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Comparative Corporate Governance:Changing Profiles of National Diversity
Corporate Governance in perspective:Diversity or Convergence
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Corporate Governance in China in the Transitional Era: A Review and A Foresight

——转轨时期的中国公司治理回顾与展望

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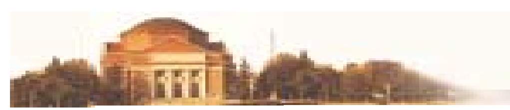


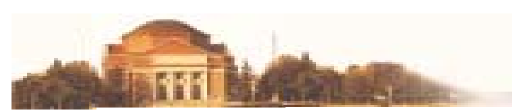
1911 – 2002

Abstract

Corporate governance necessarily results from the separation of modern enterprises′ ownership from its management. An enterprise′ ownership and control structures determine its corporate governance pattern. The nature of China′s reform and the diverse forms of ownership among Chinese enterprises have unavoidably led to corporate governance in that country, which has experienced various stages – original stage, primary stage and transitional stage. Currently, corporate governance in China, which is at the transitional stage, exhibits five major forms.

China's economic system reform has provided the background for that country's corporate governance. It's a result of the Chinese enterprises' continuous learning. It is also a choice for the purpose of getting adapted in an environment where the system of planning gradually faded away but the new system of a market economy was still in formation. After China's gaining access to the World Trade Organization, and particularly due to the Chinese Communist Party's 16th congress, corporate governance should become the necessary method to enhance the Chinese enterprises' competitive advantage. Given the momentum of China's economic development, corporate governance in that country should focus on catching up with the pace of the global economy.

Keywords: China, corporate governance, ownership, market



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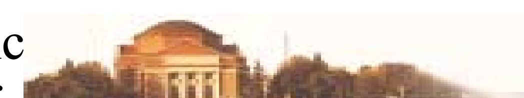
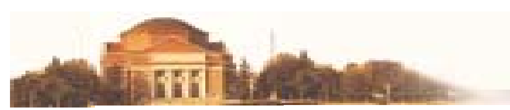


Introduction

After China's gaining access to the World Trade Organization, and particularly due to the implications of the Chinese Communist Party's 16^{th} congress, Chinese economy faces a more open environment. As all aspects should converge with the world system, China's economic reform should land in a new stage. In this important era, to improve corporate governance is not only the demand of all kinds of companies in their efforts of enhancing theirs competence in the market but also the requirement for China to smoothly complete its economic reform. We thus believe that it is necessary and beneficial to briefly review corporate governance in China and, based on that, offer a foresight of corporate governance in that country.



Corporate Governance:
A Problem with International Implications

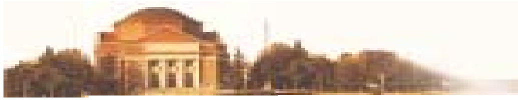
Corporate governance is a controlling and managing system of modern enterprises within the frame of their basic ownership structure. Since the 1990s, the problem of corporate governance began to arouse global attention. Today, it becomes a global problem. The study of corporate governance among China's scholars started in the 1990s. As the establishment of a modern corporate system was claimed to be the focus of state-owned enterprises' reform, corporate governance becomes more and more important.

What is corporate governance?

Companies with a modern system separate their ownership and management. Shareholders who own a company could not control its management while the management responsible for the company's daily operations does not work totally according to the shareholders' interests. Ownership's separation from operation conflicts with the rule of maximizing shareholders' values. At the same time, considering one's own benefits, powerful shareholders are likely to harm small shareholders.

Corporate governance has thus become a real problem. In the narrow sense, based on the **shareholder-value perspective**, corporate governance is an internal set of rules and systems which are used to decide and adjust the relationship between a company's shareholders and management. In the broad sense, based on the **stakeholder-society perspective**, corporate governance emphasizes the coordination of the benefits of the company and all the involved parties(such as shareholder, loaner, supplier, employee, government, community) by a set of formal or informal, internal or external system.[1] Although government is already not the traditional body of corporate governance, certain recent evolutions in the west such as the scandals of Enron and WorldCom convince us that **government regulation** should be taken into account in the framework of corporate governance

[1] The explanation of Aoki is not from the prospective of regulation. Instead, he sees corporate governance from the aspect of game theory. He argues that corporate combined domain (that connecting organization and financial transaction) consists of three groups that strategically interactive(there might have other party involved under certain circumstances): investors who provides the capital, workers as the specialized assets of the investing organization, and managers that are authorized to leverage financial capital and human resources when it is impossible to sign a contract. The managers are concerned with their own interests, such as income, promotion, position related consumption and other compensation. The manager side mentioned above is focal player. Corporate governance is a self-implementation mechanism reflecting the strategic interaction among the composing groups (Aoki, 2001)



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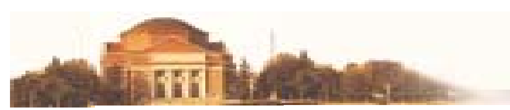


Now, China is at the stage when a traditional planning economy with some legacy of a self-sufficient economy is being gradually transformed into a modern market economy.

After twenty years′ efforts of reform, the economic system in China has changed significantly, i.e., the ownership structure is fundamentally transformed. State-owned, collective-owned, individual-owned, private-owned, foreign-owned and joint ventures and other kinds of economic players co-exist and co-develop (see table 1).

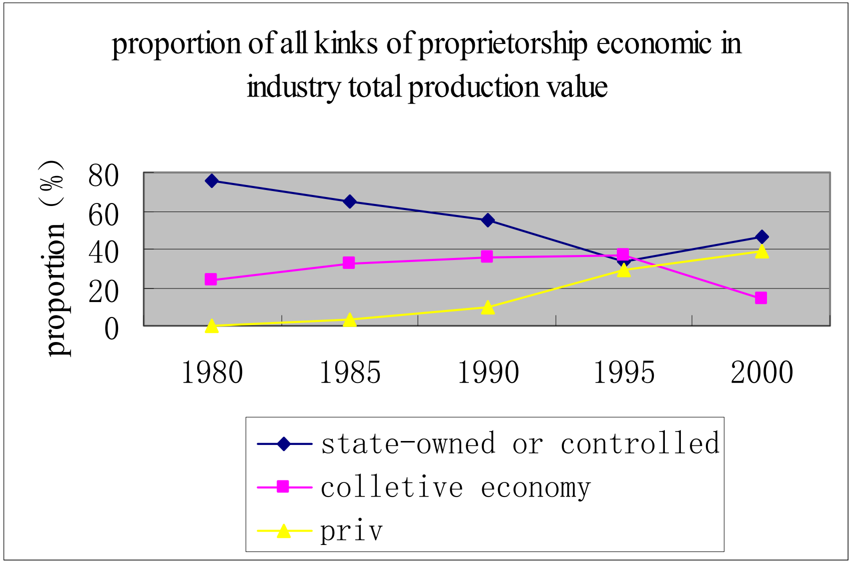
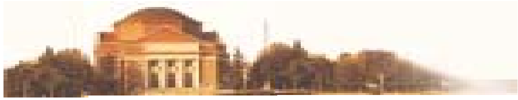


Figure 1. Distribution of Variously Owned Economies in China′s Total Industrial Production



Through various kinds of reformative measures, the management system of state-owned enterprises has been primarily adjusted. The market system has come into play various economic sectors such as commercial trade, resources allocation. The prices of various production elements began to be adjusted due to the effects of market supply and demand (see table 2). From the viewpoint of the economic system reform, a basic conclusion can be reached − China has become a pre-market economy country.

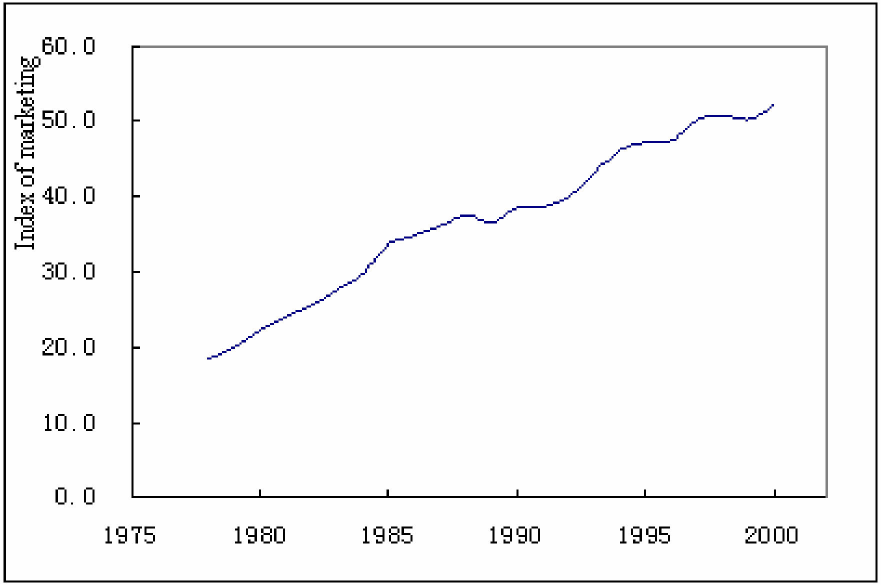


Figure 2. The Evolution of Market in China

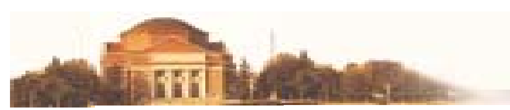
1. Corporate Governance Among State-controlled Enterprises

The Original Stage（Before the End of 1978）
The Primary Stage（1979-1992）
The Transitional Stage（1992-2002）
Converging Stage（2002 -   ）

Table 1: Four Stages of China's Economic System Reform and Corporate Governance of China's State-owned Enterprises

Stage	Time Period	Reform Objective	Characteristics of Corporate Governance of State-owned Enterprises
Original Stage	Before 1978	State decided the production plan, and configured the resources.	Corporate play as the role of government's workshop. No operation rights, Sure, no corporate governance structure too.
Primary stage	1979 — 1992	The 3rd plenary meeting of the 11th Congress decided to transfer its focus to the economy development. After the meeting, a series of reform measure about corporate empower were put into effect.	Corporate was given operation rights. All kinds of inspiring system were in trail. But no necessary restriction system.
Transitional Stage	1992 — 2002	In 1992, the 14th congress of Chinese Communist Party decided, the direction of economic system transform is to establish the socialism market economy in China. In 1993, the 14th congress of CHINESE COMMUNIST PARTY advocated; building up modern corporate system is the transform trend of state-owned enterprises. In 1997, the 15th congress of CHINESE COMMUNIST PARTY advocated to carry through the formal corporate transform according to the modern corporate system,	The rights and responsibility relationship become clear. According to the law, corporate independently operation, and assume sole responsibility for its profits and losses. Government no longer interferes operation of corporate.
Converging stage	2002 —	In 2002, the 16th congress of CHINESE COMMUNIST PARTY set up a new target, that is to develop a overall XiaoKang society, at the same time, decided to reform the system of the state-owned assets' management.	Emerge with the global economy.

Table 1: Four Stages of China's Economic System Reform and Corporate Governance of China's State-owned Enterprises



Main problems of corporate governance in the state-controlled enterprises include:

(1) stock structure is not reasonable

(2) Restriction system is invalid.

(3) Incentive system becomes invalid.

All these characteristics of the corporate governance of China′s state-owned enterprises governance lead to inefficient production and operation (Figure 3).

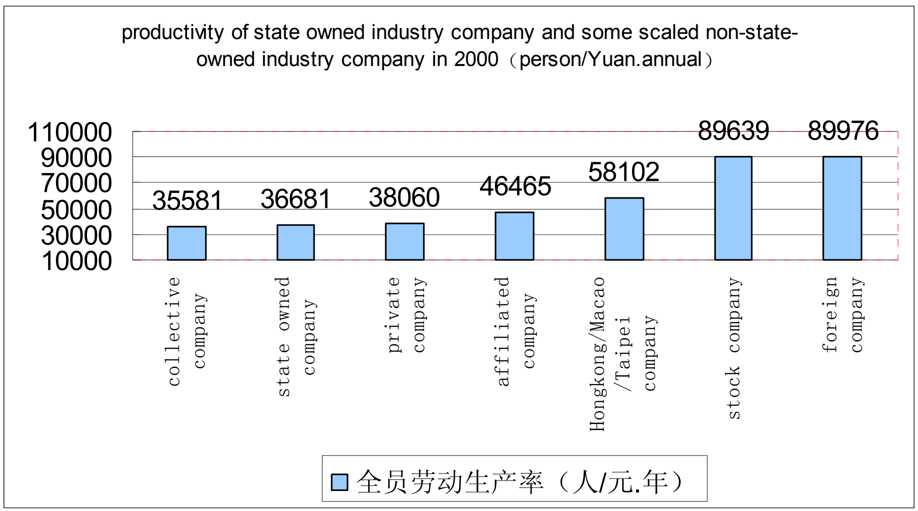


Figure 3: Productivity of State-owned Non-state-owned Industrial Companies

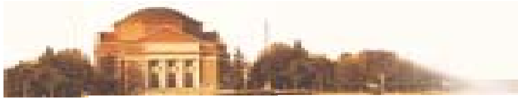
2. Corporate Governance in Family Business

Characteristics in the corporate governance of family businesses include :

(1) few persons take control.

(2) Property right and operation right integrate. The restriction for the management is not the main problem.

(3) The control right of the business has direct impact on the governance system.

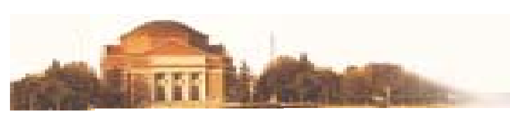


The power structure of family business is the result of its internal financing or limited financing approach during its initiative period (Table 2)

Financing approah / operation period	Self-financing	Bank loan	Non-financial institution financing	others
Less Than 3 years	92.4	2.7	2.2	2.7
3 - 5 years	92.1	3.5	0	4.4
6 - 10 years	89.0	6.3	1.5	3.2
Above 10 years	83.1	5.7	9.9	1.3
Total（average）	90.5	4.0	2.6	2.9

Table 2.Financing Structure of Private Enterprises in China

Source：Neil Gregory (2000). China's emerging private enterprise: prospects for the new century. Washington: International Finance Corporation.



3. Artificial Person Control-based Corporate Governance

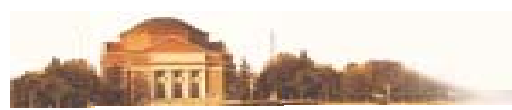
Characteristics of corporate governance in artificial person controlled companies include:

(1) Ownership relatively concentrates.
(2) Valid internal governance system.
(3) Emphasis on incentives to the management.
(4) Corporate control exists in market.

4. Corporate Governance of Joint-Ventures

There are some unique aspects in corporate governance of joint-ventures. And these aspects derive from joint-ventures′ special proprietorship structure.

Among them, the decorative position of the board of directors is the most outstanding characteristic.



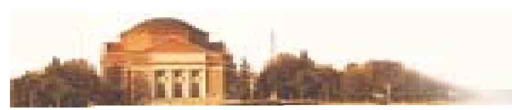
5. Transitional Corporate Governance

There are **two main kinds of companies** whose corporate governance is transitional. One kind of companies includes the four asset management corporation **(AMC)**. The other kind includes the initiative companies that are **supported by the venture capital**. Among them, high technology companies become the majority.

Basic conclusion: corporate governance in China has taken place in a backdrop of economic system reform. It results from the Chinese enterprises′ continuous learning. Beside, it is choice to adapt in the environment where a planning system is changed into the new and still forming market system (Table 3).

	state controlled corporate governance pattern	corporate governance in family business	artificial person controlled governance pattern	sino-foreign joint venture governance pattern	transition governance pattern
Corporate form	Internal	Internal	internal	external	external
Proprietorship type	State-owned	Private, part of collective	All kinds of companies	Joint-venture	AMCs, initiative companies which go VC's support
Property right structure	Concentrated	concentrated	Relatively concentrated	Owned by respective parent corporate.	Diversity.
Incentive system	Exist, but not valid.	Non-exist, but valid.	Exist.	May not exit.	Valid.
Independence of the board of the director	dependent	dependent	Owe control rights	dependent	Dynamic, unstable

Table 3. Five types of corporation governance in China



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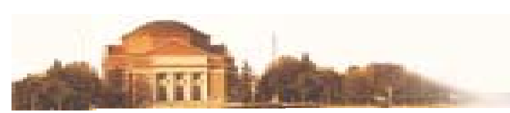
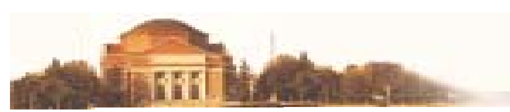


Conclusion

Since the last 20 years of the last century, the economic system reform of China and corporate governance producing from the reform are a gradually progressing process. It is an optimizing behavior in the original system. The re-tracking has not completed, in other words, the integration has just begun. Therefore, I will classify it as the evolution category instead of the progress category, although the evolution is the prerequisite of the progress. Another important reason of saying so still lies in that after China′s entry into the World Trade Organization and especially after 16th Congress of the Chinese Communist Party, the economic system reform of China is moving to a new stage. The closer to the moment of truth of the reform, the rougher the problem is, and the sharper the contradiction is.



In fact, any inside or external governance and regulation, which come from organization, cannot explain the complexity of the corporate governance. It is obvious that they are not the whole methods of solving problems of the corporate governance. Only by really self-conscious running according to the market rule and handling affairs according to the international traditional principle, we will have the probability to win in the competition. Both the government and enterprises should understand that the self-regulation and trust of the commitment should become a prerequisite of the solving problem of the corporate governance rather than a moral base discussion at any time. The corporate governance is a wisdom trial for corporations and the government.