," but clearly economic concerns still predominate. Under the economic model there is no room for government intervention in private transactions between corporations and their stakeholders, and corporations rely more on stock and bond markets for external financing. It is believed that a contractual rather than a mandatory model of corporate governance is optimal for achieving economic efficiency, and the market should prevail in shaping the structure of corporate governance.<sup>22</sup> The model prevails in many common law countries with an effective legal enforcement of shareholder rights, but aspects of the model have been applied around the world. Corporate law under this model provides relatively extensive protections for shareholders, and courts are also relatively active in enforcing those protections. Corporate law is designed out of economic consideration for corporate development and survival, rather than with the objective of fairness or paternalism in mind.<sup>23</sup>

Administrative corporate governance has its own different characteristics which involves various forms of government and administrative interference and participation. As the article demonstrates, China began its journey with a totally administrative corporate governance framework. The characteristics of administrative corporate governance can be observed in relation to share ownership, corporate control, and corporate objective and the result being profit distribution, which is typical in those jurisdictions with elements of a planned economy. First, administrative corporate governance is always connected with the ownership of shares by the government and the historical dominance of SOEs in which the state owns the shares and controls the companies with what is often seen as a detrimental presence. SOEs have been rising in influence in the global economy over the past decade and based on a study by PricewaterhouseCoopers (PwC) SOEs increased from 3% of all companies in 2005 to 15% in 2014.<sup>24</sup> De-

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*Evidence*, 90 NW. U. L. REV. 898 (1996).

<sup>20</sup> Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 ORG. SCI. 350, 354 (2004).

<sup>21</sup> *Id.* at 355.

<sup>22</sup> Frank H. Easterbrook, *International Corporate Differences: Markets or Law?*, 9 J. APPLIED CORP. FIN. 23 (1997).

<sup>23</sup> FRANK H. EASTERBROOK & DANIEL R. FISHCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW*, vii (3d. ed. 1991).

<sup>24</sup> PwC, *STATE-OWNED ENTERPRISES: CATALYSTS FOR PUBLIC VALUE CREATION?* (2015),

spite the fact that the percentage of listed SOEs has dropped in China from 74.86% to 37.88 % in the period from 2003 to 2014, they still function as a crucial part of China's economy, carrying great economic weight by constituting 64.36% of the total market capitalization.<sup>25</sup> To date over 150,000 SOEs are active at the national and local level, with half of listed corporations under government control. These SOEs also seem to do relatively well in global competition: they control an astronomical \$690 billion in assets abroad, with forty-seven centrally-owned firms ranked in the Fortune Global 500 of 2016.<sup>26</sup>

Secondly, the dominance of state ownership always lead to control-based corporate governance. Therefore, the corporate objective is subject to the interference of government and political policies. Many listed companies, especially SOEs, do accommodate objectives other than profit maximization and these might include administrative goals. Apart from making profits, these corporations have other more immediate administrative missions such as the maintenance of urban employment, other social and environmental purposes or various administrative tasks required by the China Securities and Regulation Commission (CSRC) in order to regulate China's stock market. Administrative interference aims to serve the state's interests and strategic plans by controlling or influencing multifarious issues of business operation.<sup>27</sup> The administrative approach stems from the government policy in maintaining a full or controlling ownership in corporations so as to achieve direct control of key industries such as energy, banking, and telecommunications.<sup>28</sup> Furthermore, it can entail direct involvement in upstream industries due to their strategic importance in sustaining the growth of downstream industries.

Corporations subject to administrative power pursue the often-conflicting goals of maximizing profits on the one hand and contributing to national welfare, on the other.<sup>29</sup> Connecting with its unique corporate objec-

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<http://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf>.

<sup>25</sup> T.J. Wong, *Corporate Governance Research on Listed Firms in China: Institutions, Governance and Accountability*, 9 FOUND. & TRENDS IN ACCT. 259, 271-72 (2014).

<sup>26</sup> WENDY LEUTERT & BROOKINGS INSTITUTION, CHINA'S STATE ENTERPRISE REFORM: BIGGER, YES, BUT BETTER? FULL TEXT, (2015) <http://blogs.ft.com/beyond-brics/2015/04/23/chinas-state-enterprise-reform-bigger-yes-but-better/>.

<sup>27</sup> Harry X. Wu, *Accounting for the Sources of Growth in Chinese Industry 1980-2010, DEPENDING REFORM FOR CHINA'S LONG-TERM GROWTH AND DEVELOPMENT* 431, 432-33 (Ligang Song, Ross Garnaut & Cai Fang eds., 2014).

<sup>28</sup> Qiao Liu & Zhou Lu, *Corporate Governance and Earnings Management in the Chinese Listed Companies: A Tunneling Perspective*, 13 J. CORP. FIN. 881, 884 (2007); see also Lilian Soares Outtes Wanderley, Rafael Lucian, Francisca Farache & José Milton de Sousa Filho, *CSR Information Disclosure on the Web: A Context-Based Approach Analysing the Influence of Country of Origin and Industry Sector*, 82 J. BUS. ETHICS 369 (2008).

<sup>29</sup> Zhao Feng Wang, *Corporate Governance under State Control: The Chinese Experience*, 13 THEORETICAL INQ. L. 487, 488 (2012).

tive, the decisions relating to CSR, rather than being voluntary in nature, may be a part of orders given to corporations by government or be part of their corporate mission as constituting an element of political strategy. Many listed corporations in China are carve-outs or spin-offs from large SOEs which were set up after the establishment of the Chinese stock exchanges in the early 1990s. Therefore, they share personnel functions, capital, and assets with their parent corporations.<sup>30</sup> Their corporate strategy and profit distributions are closely related to the needs of administrative planning and policy, and their board members always have a close relationship with the government and civil servants. It is argued by Mead that the mode of corporate governance in China, in relation to the administrative approach, can be accurately described as “patrimonialism,” a combination of paternalism, hierarchical order, mutual obligation, familism, and personalism.<sup>31</sup> Under administrative governance, government at all levels act as a guardian of the public and an arbitrator in organizing enterprise interests and social interests to effectively supervise SOEs in fulfilling their CSR by way of administrative intervention and economic control.

A good example of the administrative corporate governance approach in China was the quota system that was introduced officially from 1993 to 2000 and which continued to exist on a *de facto* basis until 2002. This system relied on decentralized administrative governance as a key feature of market management during the transition period. The quota system served two functions while it operated, including mitigating the serious information problems faced by regulators and investors and incentivizing local bureaucrats to select viable corporations.<sup>32</sup> From 1993 to 2000 the CSRC had a quota on the number of corporate listings in any given period. It assigned control of this to the planning commission at the provincial level, and the commission distributed listings to initial public offering (IPO) candidates, and corporate restructuring was also organised in a way that was based on the actual quota an IPO firm obtained.<sup>33</sup> This was a system that involved allocating critical resources among the regions of China, and the annual quota for each region was established during intense bargaining between regional governments and relevant central agencies. The system played an important role in the era of economic development that was dom-

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<sup>30</sup> Qiao Liu & Zhou Lu, *Corporate Governance and Earnings Management in the Chinese Listed Companies: A Tunnelling Perspective*, 13 J. CORP. FIN. 881, 885 (2007).

<sup>31</sup> S. GORDON REDDING, *THE SPIRIT OF CHINESE CAPITALISM* (1990).

<sup>32</sup> David A. Caragliano, *Administrative Governance as Corporate Governance: A Partial Explanation for the Growth of China's Stock Markets*, 30 MICH. J. INT'L 1273, 1311 (2009).

<sup>33</sup> Qiao Liu & Zhou Lu, *Corporate Governance and Earnings Management in the Chinese Listed Companies: A Tunnelling Perspective*, 13 J. CORP. FIN. 881, 884 (2007); see also Qiao Liu, *Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants*, 52 CESIFO ECON. STUD. 415 (2006); Joseph P.H. Fan, T.J. Wong & Tianyu Zhang, *Politically Connected CEOs, Corporate Governance, and Post-IPO Performance of China's Newly Partially Privatized Firms*, 84 J. FIN. ECON. 330 (2007).

inated by the planned economy. It was regarded as a basic feature of regional economic management prior to and during the Chinese economic reform process.<sup>34</sup> It facilitated ordered market entry so that the government could, on one hand, maintain certain levels of controlling power over the size and stability of the stock market, and on the other, assure an appropriate level of equity financing for the state sector.<sup>35</sup> However, the system also generated problems. It provided opportunities for corruption and enabled local bureaucrats to have “rent-seeking” opportunities as the local bureaucrats selected the corporations to be IPO candidates and this created the chance for the officials to extract benefits from expectant corporations. Additionally, through the aforementioned control the government manipulated the market. From 2000, the system was abandoned in order to foster the market economy. Therefore, it is clear that the trajectory of administrative governance in China varies and depends on many factors, such as government policies and the state of economic development.

### III. HISTORICAL PROGRESS OF CORPORATE GOVERNANCE TRANSITION IN CHINA

In this part, some of the major milestones and key transformative issues will be discussed in terms of the development of corporate governance in China in order to identify reasons for, and evidence of, transition and to demonstrate the kind of transition that has occurred.

#### *Pre-1978*

Before 1978, only the system of administrative governance existed. SOEs largely operated under the centrally-planned economy and these corporations were managed by the committee of factory management, consisting of the head of the factory, management staff, and employee representatives.<sup>36</sup> However, the arrangement was abolished after the state launched the first five-year plan to carry out socialist transformation where private capital was integrated into public ownership pursuant to the basic Soviet development model of command planning.<sup>37</sup> Under this model, resource allocation decisions were made in response to command from government planners in the administrative hierarchy instead of responding to the market. The distinct characteristics of this model was discussed by Prybyla as hav-

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<sup>34</sup> Zhiwu Chen, *Capital Markets and Legal Development: The China Case*, 14 CHINA ECON. REV. 451, 454 (2003).

<sup>35</sup> Caragliano, *supra* note 33, at 1313.

<sup>36</sup> Article 2 7, Decree on Establishment of Factory Management Committee in State-operated and Public-operated Factories (*Guanyu guoying, gongyinggongchang jianli gongchang guanli weiyuanhui de zhishi*, 关于国营、公营工厂建立工厂管理委员会的指示), 1950.

<sup>37</sup> KUOTSAI TOM LIU, MANAGING ECONOMIC REFORMS IN POST-MAO CHINA 9-28 (1998).

ing vertical information flows, centralised coordination and property, and limited and concentrated participation in economic decisions.<sup>38</sup> SOEs were, under the model, not independent commercial entities and were owned by the people and functioned as tools by the government in order to deliver economic strategies and business management.<sup>39</sup> They were employed as branches or affiliates of government departments under highly centralised and planned management.<sup>40</sup> Prior to 1978, administrative governance was characterized by features such as public ownership,<sup>41</sup> state plan-directed production activities, price controls with a system of commodity allocation, and state investment and financial control systems.<sup>42</sup> The lack of an efficient market economy mechanism and the contribution by the private sector of only 22% to China's total industrial output at the time characterised the Chinese economy throughout this period.<sup>43</sup>

### *1978 to 1986*

Following the cultural revolution that attacked all forms of traditional Chinese culture, including the Chinese economy, 1978 was regarded as a key turning point in the development of the economy when the government adopted policies that encouraged greater autonomy for SOEs and granted more decision-making power to the management team, in line with the commencement of economic reform and the implementation of the opening up process.<sup>44</sup> As for corporate governance in China, a top-down approach was implemented by the Party in order to initiate the reform in late 1978<sup>45</sup> and this approach has been dominant, being a logical result of the absolute leadership by the Party in China and its determined desire to build a socialist market economy.<sup>46</sup> More than 4,000 SOEs were selected for a pilot

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<sup>38</sup> See JAN S. PRYBYLA, REFORM IN CHINA AND OTHER SOCIALIST ECONOMIES (1990); JAN S. PRYBYLA, ISSUES IN SOCIALIST ECONOMIC MODERNIZATION (1990).

<sup>39</sup> CHENXIA SHI, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCES IN CHINA 116–117 (2012).

<sup>40</sup> SHENG HONG & ZHAO NONG, CHINA'S STATE-OWNED ENTERPRISE: NATURE PERFORMANCE AND REFORM 1 (2013).

<sup>41</sup> This includes pre-dominant state ownership and collective ownership.

<sup>42</sup> Allen Huang & Chang Xun, *China*, in FINANCING REPORTING IN THE PACIFIC ASIA REGION (Ronald Ma ed., 1997).

<sup>43</sup> Franklin Allen, Jun Qian, & Meijun Qian, *Law, Finance, and Economic Growth in China*, 77 J. FIN. ECON. 57 (2005).

<sup>44</sup> See 3<sup>rd</sup> Plenary Session of the 11<sup>th</sup> Community Party Central Committee, PEOPLE'S DAILEY (24 December 1978), [http://news.xinhuanet.com/ziliao/2003-01/20/content\\_697755.htm](http://news.xinhuanet.com/ziliao/2003-01/20/content_697755.htm).

<sup>45</sup> This top-down approach required the Party's endorsement for corporate governance related plans and proposals, before being introduced as enforceable regulation by the National People's Congress (NPC) or its Standing Committee. Conversely, a bottom-up approach would be one based on free choice in a market economy.

<sup>46</sup> JANE FU, CORPORATE DISCLOSURE AND CORPORATE GOVERNANCE IN CHINA 6 (2010).

scheme that saw them subject to reforms including emphasis on SOE autonomy and profiting sharing.<sup>47</sup> SOEs started to have certain rights to plan and manage as well as to retain a portion of profits. The government introduced an economic accountability system in 1981, which offered more autonomous power to enterprises to allow them to become independent economic units, responsible, and accountable for their own profits and losses.<sup>48</sup> The reforms were carried out without contravening the original framework of a planned economy.<sup>49</sup> The main purpose of the changes introduced in this period offered corporations control rights over their corporate decisions and the operation of firms. It also gave employees and directors (factory heads) incentives and the right to make profits for enterprises to improve output and ensure revenue growth.<sup>50</sup>

### 1987-1992

In 1987, the Thirteenth National Congress of the Communist Party of China proposed the introduction of the joint-stock system. As a result, the property rights of small SOEs could be transferred to collectives or individuals. Since the late 1980s, the emergence and increasing acceptance of a basic economic and legal entity was accompanied by a series of financial reforms that replaced state budgetary grants. Stock markets were established, with the two official stock exchanges being equipped for operation by creating a new government body, the CSRC, to regulate them. A major step in the evolution of the economy was government policy on “separating control from ownership” which, in certain ways, represented the end of the planned economy in China and the start of economic restructuring.<sup>51</sup> The provision of a two-track system can be also observed in legislation.<sup>52</sup> It is clear that the relevant authorities still retained residual power as far as important decision-making was concerned,<sup>53</sup> but it prohibited the state and its

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<sup>47</sup> This was introduced by the State Council through “The Regulations on the Expansion of Operational Management Autonomy for State-Owned Industrial Enterprises” and “the Regulations on Retention of Profits by State-Owned Enterprises; in 1979. See Regulations on the expansion of the state-owned enterprise management autonomy (*Guanyu kuoda guoyingqiye jingying guanli zizhu gaige ruogan guiding* 关于扩大国营企业经营管理自主改革若干规定).

<sup>48</sup> State-owned enterprises on the provisions of retained earnings (*Guanyu guoying qiye shixing lirunliucheng de guiding* 关于国营企业实行利润留成的规定).

<sup>49</sup> Regulations such as the “Interim Regulation on the Employee’s Congress of SOEs” was enacted in 1982 and the “Interim Regulation on SOEs” was enacted in 1983.

<sup>50</sup> Hong, *supra* note 39, at 3.

<sup>51</sup> Joseph P.H. Fan, T.J. Wong & Tianyu Zhang, *The Emergence of Corporate Pyramids in China*, (CTR. ECON. INST., Working Paper No.2006-3), <http://ideas.repec.org/p/hit/hitcei/2006-3.html>; See also Stijin Claessens, Simeon Djankov & Larry H.P. Lang, *The Separation of Ownership in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000).

<sup>52</sup> Enterprise Law was introduced in 1988 as the first codified law for SOEs.

<sup>53</sup> [Law of Industrial Enterprises Owned](promulgated by Order No. 3 of the President of

organs from encroaching on the autonomy of SOEs in their organization of production and the managing of the business.<sup>54</sup> In addition, policies, rules, and regulations for protecting the non-state owned sector<sup>55</sup> provide a legal guarantee for the development of the non-state owned sector. Despite these reforms introduced in the regulation of SOEs and steps being taken to gradually subject SOEs to market forces, the ownership pattern remained largely unchanged during that period.<sup>56</sup> However, it is fair to say that a hybrid system, including both administrative and market-based corporate governance, was under development in China at this stage.

### *Modern Enterprise System after 1992*

In November 1993 following Deng's southern tour,<sup>57</sup> the Third Plenary Session of the Fourteenth National Congress of the Communist Party of China passed the "Decision on Several Issues for Establishing a Socialist Market Economy System by the Central Committee of the CPC," which stated that the "market was to play a fundamental role concerning the resources under macro control by the State."<sup>58</sup> After 1992, we see the emergence of a modern enterprise structure via legal reform, with the introduction of the first company and securities law in 1993, which confirmed the legal bases for non-SOEs and set out the rights and responsibilities of corporations as separate legal entities, boards of directors, and shareholders' general meetings. After these two pieces of legislation were put in force, three periods followed which marked the start of the evolution of a modern corporate governance system. The first one focused on incorporatization and securitization reform (1992–1999), the second one on capital market development, and the third on implementing best corporate governance practices.<sup>59</sup> An important "decision" was adopted in 1999,<sup>60</sup> identifying

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the People's Republic of China., April 13, 1988, effective Aug. 1, 1988), art. 55, <http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200303/20030300072563.shtml> (Such as issuing a unified mandatory plan, appointing, and approving the appointment of the factory head (directors) and management).

<sup>54</sup> Article 58, Law of Industrial Enterprises Owned.

<sup>55</sup> Such as the Interim Regulations for the Administration of Urban and Rural Individual Industrial and Commercial Businesses, the Law of Foreign Invested Enterprises, and the Provisional Regulations of Private Enterprises were successively promulgated.

<sup>56</sup> Wei Shen, Qiong Zhou & Chung-Ming Lau, *Empirical Research on Corporate Governance in China: A Review and New Directions for Future*, 12 MGMT. & ORG. REV. 41, 43 (2016).

<sup>57</sup> On his Southern tour in 1992, Deng Xiaoping gave a series of speeches that are regarded as keynote addresses that signaled the beginning of the marketization of China's economy.

<sup>58</sup> See CPC Central Committee's Decision on Several Issues for Establishing a Socialist Market Economy System 1993.

<sup>59</sup> Jane Fu, CORPORATE DISCLOSURE AND CORPORATE GOVERNANCE IN CHINA 12 (2010).

<sup>60</sup> See the Fourth Plenum of the Chinese Communist Party's 15th Central Committee in



corporate governance as the core element of the modern enterprise system. During this period the market oriented economy started to play an increasingly important role, with 75% of industrial output being contributed by the private sector and, by 1999, these sectors employed more than 70% of non-agricultural employees.<sup>61</sup>

Since the advent of the new Chinese Company Law 2005 and its amendment in 2013, corporate governance developments in China have entered a new phase where effective corporate governance mechanisms and practices have become a necessary condition to achieving sustainable and enduring prosperity in the context of a globally competitive market economy.<sup>62</sup> All in all, a wide range of modern corporate governance mechanisms and practices have been adopted and adapted in China, which aim to keep corporate governance and law development consistent with its rapid economic transformation and development, such as independent directors,<sup>63</sup> supervisory boards,<sup>64</sup> and CSR.<sup>65</sup> However, inherent systemic problems remain, which hinder the effectiveness and efficiency of a sound corporate governance framework. In particular, the latest corporate law reform, involving the abolition of minimal capital,<sup>66</sup> suggested that the Chinese were ready for a bigger dose of market liberalism because regulations that impeded the entry of new firms or restricted competition were abolished. Echoing the powerful rhetoric of aligning Chinese corporate law more closely with that of other developed economies, much scholarly ink has been spilled in China. These scholars commended this legislative change as the “*legal cornerstone underpinning China’s future economic development*,”<sup>67</sup> and advocated its effectiveness in prompting the growth of the private economy. Further, many also see this legislative change as an infusion of Anglo-American liberal market values, because it is portrayed as being bor-

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September 1999.

<sup>61</sup> Franklin Allen, Jun Qian, & Meijun Qian, *Law, Finance, and Economic Growth in China*, 77 J. FIN. ECON. 57 (2005).

<sup>62</sup> On Kit Tam & Celina Ping Yu, *China Corporate Governance Development*, in HANDBOOK ON INTERNATIONAL CORPORATE GOVERNANCE: COUNTRY ANALYSES 223, 223 (Chris A. Mallin, 2<sup>nd</sup> edn., 2011).

<sup>63</sup> Chinese Company Law 2006, promulgated by The Standing Committee of the National People’s Congress, December 28, 2013, Article 122.

<sup>64</sup> Chinese Company Law 2006, promulgated by The Standing Committee of the National People’s Congress, December 28, 2013, Articles 51-55.

<sup>65</sup> Chinese Company Law 2006, promulgated by The Standing Committee of the National People’s Congress, December 28, 2013, Article 5.

<sup>66</sup> See the codified Company Law 2006 in 2013 (updated Article 26 and deletion of original 27(3) and 29).

<sup>67</sup> Junhai Liu, *The 2013 New Company Law is the Legal Cornerstone of China’s Economic Development*, (2013 *Nian Xingongsifa Shi Dazao Zhongguo Jingji Shengjiban de Falv Jishi*) (2013 年新公司法是打造中国经济“升级版”的法律基石) (May 12, 2014), <http://lad.ccpit.org/second/index.aspx?nodeid=47&page=ContentPage&contentid=1777> (emphasis added).

rowed from the U.S. legal capital regime.<sup>68</sup> These issues have their roots in administrative involvement or overly strong administrative power in the Chinese corporate governance system. Some examples include: negative consequences emanating from the dominance of state ownership of many listed corporations, the role of big state-owned banks and their influence on corporations, poor discourse and monitoring processes due to the relationship between boards of directors and government officials, and the weak enforcement of laws. These issues require us to reconsider the function, drawbacks, and challenges of administrative corporate governance, including the role played by the government and Party organizations, and issues of multiple regulators, corporate culture, and corporate objectives.<sup>69</sup>

Chinese corporate governance is moving towards a modernized model, following the principles formulated by the OECD and the introduction of regulatory changes and new rules that affect corporate governance practices in China. The reform policy is to reduce the role of government planning, and make sure the market plays a more important and active role, with the hope that it will cure China's enduring problems of administrative interference and multiple lines of command over economic activities. The corporate law legislation has been reviewed and amended in order to ensure that corporations are regarded as separate legal entities. The main goal of the transition is to build a governance system that is able to provide motivation for investment, adequate restraint and monitoring of management, and promote the optimal use of resources for wealth creation.<sup>70</sup> Against the backdrop of the Law and Development Movement, which has dominated in past decades, and sought to promote an international order of economic and social institutions similar to those in more advanced economies,<sup>71</sup> some scholars suggest that the first and foremost purpose of such burgeoning borrowing activities in China is to prepare for the international unification of law

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<sup>68</sup> *Id.*; Junhai Liu, *A Proposal to Reform the Company Law and Securities Act Simultaneously* (Jianyi Gongsifa yu Zhengquanfa Liandong Xiu gai Jianyi 《公司法》与《证券法》联动修改) 4 LEGAL FORUM (2013).

<sup>69</sup> Addressing these issues takes place in relation to the emerging Chinese economy which was the world's largest goods economy by 2014 (*China 'overtakes' US as world's largest goods trader*, BBC (Jan. 10, 2014), <http://www.bbc.co.uk/news/business-25678415>), the second largest consumer economy by 2013, possessed the largest foreign reserves by 2009 (*The World's Second Biggest Consumer*, THE ECONOMIST (February 18<sup>th</sup> 2014), <http://www.economist.com/blogs/analects/2014/02/chinas-econom>), and the second largest world economy overall by 2011 with annual GDP growth rates of 9–10 per cent for 30 years (*China Overtakes Japan as World's Second-Largest Economy*, THE GUARDIAN (FEB. 14, 2011), <http://www.theguardian.com/business/2011/feb/14/china-second-largest-economy>).

<sup>70</sup> Jian Chen, CORPORATE GOVERNANCE IN CHINA 25 (2005).

<sup>71</sup> Tom Ginsburg, *Does Law Matter for Economic Development? Evidence from East Asia* 34 L. & SOC'Y REV. 829, 829 (2000); Brian Z. Tamanaha, *The Lessons of Law-and-Development Studies* 89 AM. J. INT'L L. 470, 471 (1995).

amid globalization.<sup>72</sup> The transition process entails changing the corporate objective and the management team appointment process, identifying new capital sources, reallocating resources and shifting away from state monopoly control to mixed and shared control in order to facilitate fairness, predictability, and business confidence.<sup>73</sup> Despite the fact that policy-makers may have favoured an economic model in principle at the beginning of the planned reform,<sup>74</sup> the reality has been the evolution of a dynamic hybrid model that changes with economic advancement, and legal and cultural development in Chinese society as a whole.

#### IV. REASONS FOR TRANSITION

As China enters a more advanced phase with a transformed corporate governance system, following the introduction of adjustments and the provision of corporate governance reforms, it not only faces opportunities for development as the result of external pressure and globalization, but also challenges to the preservation and strengthening of its reform policies. The reasons for the transformation are based on the following elements.

##### *Corporatization*

China's corporate governance reform is aimed at transforming traditional SOEs into modern, competitive firms operating on a market basis, which has been regarded as the core element of continuing economic liberalization and structural reforms.<sup>75</sup> Early attempts at the reform of SOEs did not solve the inefficiency problems of Chinese corporate governance because of their limited focus on managerial incentives and autonomous expansion, without addressing or challenging fundamental ownership concerns. The corporatization process in China took place in multiple stages, in the 1990s, 2000, and 2014.<sup>76</sup> It is regarded as a part of economic reform in which stock markets are seen as an alternative to bank lending as ways of providing new sources of capital to the state sector. With the endorsement

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<sup>72</sup> Kahn-Freund has identified three prime purposes of legal transplantation, namely, "first, with the object of preparing the international unification of the law, secondly, with the object of giving adequate legal effect to a social change shared by the foreign country with one's own country, and thirdly, with the object of promoting at home a social change which foreign law is designed either to express or to produce." O. Kahn-Freund, *On Uses and Misuses of Comparative Law* 37 MOD. L. REV. 1, 27 (1974) at 2.

<sup>73</sup> Roman Tomasic, *Company Law Implementation in the PRC: The Rule of Law in the Shadow of the State*, 15 J. CORP. L. STUD. 285, 285 (2015).

<sup>74</sup> Jian Chen, *CORPORATE GOVERNANCE IN CHINA* 61 (2005).

<sup>75</sup> LENG JING, *CORPORATE GOVERNANCE AND FINANCIAL REFORM IN CHINA'S TRANSITION ECONOMY* 2 (2009).

<sup>76</sup> See Gabriel Wildau, *China Kicks off Second Round of Corporatisation*, FIN.TIMES (Aug. 10, 2014), <http://www.ft.com/cms/s/0/ec28674c-13ac-11e4-84b7-00144feabdc0.html#axzz3DOzmmx3b>.

of the Fourteenth National Congress of the Party in 1993, forms of ownership by the State were diversified, private and foreign investors entered the market, and a modernized corporate governance framework for SOEs was introduced. Thousands of poorly performing national and regional SOEs were privatized or liquidated.<sup>77</sup>

China's corporatization reform is regarded as a complicated and interactive process because official ideologies, national policies, and the interests of the involved parties have become intertwined in a dynamic manner.<sup>78</sup> This process transforms corporate governance, especially in terms of the government and administrative involvement. With the first serious attempt at SOE reform, which commenced in the early 1990s, the government tackled ownership reform in the SOE sector, and aimed to diversify the ownership structure of SOEs, by transforming them into corporations, limited by shares, with an economic corporate governance structure. The most direct method of corporatisation was the split-share structure that granted legitimate trading rights to the state-owned shares of listed SOEs.<sup>79</sup> This was a process where a certain percentage of an SOE's shares were held by the government, but it enabled the SOE to go public by issuing minority tradable shares to investors, which opened China for corporatization. The reason for reorganizing the shareholding structure in a split-share structure was to retain government control over corporations, but allow for market mechanisms to influence and discipline corporations at the same time.<sup>80</sup> This split maintained certain degrees of government and administrative involvement in listed SOEs after reform. There was mixed share ownership in tradable and non-tradable shares co-existing in listed corporations, and increased involvement of market power in the capitalization of corporations. The launch of the Shanghai and Shenzhen stock markets made the trading of shares possible for listed corporations. The launch also represented a significant step towards market-oriented corporate governance reform and cor-

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<sup>77</sup> *Id.*

<sup>78</sup> Chao Xi, Book Review of Yong Zhang, *Large Chinese State-Owned Enterprises: Corporatization and Strategic Development*, Basingstoke & New York: Palgrave Macmillan 2008, 197 *THE CHINA Q.* 217, 218 (2009).

<sup>79</sup> Li Liao, Bibo Liu & Hao Wang, *China's Secondary Privatization: Perspectives from the Split-Share Structure Reform*, 113 *J. FIN. ECON.* 500, 500 (2014).

<sup>80</sup> Henk. Berkman, Rebel A. Cole & Lawrence J. Fu, *Improving Corporate Governance where the State is the Controlling Block Holder: Evidence from China*, 20 *EUROPEAN J. FIN.* 752 (2014); see also Qian Sun & Wilson H.S. Tong, *China Share Issues Privatization: the Extent of its Success*, 70 *J. FIN. ECON.* 188 (2003); Michael A. Firth & Oliver M. Rui, *Does One Size Fit All? A Study of the Simultaneous Relations among Ownership, Corporate Governance Mechanisms and the Financial Performance of Firms in China*, in *CORPORATE GOVERNANCE: RECENT DEVELOPMENT AND NEW TRENDS* (Sabri Boubaker, Bang Dang Nguyen & Duc Khuong Nguyen eds., 2012); Kehan Xu, Laszlo Tihanyi & Michael A. Hitt, *Firm Resources, Government Power and Privatization*, 20 *J. MGMT.* 1 (2014); Young-Sam Kang & Byung-Yeon Kim, *Ownership Structure and Firm Performance: Evidence from the Chinese Corporate Reform*, 23 *CHINA ECON. REV.* 471 (2012).

poratisation in China, as it represented one of the main events that marked the transformation from a purely administrative model to a hybrid one. In this hybrid model, the government aimed to promote SOEs output, profits, and more efficient employment patterns with the involvement of market power and participation of private and foreign investments. The stock markets served as a conduit to channel the investment of domestic citizens and passive foreign investors into the ailing SOEs.<sup>81</sup> The reform adopted market mechanisms, which played an innovative role in aligning the interests of the government and public investors. The corporatization process mitigated the role played by the State by reducing its ownership, and opening up the securities market to enable investors to share the risk and profit of enterprises that had hitherto been controlled by and been responsible to the State.

### *Foreign Investment and Entering into the WTO*

According to figures from the United Nations Conference of Trade and Industry, foreign corporations invested \$128.5bn, which made China the top destination for foreign direct investment in 2014.<sup>82</sup> The dramatic increase of foreign investment is regarded as an external push for the development of corporate governance towards a position where there is less government interference and administration in the private sector, making it a better fit for the internationalised equity market. In this sense, Chinese corporate governance may have benefited from the impact of foreign investment on governance and performance. Government regulators have allowed an increasing number of foreign investors to take up substantial shareholdings, which is desirable because of the investors' experience, sophistication, and the potentially positive influence that they may bring to Chinese corporate governance.<sup>83</sup> China's accession to the WTO is a key aspect of its integration into the world economy, and constitutes both an economic and a symbolic policy success.<sup>84</sup> James Wolfensohn, former president of the World Bank group, suggested that China needed to improve its corporate

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<sup>81</sup> David A. Caragliano, *Administrative Governance as Corporate Governance: A Partial Explanation for the Growth of China's Stock Markets*, 30 MICH. J. INT'L L. 1278, 1293 (2009).

<sup>82</sup> *China Overtakes US for Foreign Direct Investment*, BBC (Jan. 30, 2015), <http://www.bbc.co.uk/news/business-31052566>; China is also at the top of the 2014-2015 list of the corporations most attractive to multinational corporations.

<sup>83</sup> Samuel A. Beatson, Jia Chen & Shujie Yao, *Foreign Investment, Corporate Governance & Performance in the Chinese Listed A Share Companies*, (School of Contemporary Chinese Studies and China Policy Institute Working Paper Series of 2014), [www.nottingham.ac.uk/cpi/. . ./working-paper-18-samuel-a-beatson.pdf](http://www.nottingham.ac.uk/cpi/. . ./working-paper-18-samuel-a-beatson.pdf).

<sup>84</sup> Razeen Sally & Rahul Sen, *Whither Trade Policies in Southeast Asia? The Wider Asian and Global Context*, 22 ASEAN ECON. BULL. 92 (2005). After an arduous negotiation process lasting more than fifteen years, China became a member of the WTO, a body that probably constitutes the most remarkable achievement of economic globalization in recent years.

governance in order to attract more foreign investment, and survive international competition following its WTO entry. He also suggested that China needed to address “special problems as a country with a huge number of State-owned enterprises.”<sup>85</sup> Trade liberalization in the context of WTO entry created pressure to reallocate productive resources according to China’s comparative advantages, which was regarded as the exercise of external pressure on China to transition to a market economy. It suggests that corporate governance arrangements will decide the way that corporations and other economic agents responded to these pressures.<sup>86</sup> The foreign investment and accession of China to the WTO can be regarded as constituting external pressure on the Chinese government to adopt international guidelines, and to make Chinese corporations more familiar with western corporate governance practices.

### *Corporate Governance Guidelines and Internationally Recognized Guidelines*

Apart from the government legislation for corporation law, the CSRC played an active role in improving corporate governance. In January 2001, the CSRC issued its *Code of Corporate Governance for Listed Companies* (the Code) in China. The Code, like many other codes around the world, contains broad and vague language describing guiding principles, rather than providing explicit regulation. The Code converges considerably with international corporate governance guidelines, since the draft largely relied on the OECD’s *Corporate Governance Principles*,<sup>87</sup> and almost all the provisions contained in it have parallel provisions in the law of the United Kingdom and the United States or the UK Corporate Governance Code. Despite the fact that there are many doubts whether the OECD Principles are appropriate in an emerging economy like China,<sup>88</sup> the Code proposes good corporate governance practices, including the requirement for active boards of directors, independent outside directors as a majority of the board, and protecting the interests of minority shareholders and stakeholders,

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<sup>85</sup> *WB President: Urgent to Improve Corporate Governance in Post-WTO China*, PEOPLE’S DAILY (May 27, 2002), <http://www.china.org.cn/english/33352.htm>.

<sup>86</sup> STOYAN TENEV & CHUNLIN ZHANG & LOUP BREFORD, *CORPORATE GOVERNANCE AND ENTERPRISE REFORM IN CHINA: BUILDING THE INSTITUTIONS OF MODERN MARKETS 2* (2002). WTO membership has been seen as the most important government push for SOE reform, characterized by the acceleration of decentralized corporatization and the emphasis of corporate governance primacy, with corresponding financial reforms in the banking and securities sectors.

<sup>87</sup> Organization for Economic Co-operation and Development [OECD], *OECD Principles of Corporate Governance* (May 1999). While the guidelines have since been update in 2015, this is the version that has been followed by the Code. See Victor Zitian Chen, Jing Li & Daniel M. Shapiro, *Are OECD-prescribed “Good Corporate Governance Practices” Really Good in an Emerging Economy*, 28 ASIA PAC. J. MGMT. 115 (2011).

<sup>88</sup> See Chen, Li & Shapiro, *supra* note 87.

which all require strong free markets and economic governance with minimum government interference.

The International CSR standards have been regarded as examples of external pressure brought to bear for the development of corporate governance in China. The most popular standard for manufacturers in China is SA8000.<sup>89</sup> However, adopting SA8000 is a controversial issue in China, because there are various opinions about the role of CSR standards in the global supply chain. That the Chinese authorities now recognize CSR as a way to improve the competitiveness of corporations suggests that the impact of SA8000 on Chinese industry and export-oriented firms has been taken on board.<sup>90</sup> The International Integrated Reporting Council introduced ISO 26000, the Guidance on Social Responsibility, in 2010 as a new approach to corporate reporting, and it has had a significant impact worldwide. The Standardization Administration of the People's Republic of China published and translated a Chinese version of ISO 26000, under the authorization of the International Organization for Standardization, and provides "a solid start" as a new way of conducting business.<sup>91</sup> These internationally recognized CSR standards make a self-regulatory framework increasingly important for Chinese corporations, to promote their corporate image and sustainability. They also address social and environmental problems, which were regarded as government problems that may only be settled through government policies and economic strategies in SOEs under administrative governance.

### *Cross-listing of Chinese Corporations*

Figures from 2012<sup>92</sup> show that eighty-four Chinese listed companies cross-listed their stocks.<sup>93</sup> Cross-listing securities is an efficient way to ac-

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<sup>89</sup> See SOCIAL ACCOUNTABILITY ACCREDITATION SERVICES, <http://www.saasaccreditation.org>. SA8000 is now internationally recognised and widely accepted as the most viable and comprehensive workplace management system for ethical issues. The system requires ongoing compliance and continual improvement of ethical standards of corporations, with involvement from stakeholders including participation by all key sectors in the SA8000 system, including employees, trade unions, companies, socially responsible investors, nongovernmental organisations, the government and the public.

<sup>90</sup> LIANGRONG ZU, CORPORATE SOCIAL RESPONSIBILITY, CORPORATE RESTRUCTURING AND FIRM'S PERFORMANCE 46 (2009).

<sup>91</sup> Chen Wang, *ISO 26000 in China: A New Way of Doing Business*, ISO FOCUS+, May 2012.

<sup>92</sup> Fuxiu Jiang & Kenneth A. Kim, *Corporate Governance in China: A Modern Perspective*, 32 J. CORP. FIN. 190, 213 (2015). Eight-four Chinese listed corporations are cross-listed on another stock exchange, including eighty on the Hong Kong stock exchange, ten on both the Hong Kong and New York stock exchanges, one on the Singapore stock exchange and two on both the Hong Kong and London stock exchanges. One is on three exchanges, namely the Hong Kong, New York and London stock exchanges.

<sup>93</sup> Jiang & Kim, *supra* note 92, at 113. There are seventy firms listed on the Hong Kong

cess international financial markets, and it is a mechanism that is often related to improved corporate governance practices in a stronger investment environment, providing higher requirements for information disclosure and corporate governance rules.<sup>94</sup> Cross-listing may also help corporations improve their corporate governance by voluntarily embracing both stronger regulatory regimes and soft laws, which include regulations for stock exchanges and corporate governance codes required by the host exchange.<sup>95</sup> As to corporations in emerging markets, cross-listing through American Depository Receipts programs is associated with more crossborder flows, and greater integration in globalized capital markets.<sup>96</sup> A good example of enhanced cross-listing is South Korea, where listed corporations are given the option to cross-list in nine foreign stock markets,<sup>97</sup> as part of the country's modernization and globalization, and embrace of convergent corporate governance practice. The percentage of firms cross-listed in the United States by Chinese corporations increased from 6% (ranked fifth), at the end of 2000, to 29% (ranked first), at the end of 2010.<sup>98</sup>

Despite the fact that listing on the Hong Kong or Singapore stock exchanges may be more feasible and culturally friendly to Chinese corporations, these advantages have not dissuaded Chinese investors from listing in the US. China still has the highest percentage of cross-listing in the US. The high-volume cross-listing will inevitably transform the corporate governance model in China towards a more Anglo-American model. Aguilera and Cuervo-Cazurra have also argued that cross-listing in a US-based exchange is likely to implant a corporate governance code to enhance the efficiency of corporate governance in China.<sup>99</sup>

Further, accounting and reporting practices of cross-listing Chinese corporations will therefore converge with those requirements extant in the US. These requirements are normally designed to avoid market abuse, and the enforcement of these regimens will reduce the involvement of administrative governance. It is argued that cross-listing can facilitate competition

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Stock Exchange, ten are listed on both the Hong Kong and New York Stock Exchanges, one corporation is listed on the Singapore Stock exchange, and two are listed on both the Hong Kong and London Stock Exchanges.

<sup>94</sup> John C. Coffee Jr., *Do Norms Matter? A Cross-country Evaluation*, 149 U. PA. L. REV. 2151 (2001).

<sup>95</sup> Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY INT'L L. J. 195, 201-202 (2004).

<sup>96</sup> G. Andrew Karolyi, *The Role of American Depositary Receipts in the Development and Integration of Emerging Equity Markets*, 86 THE REV. ECON. STAT. 670 (2003).

<sup>97</sup> The cross-listing stock exchanges include NYSE, NASDAQ, AMEX, and stock markets in London, Frankfurt, Paris, Tokyo, Hong Kong and Singapore.

<sup>98</sup> The data is adapted from Citibank Universal Issuance Guide (data refers to the NSDAQ and NYSE) (2011).

<sup>99</sup> Ruth V. Aguilera & Alvaro Cuervo-Cazurra, *Codes of Good Governance Worldwide: What is the Trigger?*, 25 ORG. STUD. 415 (2004).



among stock exchanges in terms of regulatory competition with resulting harmonisation and/or convergence.<sup>100</sup> Listing corporations in jurisdictions with more developed legal systems and corporate governance models will subject corporations to a higher governance standard and a more sophisticated market discipline. On a different note, cross-listing will change the shareholding structure in China and reduce the concentrated ownership of the State. This will also lead to the greater internationalisation of Chinese corporations.

## V. ADVANTAGES OF ADMINISTRATIVE ASPECTS OF CORPORATE GOVERNANCE

The problems that administrative governance can cause are deeply rooted in the Chinese political system, culture, and shareholding ownership scheme. Government involvement and administrative governance will be elements of Chinese corporate governance as long as the Party is the sole political party in China and state ownership and control exists. The Party's participation constitutes the primary way to secure political support to ensure that it remains in power. The market transition in China from a poor agrarian economy based in state socialism to a dynamic capitalist engine has riveted attention on the role played by government and administrative power in promoting transformative economic development.<sup>101</sup> It is submitted that both administrative and economic governance will co-exist in China for a long time without the likely possibility of convergence to any extreme models. Thus, it is worth discussing how advantage might be taken of administrative governance in order to enhance fairness, efficiency and accountability in corporate governance, and to provide a more sound and sustainable response to globalisation of the Chinese market and economy. These positive effects may also be relevant to other jurisdictions that have emerging and/or mature markets.

### *A Critical but Accepting Attitudes towards Administrative Governance*

For the pure economic corporate purpose of maximizing firm value there should be no state control and ownership concentration in China. Administrative governance can be explained by politically-oriented reasons, such as retaining the ability of the state to impose on corporations aims other than shareholder value maximization. These include retaining employees, enhancing societal harmony, ensuring employment across both urban and rural areas, maintaining control of certain industries, and the provision of

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<sup>100</sup> Hwa-Jin Kim, *Cross-Listing of Korean Companies on Foreign Exchanges: Law and Policy*, 3 J. KOREAN L. 1, 13 (2003).

<sup>101</sup> Victor Nee, Sonja Oppen & Sonia Wong, *Developmental State and Corporate Governance in China*, 3 MGMT. & ORG. REV. 19, 19 (2007).

social safety net services.<sup>102</sup> Premier Li has argued that government is the organiser for reform, and also the promoter of, and the object for, economic reform. Therefore, consideration needs to be given to how to enhance the positive role played by administrative governance in this transition.<sup>103</sup> Looking to the future, the Economist predicted that China will emerge as the largest economy in the world by 2021.<sup>104</sup> We maintain that healthy and sound corporate governance will play a vital role in China's self-sustaining momentum, and administrative power and interference are unavoidable and critical.<sup>105</sup>

In the liberal political economy proposed by Adam Smith in his seminal work, *An Inquiry into the Nature and Causes of the Wealth of Nations*,<sup>106</sup> the government monitors and enforces the regulatory environment in which corporations compete for profit, but it should not directly be involved in a corporation's decisions and transactions. Since this was posited, many reasons have been advanced arguing that state control over commercial transactions will lead to benefits for business organisations. It is argued that, based on the efficiency of the corporate form, direct involvement of state officials will impose on the corporations' multiple political interests which will dilute marketing motives when social objectives collide with shareholders' wealth maximisation. Information asymmetry and uncertainty will constrain the effectiveness of coordination and interference from government. The willingness of the government to share the risk might both weaken the motivation of corporations to make more profits and lead to soft budgetary constraints with a subsequent attenuation of a firm's efficiency. However, the effectiveness and necessity of government interference in business organisations has been questioned and discussed in various dimensions especially after the financial crisis of 2008. Instead of having a direct role in facilitating and shaping the dynamic growth played by the state, it is posited that the State's ability in creating and maintaining a supportive climate of growth is key for an emerging market to achieve good levels of economic development and stability.<sup>107</sup> However, it is important for admin-

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<sup>102</sup> See *supra* note 75, at 226. It is argued that the most important political reason for maintaining state ownership is to defend the ruling position of the Party under the current political regime in terms of economic ownership and control of resource allocation, which is regarded as an important basis for the authority and legitimacy of government.

<sup>103</sup> Li Keqiang, *Some Issues on Deepening Economic System Reform*, SEEKING TRUTH (Sept. 2014), [http://www.qstheory.cn/zxdk/2014/201409/201404/t20140428\\_344319.htm](http://www.qstheory.cn/zxdk/2014/201409/201404/t20140428_344319.htm).

<sup>104</sup> *Chinese and American GDP Forecasts: Catching the Eagle*, ECONOMIST, Nov 21st 2013, <https://www.economist.com/blogs/graphicdetail/2014/08/chinese-and-american-gdp-forecasts>

<sup>105</sup> *The New Titans: A Survey of the World Economy*, ECONOMIST, Sept. 14, 2006, at 5.

<sup>106</sup> ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (Edwin Cannan ed. 1777).

<sup>107</sup> Guido Bertucci & Adriana Alberti, *Globalization and the Role of the State: Challenges and Perspectives*, in *REINVENTING GOVERNMENT FOR THE TWENTY-FIRST CENTURY: STATE*

istrative involvement to be effective and only applicable when necessary. Positive attempts have been made to modernize the administrative governance system and reduce transaction costs, including abolition of both the minimum registered capital<sup>108</sup> and the current paid-in capital registration system.<sup>109</sup> These legislative reforms aim to abolish excessive administrative burdens, reduce both bureaucratic procedures and the cost of market entry in order to stimulate investment, and make administrative governance flexible to fit with inevitable developments.

### *Long Term Strategic Planning and Multiple Goals of SOEs*

It is argued that, government intervention, often the most visible aspect of administrative governance, may inevitably change the corporate objective of SOEs in the direction that is preferred or designed by the government.<sup>110</sup> This distortion of the corporate objective may lead to investment inefficiency. SOEs may miss profitable investment opportunities due to the resources expended in executing the plans and policies of the government, and SOEs may find it difficult to terminate the unprofitable projects or reduce their investment in these projects due to potential conflicts with government agenda and policy.<sup>111</sup> However, to see this as totally negative ignores various support that could be offered to corporations subject to administrative governance. This support includes giving boards of directors the right to consider the long-term interests of corporations, and to make recommendations on the long-term strategic development plans and major investment decisions of the corporation as provided for in the corporate governance code. Within allowances made by government, administrative governance enables the corporation to employ corporate profit for further internal and external investment expansion and sustainable corporate strategic development. It also lays the foundation for government supervision in order to mitigate the problems resulting from unstable financial markets in China. Furthermore, at the international level, SOEs are at the forefront of negotiations and business relationship with foreign governments, multinational corporations and international institutional investors who are willing

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CAPACITY IN A GLOBALIZING SOCIETY 17-33 (Dennis A. Rondinelli et al. eds., 2003).

<sup>108</sup> Company Law of the People's Republic of China 2005, arts. 26 & 81. Under the unrevised Law, the minimum registered capital was RMB5 million (about US\$800,000) for a corporation limited by shares, and RMB30,000 (about US\$5,000) for a corporation with limited liability.

<sup>109</sup> Company Law of the People's Republic of China 2005, arts. 26, 30, 81 & 84 (requiring companies to file details of both their registered capital and paid-in capital with the State Administration for Industry and Commerce or its relevant branch. Furthermore, it removes the requirement for minimum cash contributions making up 30% of the registered capital based on Unrevised Company Law Arts 27).

<sup>110</sup> Justin Y. Lin, ET AL., *Competition, Policy Burdens, and State-owned Enterprise Reform*, 88 AM. ECON. REV. 422 (1998).

<sup>111</sup> *Id.* at 425-27.

to interact with the Chinese government and Chinese corporations. State presence in SOEs is significant for the long-term healthy growth of the global economy and the sustainability of business and civil society as a whole.

An excessive concentration on short-term considerations is one reason often given for the rapid financial growth globally in the last decade and the ongoing worldwide crisis.<sup>112</sup> A lack of long-term goals and investment in human and social capital has been regarded as a patent problem for Anglo-American corporations, which has led to competitive disadvantages.<sup>113</sup> Short-term motivation has led to the pursuit of short-term reckless business strategies and insufficient risk management. The political economy literature has observed that government and administrative agencies are typically serving multiple goals which could, in the short run, impede corporations pursuing long-term interests.<sup>114</sup> Administrative governance with government interference may ease the pressure of corporations pursuing shareholder value in the short-term and put the emphasis on the long-term value of corporations and national goals. Administrative governance could be used as an additional governance mechanism to mitigate conflicts such as those that exist in the case of corporations trading across community boundaries, secondary policies in public procurement, and redundancies and reemployment to secure broader social consensus. Thus, administrative governance could facilitate and shape dynamic economic growth by establishing supportive business environments and introducing legislation that enables rather than hinders investors to establish corporations as vehicles to do business.

Following the financial crisis of 2008, both government policies and

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<sup>112</sup> Sheila Bair, *Lessons of the Financial Crisis: The Dangers of Short-Termism*, Posted by the Harvard Law School Forum on Corporate Governance & Financial Regulation, on Monday, July 4, 2011 available via <https://corpgov.law.harvard.edu/2011/07/04/lessons-of-the-financial-crisis-the-dangers-of-short-termism/>; John C. Coffee, *What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis*, 9 J. CORP. L. STUD. 1(2009); William Lazonick, *In the Name of Shareholder Value: How Executive Pay and Stock Buy-backs are Damaging the US Economy*, in THE SAGE HANDBOOK OF CORPORATE GOVERNANCE, 476 (Thomas Clarke & Douglas Branson eds., 2012); Emiliós Avgouleas, *The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy*, 9 J. CORP. L. STUD. 23 (2009); Shaun Frencha, ET AL., *A Very Geographical Crisis: the Making and Breaking of the 2007-2008 Financial Crisis*, 2 CAMBRIDGE J. REGIONS, ECON. & SOC'Y 287 (2009); Thomas Clarke, *The Impact of Financialisation on International Corporate Governance: The Role of Agency Theory and Maximising Shareholder Value*, 8 L. & FIN. MARKETS REV. 39 (2014); Thomas Clarke, *Dangerous Frontiers in Corporate Governance*, 20 J. MGMT. & ORG. 26 (2014).

<sup>113</sup> For instance, see Michael E. Porter, *Capital Choices: Changing the Way American Invests in Industry*, in STUDIES IN INTERNATIONAL CORPORATE FINANCE AND GOVERNANCE SYSTEMS: A COMPARISON OF THE U.S., JAPAN, & EUROPE 5-8 (Donald H. Chew ed., 1997).

<sup>114</sup> David E. Sappington & Joseph E. Stiglitz, *Privatization, Information, and Incentives*, 6 J. POL'Y ANALYSIS & MGMT. 567 (1987).

academic literature have sought to develop a long-term approach in corporate life.<sup>115</sup> This long term strategic planning is critical for China. The fact that it has a population of 1.378 billion<sup>116</sup> means that there are many potential social and environmental problems such as the need for employment, fiscal health, regional development, and social stability.<sup>117</sup> Positively, the World Bank reported that transformative economic growth in China resulted in 170 million people moving out of absolute poverty, thus accounting for more than a 75 percent poverty reduction in the developing world from 1990 to 2000.<sup>118</sup> At the national level, SOEs can be regarded as important vehicles that may have an impact on elements of entire markets and enable governments to intervene in resource allocation, prices in the economy, or settling social problems like unemployment in order to achieve long term government strategy.<sup>119</sup>

Under the corporate governance regime with which governments could identify, the ability to monitor corporations and enforce their interests as owners, government officials could replace entrepreneurs as the actors driving the economic performance of corporations, especially SOEs.<sup>120</sup> Despite the fact that economic literature suggests that direct involvement of state officials who impose on corporations multiple political interests may dilute profit-making as the primary goal of corporations and inhibit economic reforms in China, administrative involvement does have a function in long-term strategic planning because it is free from the pressure of pursuing immediate returns for demanding shareholders. Chinese SOEs have social responsibility as an additional goal and they serve as key vehicles to enable

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<sup>115</sup> G. Cox, *Overcoming Short-termism within British Business: The Key to Sustained Economic Growth: An independent review by Sir George Cox commissioned by the Labour Party*, p.4, available via Your Britain, the Labour party policy review website [http://www.yourbritain.org.uk/uploads/.../Overcoming\\_Short-termism.pdf](http://www.yourbritain.org.uk/uploads/.../Overcoming_Short-termism.pdf); Yan Liang, *China's Short-Term and Long-Term Development After the 2007 Global Financial Crisis: Some Critical Reflection*, 45 THE CHINA ECON. 3 (2012); Marc, T. Moore & Edward Walker-Arnott, *A Fresh Look at Stock Market Short-termism*, 41 J. L. & SOC'Y 416 (2014); Andrew Johnston & Paige Morrow, *Towards Long-Termism in Corporate Governance: the Shareholder Rights Directive and Beyond*, in LONG-TERM INVESTMENT AND THE SUSTAINABLE COMPANY: A STAKEHOLDER PERSPECTIVE VOL. III 19 (Sigurt Vitols ed., 2015); Pierre Habbard, *Shifting to the Long-term: The Road Ahead*, in LONG-TERM INVESTMENT AND THE SUSTAINABLE COMPANY: A STAKEHOLDER PERSPECTIVE VOL. III 93 (Sigurt Vitols ed., 2015).

<sup>116</sup> The World Bank Data of 2016; see <https://data.worldbank.org/indicator/SP.POP.TOTL>.

<sup>117</sup> Shimin Chen, ET AL., *Government Intervention and Investment Efficiency: Evidence from China*, 17 J. CORP. FIN. 259, 260 (2011).

<sup>118</sup> World Bank, *World Development Indicators*, World Bank, Washington D.C (2004).

<sup>119</sup> Zhaofeng Wang, *Corporate Governance under State Control: The Chinese Experience*, 13 THEORETICAL INQ. L. 487, 491 (2012).

<sup>120</sup> Victor Nee, Sonja Oppen & Sonia Wong, *Developmental State and Corporate Governance in China*, 3 MGMT. & ORG. REV. 19, 20 (2007).

the State to achieve economic stability, development and sustainability.<sup>121</sup> SOEs are used to serve political and social objectives which may have a negative impact on firms' economic performance based on the "grabbing hand theory."<sup>122</sup> However, it is argued as "overly simplistic"<sup>123</sup> that the "helping hand theory" may help government generate a positive effect on corporations' performance in securing limited resources and using them in a more organised and strategic manner in a quasi-market economy to mitigate agency problems in a transformative corporate governance model.<sup>124</sup> Therefore, SOEs are able to achieve a combined objective of national goals and corporate performance setting a model for compliance with the law and undertaking social responsibility.

Government officials are regarded as market oriented agencies and could use superior information and monitoring capacity to achieve long-term planning.<sup>125</sup> Like most other countries, one of the main roles and missions of SOEs is to promote social welfare where corporations can curry favour with government by engaging in CSR activities.<sup>126</sup> Advocates of free markets argue that governments should have minimum interference in the business operation because it could prompt decisions that threaten a corporation's financial goal.<sup>127</sup> However, arguably administrative power will provide more political power for corporations and the board of directors would be under less pressure from its shareholders to pursue short-term interests. It will be comparatively easier for it to take advantages of examples including scientific technology to maintain a sustainable and effective business environment in order to achieve strategic goals in the longer term.<sup>128</sup> China is undergoing a considerable corporate governance evolution but has yet to

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<sup>121</sup> See *supra* note 118.

<sup>122</sup> Yingyi Qian, *Enterprise Reform in China: Agency Problems and Political Control*, 4 ECON. TRANSITION 427 (1996); see also Richard McGregor, *The Little Red Book of Business in China*, Financial Times, July 8, 2001.

<sup>123</sup> JIANGYU WANG, COMPANY LAW IN CHINA: REGULATION OF BUSINESS ORGANIZATIONS IN A SOCIALIST MARKET ECONOMY 152 (2014).

<sup>124</sup> Eric C. Chang & Sonia M.L. Wong, *Political Control and Performance in China's Listed Companies*, 32 J. COMP. ECON. 617, 618 (2004).

<sup>125</sup> With this function of the government, the long-term strategy also enables corporations, especially SOEs, to address economic, political, social and environmental goals of government.

<sup>126</sup> Fuxiu Jiang & Kenneth A. Kim, *Corporate Governance in China: A Modern Perspective*, 32 J. CORP. FIN. 190, 195, 213 (2015).

<sup>127</sup> Alvaro Cuervo & Belen Villalonga, *Explaining the Variance in the Performance Effects of Privatization*, 25 ACAD. MGMT. 581 (2000); see also JOHN ZYSMAN, GOVERNMENTS, MARKETS AND GROWTH: FINANCIAL SYSTEMS AND THE POLITICS OF INDUSTRIAL CHANGE (1983).

<sup>128</sup> Petronas, a SOE in Malaysia is a good example of success as industrial top quartile which began an operational excellence campaign focusing on technical capabilities and more effective working cultural. See the 2009 sustainability report of Petronas available via [www.petronas.com.my/sustainability/. . /sustainability%20report2009.pdf](http://www.petronas.com.my/sustainability/. . /sustainability%20report2009.pdf).

establish a unifying system that balances social-economic forces with the needs of the economy.

Government action could impact both corporations in which the state has controlling shares and those in which the state only owns part of the shares. Musacchio argues that the government has improved corporate governance practices of SOEs.<sup>129</sup> In corporations that the government out-sources management to the private sector due to reasons of privatisation and international investment, the State still has a veto power over key strategic decisions.<sup>130</sup> A variety of state capitalism exists, including situations where the State acts as majority shareholder or minority shareholder, and in each type of case the State is able to offer strategic support through policies stimulating corporations' capabilities and long-term planning to achieve sustainable corporate goals. As the result of the administrative reforms carried out in the 1980s, government regulations, policies, and procedural guidelines have become increasingly more precise and transparent. This has had a positive impact on the predictability of bureaucratic decisions reducing the uncertainty of government economic policies and strategic planning thus encouraging more active international investment for long-term, sustainable, and quality growth in China.<sup>131</sup>

### *Effectiveness of Government Interference*

The policies, rules, and legislation introduced to further transformation can be categorised in two ways: globalization and devolution. The government plays a key role in both.<sup>132</sup> The transformation of corporate governance can also be regarded as the process by which we see the globalisation of the Chinese corporate governance model and the devolution of central government power in order to give corporations and boards of directors

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<sup>129</sup> Aldo Musacchio, ET AL., *New Varieties of State Capitalism: Strategic and Governance Implications*, ACAD. MGMT. PERSP. 115, 115 (2015). Taking Sinopec (China's national oil corporations) as an example, so far as aspects of listing corporations on stock exchanges, recruiting independent board members and enhancing financial reporting and these reforms have reduced agency conflicts and attracted minority private investors.

<sup>130</sup> See *supra* note 128 at 116; for a case study of Leviathan see Carlos F. K. V. Inoue, Sergio G. Lazzarini, & Aldo Musacchio, *Leviathan as a Minority Shareholder: Firm-level Performance Implications of Equity Purchases by the Government*, 56 ACAD. MGMT. J. 1775 (2013).

<sup>131</sup> Victor Nee, Sonja Oppen, & Sonia Wong, *Developmental State and Corporate Governance in China*, 3 MGMT. & ORG. REV. 19, 24 (2007); see also Derek Headey, Ravi Kanbur & Xiaobo Zhang, *China's Growth Strategies*, GOVERNING GROWTH IN CHINA: EQUITY AND INSTITUTIONS 1 (Ravi Kanbur & Xiaobo Zhang eds., 2008); for the discussion on government policy and Chinese stock market see YANRUI WU, SAM HAK KAN TANG, XIANG MEI FAN & NICOLAAS GROENEWOLD, *THE CHINESE STOCK MARKET: EFFICIENCY, PREDICTABILITY AND PROFITABILITY* (2004).

<sup>132</sup> Donald F. Kettl, *The Transformation of Governance: Globalization, Devolution and the Role of Government*, 60 PUB. ADMIN. REV. 488 (2000).

more autonomy to control corporations. This includes SOEs. These transformations will also lead to economic globalisation, deepen China's market economy and intensify market competition. Therefore, the government will act as the main facilitator of economic development and adjust the market to direct the route of transformation.<sup>133</sup> The government plays a triple role in the enforcement of the law, namely as a regulator in overseeing markets and corporations, as a supervisor and promoter of corporations, as well as having a role in the adaption and utilization of international rules on corporate governance.<sup>134</sup> The government could use mandatory administration and legal means to remedy market failures to promote economic growth and industrialization. In a country that lacks an independent and effective judicial system and a sufficient number of qualified legal professionals,<sup>135</sup> the administrative power that is derived from government interference is functional in responding to the inadequacies of efficient markets, and the existence of a unique market economy with Chinese characteristics.<sup>136</sup> Administrative governance is introduced with multiple aims including investor protection, information disclosure, and addressing systemic risks in order to maintain fair, efficient and transparent markets.

As for the market regulator, CSRC, it is a ministerial-level public institution directly under the auspices of the State Council and performs a unified regulatory function.<sup>137</sup> Thus, it needs to be emphasized that the CSRC is not independent. A good example of the government role in having a quick and swift market interference is CSRC's policy to bail out the stock market in July 2015. In order to slow down the stock market plunge, CSRC took the drastic step of banning, for six months, shareholders holding more than 5% of a corporation's capital from selling shares in an effort to halt a plunge in stock prices.<sup>138</sup> This was done in order to maintain the stability of the capital market and effectively protect investors' lawful rights and interests in responding to an irrational slump that the Chinese securities market had experienced.<sup>139</sup> The CSRC used the halt in trading and other measures

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<sup>133</sup> Meixia Chen, *Transformation of Chinese Government's Economic Function under Globalization*, Proceeding for International Conference on Public Management: International Integration for Regional Public Management: New Challenges and Opportunities (2014).

<sup>134</sup> For example, adapting and adopting the new G20/OECD corporate governance principle.

<sup>135</sup> See Franklin Allen, Jun Qian, and Meijun Qian, *Law, Finance, and Economic Growth in China*, 77 J. FIN. ECON. 57(2005).

<sup>136</sup> It might be argued that the role of the State in this way means that judicial effectiveness may never develop.

<sup>137</sup> CSRC, *Introducing the CSRC*, available via [http://www.csrc.gov.cn/pub/csrc\\_en/about/](http://www.csrc.gov.cn/pub/csrc_en/about/).

<sup>138</sup> *China Bans Major Shareholders from Selling Their Stakes for Next Six Months*, The Guardian, (Jul. 8, 2015), <http://www.theguardian.com/world/2015/jul/09/china-bans-major-shareholders-from-selling-their-stakes-for-next-six-months>.

<sup>139</sup> China Sec. Reg. Comm'n, Announcement No. 18 [2015]. (Aug. 7 2015),



to control downward pressure amid volatility.<sup>140</sup> Another mechanism implemented by the CSRC was the “circuit breaker” mechanism.<sup>141</sup> This mechanism was introduced to give markets a cooling-off period to provide the markets and investors time to digest the market information and to enhance the stability of the Chinese stock market, but was suspended after seven days.<sup>142</sup> This demonstrates that the government is capable of making instant responses to the market with immediate effect through administrative governance. Despite the fact that these administrative interferences may have a negative impact on the predictability of rules and legislation, the efficient response from the government is effective and inevitable for the Chinese stock market. In the transformative journey of corporate governance, the government’s responses to problems such as immature market failure, temporary market conditions, and the abolition of ineffective legislative approaches are crucial for China, a country with a massive number of individual market participants.<sup>143</sup>

## VI. CHARACTERISTICS AND IMPACT OF ADMINISTRATIVE GOVERNANCE IN THE TRANSFORMATION PROCESS

In this section, the characteristics and impact of administrative corporate governance will be examined to illuminate the uniqueness of corporate governance in China. The nature of administrative governance and government interference in corporations will be discussed as important elements in

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<http://webcache.googleusercontent.com/search?q=cache:IEwAAKLwLkgJ:www.lawinfochina.com/display.aspx%3Fid%3D19456%26lib%3Dlaw+&cd=1&hl=en&ct=clnk&gl=us> (The prohibition applied to foreign investors who held stakes in Shanghai- or Shenzhen-listed corporations, although most of their holdings are below 5%).

<sup>140</sup> However, some observers felt the system as designed could have increased investor concerns about the health of the market.

<sup>141</sup> Circuit breaker mechanism is the measure approved by the SEC originally in 1987 in order to curb panic-selling on U.S. stock exchanges and excessive volatility. This was introduced on New Year’s Day 2016, to prevent sharp falls and contain wild swings in the markets in late 2015. The mechanism is closely attached to CSI300 Index (the Index tracks the largest listed corporations in Shanghai and Shenzhen). According to the circuit breaker mechanism, a move of five percent, either up or down, from the index’s previous close will led to a half-an-hour trade suspension across equity indexes of China if the move occurs before 2:30 pm local time. After that, a five percent move will freeze trading until the market close at 3.00 pm.

<sup>142</sup> See K. Allen & G. Wearden, *China Suspends Circuit Breaker Aimed at Ending Stock Market Turmoil*, The Guardian (Jan. 7, 2016), <https://www.theguardian.com/business/2016/jan/07/china-suspends-mechanism-ending-stock-market-turmoil>. (The CSRC said that “the circuit breaker mechanism was not the main reason for the market slump. It just didn’t work as anticipated. The negative effect of the mechanism outweighed its positive effect”).

<sup>143</sup> There were 91 million participants (*gu min*) at July 2015 with an incredible 80% of urban Chinese households that are/were investors in the equity market: see the report of CSDC. See generally, [http://www.chinaclear.cn/english/en\\_index.shtml](http://www.chinaclear.cn/english/en_index.shtml).

the transformation process.

### *Administrative Power and Corporate Governance in China*

The long-term coexistence of administrative and economic corporate governance is an aspect that is unique to China. The impact from administrative power on corporate governance in China lies in the “administrativization” of resource allocation, corporate objectives, the appointment and removal of senior executives, and imposition of administrative liability for the breaching of directors’ duties.<sup>144</sup> The political involvement in corporate governance is seen as one of the primary manifestations of administrative corporate governance.<sup>145</sup> China launched a major economic reform and liberalization strategy in the 1980s. This involved the introduction of two important strategies during this period, namely the separation of state ownership and control and the separation of enterprise from government administration.<sup>146</sup> Instead of having no independent decision-making powers, the corporation’s role changed fundamentally.<sup>147</sup> The Chinese stock market was originally organized by the government as a vehicle for SOEs to raise capital and improve operating performance.<sup>148</sup> The Chinese government also tried to develop a unique corporate governance system that possessed specific characteristics including clearly defined property rights, designated authorities and responsibilities, separate functions between government and enterprise, and scientific management.<sup>149</sup> Notwithstanding the

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<sup>144</sup> Administrative penalties as the result of breach of the duties include warnings, fines, confiscation of illegal income or property, and administrative detention. See China Sec. Reg. Comm’n, 2014 Annual Report (2015); China Sec. Reg. Comm’n, 2013 Annual Report (2014); China Sec. Reg. Comm’n, 2013 Annual Report (2014) (Amongst all cases concluded by CSRC, administrative sanctions were imposed upon 158, 79, and 56 cases in 2014, 2013, and 2012 consecutively).

<sup>145</sup> Weian Li, Aichao Qiu & Zhihui Gu, *Dual Corporate Governance Environment, Political Connections Preference and Firm Performance—Study on Governance Transition of China’s Private Listed Firms* (Shuangcong gongsi zhili huanjing: zhengzhi lianxi pianhao yu gongsi jixiao jiyu zhongguo minying shangshi gongsi zhili zhuanxing de yanjiu 双重公司治理环境\_政治联系偏好与公司绩效\_基于中国民营上市公司治理转型的研究), 6 CHINA IND. ECON. 85, 94 (2010).

<sup>146</sup> The decision of the Central Committee on Economic Structure Reform was announced in 1983, indicating the start of enterprise reform in order to improve inefficient SOEs. The committee was trying to transform the corporations into legal entities with the goal of making profits, but also making them responsible for their losses.

<sup>147</sup> On Kit Tam, *Capital Market Development in China*, 19 WORLD DEV. 511 (1991). (The policy of autonomy allowed corporations to retain a certain portion of their profits for future strategic development).

<sup>148</sup> STEPHEN GREEN, CHINA’S STOCK MARKET: A GUIDE TO ITS PROGRESS, PLAYERS AND PROSPECTS: THE PLAYERS, THE INSTITUTIONS AND THE FUTURE (2003).

<sup>149</sup> This is due to the reason that the Chinese government allowed productive enterprises to become separate legal persons in 1987. See Zhonghua Renmin Gonghe Guo Minfa Tongze (中华人民共和国民法通则) [The General Principles of the Civil Law of the People’s

fact that the first Chinese company law enshrined many classic features of corporate governance that were consistent with the Anglo-American model,<sup>150</sup> regulations were drafted in such a way as to favour SOEs or corporations with close ties to the government.<sup>151</sup> Therefore, it is clear that consideration of both the transition in corporate governance and the dynamic role played by administrative power can contribute significantly to determine how the corporate governance model in China is going to be shaped and structured in the future. The developments in corporate governance that were initiated in the early days were labelled as producing “modern” corporations, and reflected the intention behind the transition to a market-oriented economy, but with Chinese characteristics. Deng Xiaoping clarified that “planned” and “market” were merely economic means to achieve ends, and socialism can have a market too. Leaving aside arguments over whether the theory of the socialist market comes from orthodox Marxist economic theory, it seems that for the foreseeable future, the ownership structure will not be substantially changed so that the country can “keep to the socialist road.”<sup>152</sup>

Along with the development of a socialist country, a market economy and a market-oriented corporate governance system have been introduced with unique Chinese characteristics.<sup>153</sup> However, the unbalanced progress in the development of complementary, social, political, legal and economic infrastructure, as well as the high percentage of control and ownership of the shares by the State, makes it impossible for corporate governance to develop a model based solely on successful Western experiences, and it is probably unreasonable and unnecessary for China to develop its corporate

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Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987), art. 41, <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3990&context=lcp>; see also On Kit Tam, *Ethical Issues in Evolution of Corporate Governance in China*, 37 J. BUS. ETHICS 303, 307(2002).

<sup>150</sup> See Zhonghua Renmin Gonghe Guo Minfa Tongze (中华人民共和国民法通则) [The General Principles of the Civil Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987), art. 1, 5, 6, 14, <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3990&context=lcp>; see also ON KIT TAM, *THE DEVELOPMENT OF CORPORATE GOVERNANCE IN CHINA* ch. 6-7 (1999).

<sup>151</sup> Qiao Liu & Zhou Lu, *Corporate Governance and Earnings Management in the Chinese Listed Companies: A Tunnelling Perspective*, 13 J. CORP. FIN. 881, 884 (2007).

<sup>152</sup> Ligang Song, *Emerging Private Enterprise in China: Transition Path and Implications*, in CHINA'S THIRD ECONOMIC TRANSFORMATION: THE RISE OF THE PRIVATE ECONOMY 29, 44-45 (Ross Garnaut & Ligang. Song eds., 2005); see also Derek Morris, *The Reform of State-Owned Enterprises in China: The Art of the Possible*, 11 OXFORD REV. ECON. POL'Y. 54 (1995); Dongwei Su & Xingxing He, *Ownership Structure, Corporate Governance and Productive Efficiency in China*, 38 J. PROD. ANALYSIS 303 (2012).

<sup>153</sup> See Yingyi Qian and Barry Weingast, *China's Transition to Markets: Market-preserving Federalism, Chinese Style*, J. POL. REFORM 149 (1996); Junjie Hong, Chengqi Wang & Mario Kafourous, *The Role of the State in Explaining the Internationalization of Emerging Market Enterprise*, 26 BRITISH J. MGMT. 45 (2015).

governance in what would be, for China, an extreme direction. SOEs have undoubtedly become the dominant force in implementing this strategy, as evidenced by their control of over \$690 billion in assets abroad. Forty-seven centrally-owned Chinese firms ranked in last year's Fortune Global 500<sup>154</sup> and there were three Chinese centrally-owned banks holding the top three spots in the 2016 Forbes Global 2000.<sup>155</sup> The role of government as shareholders, the administrative governance on SOEs, and political and social mission of SOEs make administrative corporate governance indispensable and SOEs, as the "the eldest son of the Party-State", still denote their long-lasting and unbreakable ties with the Party-State administrative power.

### *Government Interference and Influence in China*

Government decisions now only have a partial impact on the internal governance of Chinese-listed corporations, even those that the government controls.<sup>156</sup> This implies "dynamic interplay" between external and internal government mechanisms.<sup>157</sup> The transition that has taken place thus far has led to a corporate governance model characterised by gradualism, dualism, systematisation, and path dependency.<sup>158</sup> The new corporate governance model has resulted from a systematic reform brought about by developments in legislation and legal enforcement, as well as changes in the nature of the shareholding structure, but all of these are subject to the influence of other factors such as Chinese traditions, history, values, and culture. The state's large shareholdings and its resultant control of corporations is a solid reason for government involvement in the corporate governance. This indicates that government policy placed increasing importance on establishing a market economy and it shifted towards a rule-based framework, but it is always in the shadow of the still dominant SOE sectors.<sup>159</sup>

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<sup>154</sup> Wendy Leutert & Brookings Institution, *China's State Enterprise Reform: Bigger, Yes, but Better?* FIN. TIMES, (Apr. 23, 2015), <http://blogs.ft.com/beyond-brics/2015/04/23/chinas-state-enterprise-reform-bigger-yes-but-better/>.

<sup>155</sup> Steve Schaefer, *The World's Largest Companies 2016*, Forbes, (May 25, 2016), <https://www.forbes.com/sites/steveschaefer/2016/05/25/the-worlds-largest-companies-2016/#5bb5af6145a6>.

<sup>156</sup> Weian Li & Daying Yan, *Transition from Administrative to Economic Model of Corporate Governance: A New Analytical Framework for Research on China's Corporate Governance*, 4 NANKAI BUS. REV. INT'L 4, 6 (2013).

<sup>157</sup> Weian Li, *Corporate Governance Code in China and its Interpretation Draft (Zhongguo Gongsi Zhiliyuance (Caoan) Jiqi Jieshuo)*, 1 NANKAI BUS. REV. (NANKAI GUANLI PINGLU) 9, 10-11 (2001).

<sup>158</sup> Weian Li & Daying Yan, *Transition from Administrative to Economic Model of Corporate Governance: A New Analytical Framework for Research on China's Corporate Governance*, 4 NANKAI BUS. REV. INT'L 4, 5-7 (2013).

<sup>159</sup> MICHAEL J. WHINCOP, CORPORATE GOVERNANCE IN GOVERNMENT CORPORATIONS 52 (2005).

The hybrid and transformative model discussed in this article makes the role of the CSRC unpredictable and unsystematic. CSRC is directly under the State Council, and is designed to perform a regulatory function in order to maintain legitimate and orderly securities and capital markets. For example, from the early 1990s when the Shanghai and Shenzhen Stock Exchanges were launched, the CSRC has been responsible for approving IPOs, and the government tightly controlled the IPO process.<sup>160</sup> This situation changed during the late 1990s as the investment banks gradually took a greater role in the IPO process and assumed heavier responsibilities for identifying and developing candidates for listing.<sup>161</sup> The current official role of the CSRC in the IPO process is to ensure that issuers comply with the rules. However, while the foregoing seems to suggest a major move towards economic governance, the reality is that the CSRC still controls the IPO process tightly, for the CSRC has the power of financial approval regarding which firms can go public.<sup>162</sup> The CSRC plays a key role in administrative governance by exercising a supervisory role over the domestic securities regulatory institutions, which consequently enables it to control the securities markets. Stock markets in China have grown very rapidly since they were established in the early 1990s and have done so with weak or modest legal and corporate governance structures.<sup>163</sup> The weak legal system and immature corporate governance system make the government role distinct, necessary and direct.

The reforms that have been introduced came as a result of the fact that administrative corporate governance was heavily criticised due to its lack of efficiency and fairness. The main response to these criticisms has been a focus on the corporatisation of SOEs, as discussed in the reasons for transformation, with thousands of poorly performing national and regional SOEs being either privatized or liquidated.<sup>164</sup> Since 1980, the SOEs have gradual-

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<sup>160</sup> Yan-Leung Cheung, Zhiwei Ouyang & Weiqiang Tan, *How Regulatory Changes Affect IPO Underpricing in China*, 20 CHINA ECON. REV. 692, 693 (2009); Joseph Aharony, Jiwei Wang & Hongqi Yuan, *Tunnelling as an Incentive for Earnings Management during the IPO process in China*, 29 J. ACCT. & PUB. POL'Y 1 (2010); Joseph D. Piotroski & Tianyu Zhang, *Politicians and the IPO Decision: The Impact of Impending Political Portions on IPO Activity in China*, 111 J. FIN. ECON. 111 (2014).

<sup>161</sup> See also Enda Curran, *Chinese Investment Banks on the Rise: China Renaissance Securities Is the Top Adviser on Chinese IPOs in New York This Year*, THE WALL ST. J. Jun. 20, 2014; Bill B. Francis, Iftekhhar Hasan & Xian Sun, *Political Connections and the Process of Going Public: Evidence from China*, 28 J. INT'L MONEY & FIN. 696 (2009).

<sup>162</sup> Fuxiu Jiang & Kenneth A. Kim, *Corporate Governance in China: A Modern Perspective*, 32 J. CORP. FIN. 190, 191 (2014).

<sup>163</sup> Gongmeng Chen, Michael Firth, Daniel N. Gao, & Oliver M. Rui, *Is China's Securities Regulatory Agency a Toothless Tiger? Evidence from Enforcement Actions*, 24 J. ACCT. & PUB. POL'Y 451, 479-480 (2005).

<sup>164</sup> See Gabriel Wildau, *China Kicks off Second Round of Privatisation SOE Reform*, FIN. TIMES. (Aug. 10, 2014), <http://www.ft.com/cms/s/0/ec28674c-13ac-11e4-84b7-00144feabd c0.html#axzz3DOzmmx3b>.

ly lost some of their primacy and advantage with the introduction of the Chinese government's policy on the separation of government functions and business operations. The transformation from the policy opening up to unprecedented opportunity for market actors to influence policy decision-making under Jiang's leadership, which ended in 2002, enabled two important changes to occur, namely a slow withdrawal from economic reform primarily dependent on SOEs' reconstruction and a transformation of state role from an active agent in the economy to a regulator.<sup>165</sup> Under Hu's leadership (2002-2012), the process of corporatization slowed down in order to deal with social problems, such as unemployment, in keeping with the Chinese value of establishing a harmonious society. Since 2013, under Xi's leadership, "China dream" became the prevailing domestic theme. This theme encapsulated a vision for a successful, modern China. One of the significant factors underpinning the campaign that was related to the theme was growing self-confidence within the governing regime over economic achievements during the past decade.<sup>166</sup> The growing assurance has been reflected in Chinese foreign policy and the rhetoric in relation to the policy while Xi has been credited with launching a series of new policies including the most eye-catching one: the "one belt, one road" initiative (OBOR). The initiative commenced in autumn 2013 when Xi visited Russia and Kazakhstan, where he announced the transport project plan with the view to establishing an "economic belt." The belt is designed to link China with Mongolia, Russia, Iran, Turkey, central Asia, "central and Eastern Europe, and ultimately Germany and the Netherlands" with the potential involvement of 60 countries and 4 billion people by way of transport initiatives.<sup>167</sup> Marked by the robust initiation of this OBOR initiative, the internationalization of SOEs has entered into a "new era". Intercontinental trade and infrastructure initiative, along with the recent issuing of Guidance on Deepening SOE Reforms signals the finalisation of the SOE reform plan at the central leadership level. Central government-owned enterprises have since been undertaking major projects in implementing the OBOR initiative, "such as the Khorgos 'dry port' on the Kazakh-Chinese border and a railway link connecting Kazakhstan with Iran,"<sup>168</sup> which have profound implications for re-

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<sup>165</sup> Jessica C. Teets, Stanley Rosen & Peter Hays Gries, *Introduction: Political Change, Contestation and Pluralization in China Today*, CHINESE POLITICS: STATE, SOCIETY AND THE MARKET 1, 15 (Peter H. Gries & Stanley Rosen eds., 2010).

<sup>166</sup> See William A. Callahan, *History, Tradition and the China Dream: Socialist Modernization in the World of Great Harmony*, 24 J. CONTEMP. CHINA 983 (2015).

<sup>167</sup> Peter Ferdinand, *Westward ho—the China Dream and 'One Belt, One Road': Chinese Foreign Policy under Xi Jinping*, 92 INT'L AFF. 941, 950 (2016).

<sup>168</sup> The OBOR Initiative focuses on connectivity and cooperation among countries between China and the rest of Eurasia, consisting of both the land-based "Silk Road Economic Belt" and the ocean-based "Maritime Silk Road." It is estimated to cover "65 percent of the world's population, about one-third of the world's GDP, and about a quarter of all the goods and services the world moves." *China's One Belt, One Road: Will It Reshape Global*

gional collaboration, as well as provision for economic impact. SOEs investing abroad financed by the Chinese-controlled Asia Infrastructure Investment Bank seems to be one of the chief instruments used by China to realize its geopolitical goals and its more muscular foreign policies, at least in the near future. The conduct of Chinese SOEs and other companies investing in the OBOR project is more likely to be subject to stricter scrutiny and incorporate international standards. Regulations and guidelines have been, and will continue to be, introduced in China in response to the OBOR initiative in order to manage the conduct of corporations involved in international investments. With the OBOR initiatives, a new development strategy will enable China to “broaden its role in global markets and production networks as well as its potential geopolitical influence.”<sup>169</sup> External pressures, internationalized practice, and the introduction of a regulatory framework have precipitated the transformation of corporate governance from a purely administrative model to a hybrid one in order to promote transparency and effectiveness in corporate governance, the sustainable development of China’s economy, and the Government’s expanding plan through the mechanism of OBOR. This hybrid model will be retained if there is no substantial change of the political system and while the state owns and controls corporations engaged in the country’s main industries.

This administrative corporate governance has less impact on non-SOE corporations because their shareholders and directors do not have such a strong relationship with the government, and while the government can provide for mechanisms that permit it to interfere, it does not do so as frequently as with SOEs. Therefore, the upshot is that despite the fact that these corporations are subject to administrative regulations from the central government, provincial governments and stock exchanges, they are comparatively more independent and are able to take greater advantages of market forces. These corporations are open to private investment and are more flexible and willing to adopt westernized corporate governance and investment philosophy. These corporations have employment relationships and supply chains that rely heavily on market power rather than central administrative allocations and appointments.

It is worth mentioning that government interference is not just a potential problem in China, but is also the case in many other jurisdictions with emerging markets.<sup>170</sup> It is characterised by a high level “of state ownership

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*Trade?*, MCKINSEY & COMPANY, (July 2016), (<http://www.mckinsey.com/global-themes/china/chinas-one-belt-one-road-will-it-reshape-global-trade>); see Jack Farchy, James Kyngé, Chris Campbell & David Blood, *One Belt, One Road*, Financial Times Special Reports, available at <https://ig.ft.com/sites/special-reports/one-belt-one-road/>.

<sup>169</sup> Mimi Zou, *China Must Set Ethical Standards for its Belt and Road Investments*, SOUTH CHINA MORNING (May 16, 2016) <http://www.scmp.com/comment/insight-opinion/article/1945649/china-must-set-ethical-standards-its-belt-and-road>.

<sup>170</sup> Jingchen Zhao, *Promoting a More Efficient Corporate Governance Model in Emerg-*

and weak market<sup>72</sup>-oriented apparatus, and governments therefore often act as functional substitute for control failure.<sup>171</sup>

*Are Administrative Factors Hindering the Development of Efficient Chinese Corporate Governance?*

It may be argued that the involvement of administrative factors could have a negative impact on sound corporate governance that fits into a competitive and globalized Chinese economy. The corporate governance model in China builds on a strong, authoritarian national leadership and an elite state bureaucracy pursuing development-oriented policies, including the direct means of governing the market.<sup>172</sup> The economic success in the last two decades is the result of combative policies, sometimes ones that are inconsistent with government control, interference, and administrative involvement. These include liberalisation of the product and labor markets, entry into the WTO, and corporatization. These factors are seemingly in opposition to the administrative approach and may, in the following ways, hinder the development of corporate governance and be regarded as barriers to the further improvement of corporate governance in China.

First, corruption as the result of administrative interference could be a primary concern that China faces in promoting more efficient corporate governance.<sup>173</sup> Despite the fact that China's anti-corruption campaign has led to the fall of hundreds of government officials, including board members of SOEs, one of the most frequent problems emanating from administrative involvement in corporate governance is the possibility of excessive corruption as the result of abuse of power perpetrated by directors, and something known as state executive corruptions (*gaoguan fubai*

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ing Markets through Corporate Law, 15 WASH. U. GLOBAL STUD. L. REV. 447, 457-463 (2016); see also Stijn Claessens & B. Burcin Yurtoglu, *Corporate Governance in Emerging Markets: A Survey*, 15 EMERGING MARKETS REV. 1 (2013); Joseph P. H. Fan, K.C. John Wei, Xinzhong Xu, *Corporate Finance and Governance in Emerging Markets: A Selective Review and an Agenda for Future Research*, 17 J. CORP. FIN. 207 (2011); Michael N. Young, Mike W. Peng, David Ahlstrom, Garry D. Bruton & Yi Jiang, *Corporate Governance in Emerging Economies: A Review of the Principal-Principal Perspective*, 45 J. MGMT. STUD. 196 (2008).

<sup>171</sup> Junjie Hong, Chengqi Wang & Mario Kafourous, *The Role of the State in Explaining the Internationalization of Emerging Market Enterprises*, 26 BRITISH J. MGMT. 45, 45 (2015).

<sup>172</sup> ROBERT WADE, *GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION* 26 (1990).

<sup>173</sup> See Qigui Liu, Tianpei Luo & Gary Tian, *Political Connections with Corrupt Government Bureaucrats and Corporate M&A Decisions: A Natural Experiment from the Anti-Corruption Cases in China*, 37 PAC.-BASIN FIN. J. 52 (2016); see also Xun Wu, *Corporate Governance and Corruption: A Cross Country Analysis*, 18 GOVERNANCE 151 (2005); Chunxin Jia, Shujun Ding, Yuanshun Li & Zhenyu Wu, *Fraud, Enforcement Action, and the Role of Corporate Governance: Evidence from China*, 90 J. BUS. ETHICS 561 (2009).



高管腐败).<sup>174</sup> It constitutes 60% of the cases involving the acceptance of bribes, according to the China Entrepreneur Report on Crime.<sup>175</sup> Administrative governance increases the opportunity for corruption in the management team and it derives from shareholding ownership and involvement of the State and the Party in SOEs. According to the Chinese Company Law, decisions on matters concerning electing and replacing directors and supervisors and the remuneration of directors and supervisors are entirely determined by the shareholders' general meeting.<sup>176</sup> Therefore, the fact that the State is the controlling shareholder places it in the absolute dominant position in many SOEs. Apart from the influence of the State via shareholders' meetings, the influence could also come from the Party. It is stated in the Company Law 2005 that "an organization of the CCP [the Party] shall be established to carry out the activities of the CCP in accordance with the charter of the CCP and the corporation shall provide the necessary conditions for the activities of the party organization."<sup>177</sup>

Another awkward feature in Chinese SOEs is administrative rankings that are given to the chairmen and the senior executives by the government as they are an important factor and reflect the political connections that these senior officials have with political power.<sup>178</sup> These senior officers can be exchanged directly with officials in provisional or central government.<sup>179</sup> The administrative ranking is closely related to the culture of *guanxi* (relationship), *mianzi* (giving face), promotion and demotion with strong possibilities of misuse of these rankings to foster corrupt purposes.<sup>180</sup>

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<sup>174</sup> Xin Lu, Ting Wu & Dan Long, *Executives of State-owned Enterprises Corruption, Incentive Failure or Constraint Missing?—Analysis Based on The "Gujing Scandal,"* 12 HUM. RESOURCES DEV. CHINA 61 (2015); see also Junfang Xia, *Study of Evaluation Methods of SOEs Manager's Performance for Inhibiting Corruption*, 6 MODERN ECON. 1051 (2015); Jamil Anderlini, *China Corruption Purge Snares 115 SOE 'Tigers': A Fifth of Those 'Toppled from Their Horses' Come from the Energy*, F.T. May 18, 2015, available via <https://www.ft.com/content/ad997d5c-fd3c-11e4-9e96-00144feabdc0>. It is worth noting that China ranks 83rd globally on corruption based on perceived corruption scores based on the "Transparency International" in 2015. Transparency International: The Global Coalition against Corruption, *Corruption Perceptions Index 2015*, available at <http://www.transparency.org/cpi2015>.

<sup>175</sup> Shenzhen Evening News, *State Executive Crime Hits New High* (Shenzhen February 11 2015) A21.

<sup>176</sup> [Company Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) art. 38(2).

<sup>177</sup> Article 37(2) Chinese Company Law 2005.

<sup>178</sup> For details of administrative levels in China, see Article 16 of Civil Servant Law of the People's Republic of China 2005.

<sup>179</sup> Jing Liu, *Political Connection of State-Owned Enterprises: An Analysis Based on the Listed Companies of Shanghai and Shenzhen Stock Markets*, THE 19<sup>TH</sup> INTERNATIONAL CONFERENCE ON INDUSTRIAL ENGINEERING AND ENGINEERING MANAGEMENT 1009, 1012-2013 (Ershi Qi, Jiang Shen & Runliang Dou eds., 2013).

<sup>180</sup> See David Smith, *Guanxi, Mianzi, and Business: The Impact of Culture on Corporate*

Secondly, administrative power may hinder the efficiency of corporate governance. One of the main issues that exists in Chinese corporate governance is the conflicting roles of the government between the establishment of a functional corporate governance environment in connection with the market economy and the incomparable arbitrary and politically motivated government control. The administrative power somehow hinders the efficiency of corporate governance in terms of time-scale and the strategic direction of the decision-making process. There are many uncertainties that lie in relation to the implementation of governance. Two of these are the fact that judicial decisions are ignored by agencies and corporate decisions that involve interference by government through the vast administrative bureaucracy within the hierarchy.<sup>181</sup> In addition to the national representative bodies, including the executive, judicial, and administrative functions of the government, state-owned property and governance of this property is still closely regulated and supervised by the Chinese government, which involves a range of issues including accounting, investment, deposition, debt repayment, transfer, and auditing of state-owned properties.<sup>182</sup>

Furthermore, the administrative involvement through various channels at different levels may also make the corporate governance rules uncertain and unpredictable. The administrative power related to the drafting and implementing of corporate governance-related rules at different levels, including those devised by the state, government agencies such as the State-Owned Assets Supervision and Administration Commission of the State Council, stock exchanges, and the provincial and city level may cause foreign investors to feel that the legislative framework is unstable and unpredictable. This may hinder further investments and could impede the development of corporate governance. The administrative power may also deter foreign investors because of the layers of a bureaucracy, which may be unpredictable at times. These factors add additional transaction costs and make doing business unnecessarily complicated.

### *No Universal Path for Transition*

It is suggested, based on the dynamic theory of corporate govern-

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*Governance in China*, 26 PRIVATE SECTOR OPINION 1 (2012); see also Udo C. Braendle, Tanja Gasser & Juergen Noll, *Corporate Governance in China—Is Economic Growth Potential Hindered by Guanxi?*, 110 BUS. & SOC'Y REV. 389 (2005); Andrew Keay & Jingchen Zhao, *Accountability in Corporate Governance in China and the Impact of Guanxi as a Double-Edge Sword* 11 BROOK. J. CORP. FIN. & COM. L. 377 (2017).

<sup>181</sup> Pitman B. Potter, *The Future of China's Legal Regime*, CHARTING CHINA'S FUTURE: DOMESTIC AND INTERNATIONAL CHALLENGES 67, 69 (David Shambaugh ed., 2011).

<sup>182</sup> Jichun Shi, *Consideration on the Relationship between Government and Market from the Legal Perspective* (zhengfu yu shichang guanxi de fazhi sikao 政府与市场关系的法治思考), 18 J. PARTY OF CENT. COMMITTEE THE C.P.C 10, 14 (2014); see also Gary Jefferson, *State-Owned Enterprise in China: Reform, Performance and Prospects*, BRANDEIS UNIVERSITY WORKING PAPER SERIES 109 (2016).

ance,<sup>183</sup> that there is no universal path for the development of corporate governance,<sup>184</sup> and this is true for Chinese corporate governance development and transformation. Chinese corporate governance has advanced due to many factors that are related to government policies, culture, the legal system, board structure, the country's economic development, and the structure of the shareholding of its corporations. Unlike classic corporate governance models, the governance model adopted by Chinese listed firms can best be described as a control-based system, in which the controlling shareholders, predominantly the State or State officials, "tightly control the listed firms through concentrated ownership and management-friendly boards."<sup>185</sup> This hybrid model can be explained based on a political model of corporate governance provided by Mark Roe, who argued that path dependence can largely explain particular corporate governance models in different jurisdictions.<sup>186</sup> Any transition in style of corporate governance can only be achieved during a long process, and during this time both administrative and economic elements of corporate governance will co-exist in a Chinese model. This transformation is a systematic one and the corporate governance model in China is certainly undergoing continuous change. This is particularly the case in a country with an emerging and transitional capi-

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<sup>183</sup> See Steve Toms, *The Life Cycle of Corporate Governance*, THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE 365, 381 (Douglas Michael Wright, Donald S. Siegel, Kevin Keasey & Igor Filatotchev eds., 2013); see also See LENG, *supra* note 75; Mariusz Bratnicki, Aldona Fraczekiewicz & Rafał Kozłowski, *The Dialectics of Entrepreneurial Leadership: Toward a Dynamic Theory of Corporate Governance*, 18 PROCEEDINGS EIGHTEENTH ANNUAL MEETING OF THE INTERNATIONAL ASSOCIATION 333 (2007).

<sup>184</sup> Jingchen Zhao, *Promoting a More Efficient Corporate Governance Model in Emerging Markets through Corporate Law*, 15 WASH. U. GLOBAL STUD. L. REV. 447 (2016); see also Thomas Clarke, *The Continuing Diversity of Corporate Governance: Theories of Convergence and Variety*, 16 EPHEMERA THEORY & POL. IN ORG. 19 (2016); Michael A. Firth & Oliver M. Rui, *Does One Size Fit All? A Study of the Simultaneous Relations Among Ownership, Corporate Governance Mechanisms, and the Financial Performance of Firms in China*, CORPORATE GOVERNANCE: RECENT DEVELOPMENTS AND NEW TRENDS 29 (Sabri Bou-baker, Bang Dang Nguyen & Duc Khuong Nguyen eds., 2012).

<sup>185</sup> Qiao Liu, *Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants*, 52 CESIFO ECON. STUD. 415, 429 (2006); see also Noel W. Leung & Mei-Ai Cheng, *Corporate Governance and Firm Value: Evidence from Chinese State-Controlled Listed Firms*, 6 CHINA J. ACCT. RES. 89 (2013).

<sup>186</sup> MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); see also MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2003). The control-based model is a hybrid due to the gradual transition process that has been occurring over the past three decades during the transformation of the Chinese economy from a planned to a market model. See Wei'an Li, Yekun Xu, Jianbo Niu & Aichao Qiu, *A Survey of Corporate Governance: International Trends and China's Mode*, 3 NANKAI BUS. REV. INT'L 4, 5–7(2012); see also WEIAN LI, XIAOHONG CHEN & QINGHONG YUAN, CHINESE CORPORATE GOVERNANCE: ROAD TO TRANSITION AND PERFECTION (ZHONGGUO GONGSI ZHILI: ZHUANXING YU WANSHAN ZHILU 中国公司治理：转型与完善之路) 139-41 (2012).

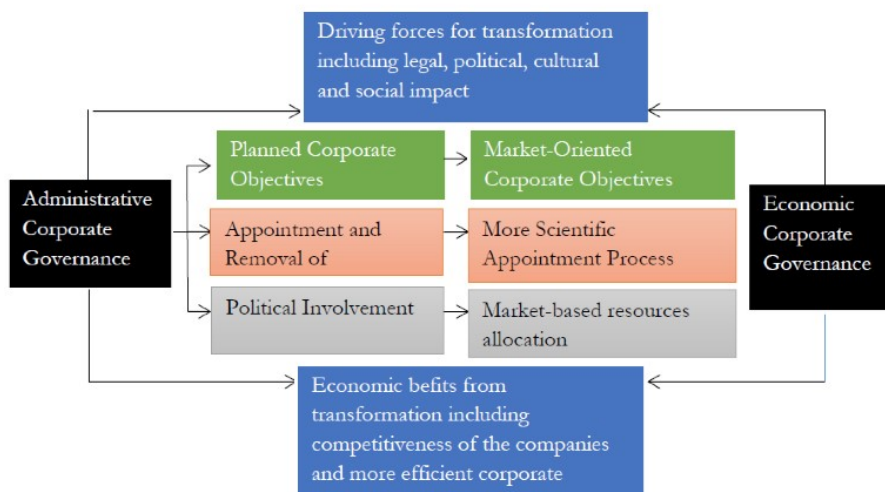
tal market and where there are imperfect market regulatory mechanisms, immature investors, and a unique shareholding structure.<sup>187</sup>

The existence of some elements of administrative corporate governance in China's present corporate governance model is seen as the result of continued government control over the decisions of corporations, especially SOEs, in terms of resource allocation, strategic operational policy and objectives, and senior management appointments.<sup>188</sup> Within the administrative corporate governance model, directors of SOEs are appointed directly by the Chinese government, and directors always retain certain administrative roles within the government while also acting as directors. The transformation of corporate governance is driven by internal and external forces which have legal, political, cultural and social impact through revised corporate objectives, amended mechanisms for appointing members of boards of directors, and stronger reliance on market forces. The process of transformation of Chinese corporate governance can be demonstrated by the following diagram, which shows the driving forces that lead to the economic result.

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<sup>187</sup> International Symposium on Securities Investors Protection Opened in Beijing, available at [www.csrc.gov.cn/pub/newsite/bgt/xwdd/200911/t20091106\\_16722.htm](http://www.csrc.gov.cn/pub/newsite/bgt/xwdd/200911/t20091106_16722.htm); see also Yan-Leung Cheung, Ping Jiang, Piman Limpaphayom & Tong Lu, *Corporate Governance in China: A Step Forward*, 16 EUROPEAN FIN. MGMT. 94 (2008); Randall Morck & Bernard Yeung, *Corporate Governance in China*, 26 J. APPLIED CORP. FIN. 20 (2014).

<sup>188</sup> See Fan Gang & Nicholas C. Hope, *The Role of State-Owned Enterprises in the Chinese Economy*, China-United States Exchange Foundation, China-US 2022, Economic Relations in the Next 10 Years, Chapter 16, 5 (2013), available at <http://www.chinausfocus.com/2022/wp-content/uploads/Part+02-Chapter+16.pdf>.



On this uncertain journey of corporate governance transition, both profit motives and the political motives of government officials under the administrative corporate governance model “have the potential to distort policy objectives significantly.”<sup>189</sup> For example, the political targets of SOEs are not compatible with an economic development of corporate governance, and are in conflict with economic targets of profit-making or profit-maximisation. The government lacks adequate means to pursue corporate goals purely from the perspective that looking at corporations as vehicles of doing business, and “meta-agency” problems in government controlled and owned corporations. This may lead to the government failing to “seek to maximize the welfare of their principals,” which is the public; rather government officers may well prefer to maximize their own welfare or pursue other politically-oriented missions.<sup>190</sup>

The corporate governance transformation is characterised, looking at the general trends, by the weakening of administrative governance and the strengthening of economic governance. However, this hybrid corporate governance model does retain many administrative characteristics, and it continues to be subject to strong government interference and reliance on government support and direction. It is also shaped by top-down bureau-

<sup>189</sup> See *supra* note 75, at 49; see also Hong et al., *supra* note 169, at 45.

<sup>190</sup> Michael Trebilcock & Edward M. Iacobucci, *Public Values in an Era of Privatization: Privatization and Accountability*, 116 HARV. L. REV. 1422, 1443 (2003).

cratic intervention and government control through the government's controlling power over corporate management, via agents appointed by the State who were previously government officials.<sup>191</sup> The reforms and developments, such as corporatization and the convergence of corporate governance, have encountered serious challenges in China's immature legal and institutional environment. The legal mechanisms that are traditionally seen as important in reducing agency costs, such as executive compensation contracts, the risk of takeover and takeover mechanisms, the value of managerial reputations and a well-functioning competitive market are all very immature in China, especially in SOEs.<sup>192</sup> Therefore, administrative governance could be necessary and functional due to underdevelopment of the legal infrastructure, loose law enforcement, and a problematic court system which lacks a fully independent judiciary. Nevertheless, it has its own advantages at particular periods.

## VII. CONCLUSION

The article offers a systemic, historical, and rigorous study of Chinese corporate governance transformation, focusing on the development from a totally administrative model, one which relies on government and administrative power and imposes administrative duties and objectives of corporations' controllers, to a hybrid model which has both administrative and economic governance characteristics. This uniquely Chinese corporate governance consists of a set of customs, strategies, and institutions which are designed to mitigate or even eliminate double agency problems<sup>193</sup> that arise as the result of separation of ownership and control and separate government functions from enterprise management.

The role of market forces is still limited and restrained by political power and government interference in China. The existence and restrictions on state shareholders, state-controlled corporations, and SOEs hinder the development of the market for corporate control.<sup>194</sup> We perceive that the state continues to have a key role in corporate governance in China which makes administrative interference and power something that is embedded in

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<sup>191</sup> Young, *supra* note 169, at 211.

<sup>192</sup> See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Oliver D. Hart, *The Market Mechanism as an Incentive Scheme*, 14 BELL J. ECON. 366 (1983). Other scholars indeed would throw some doubts on whether legal mechanisms do reduce agency cost. See, e.g., Robert H. Sitkoff, *An Agency Cost Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004); Anita Anand, Frank Milne & Lynnette Purda, *Monitoring to Reduce Agency Costs: Examining the Behaviour of Independent and Non-Independent Boards*, 33 SEATTLE U. L. REV. 809 (2010).

<sup>193</sup> SHAOWEI LIN, *DERIVATIVE ACTIONS IN CHINESE COMPANY LAW* (2015).

<sup>194</sup> Charles W. Calomiris, Raymond Fisman & Yongxiang Wang, *Profiting from Government Stakes in a Command Economy: Evidence from Chinese Asset Sales*, 96 J. FIN. ECON. 399 (2010).

the corporate governance regime through public and political policies, law enforcement, and the strategic management policies of each corporation. Apart from being a dynamic and vibrant process that needs to react to business and political environmental variations, the transformation of corporate governance in China is one that involves a series of changes as a collective transformation including economic policies, and systems relating to leadership, labor, wages, social security, ownership as well as political policies.

Discussions on corporate governance transformation in a unique Chinese context give us new insights into the reconceptualization of Chinese corporate governance, rather than just purely criticising lack of effectiveness and efficiency of corporate governance because of administrative involvement. The administrative involvement might sacrifice efficiency and effective market and corporate responses. However, it may bring comparative advantages for Chinese corporate governance in terms of support, long term strategic planning, and the setting of multiple goals for SOEs, with government interference producing immediate effect to prevent market failure.

The application of administrative power and administrative governance in the transformation of corporate governance might be seen, in many ways, as being justified, rational, and fair in the context of China. Likewise, government and administrative interference may also be regarded as elements that enhance and establish a sounder corporate governance, or even as ways that provide remedies for market failure. For future research, it may worth considering how administrative/government enhancement and judicial intervention in corporate governance could be balanced.<sup>195</sup> Moreover, to apply the discussion of the article in a wider context, the Chinese experience on administrative governance may provide some useful insights for both developing and transitioning economies seeking to establish capital markets and emerging markets in which government interference plays a vital role in financial and securities market.

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<sup>195</sup> For discussion on juridical intervention of corporate governance in China, *see* QINFA YANG, JUDICIAL INTERVENTION IN CORPORATE GOVERNANCE (GONGSI ZHILI DE SIFA JIERU 公司治理的司法介入) (2008).