Corporate Governance in China in the Transitional Era: A Review and A Foresight

By

Angang Hu, Ph. D., Professor

Guangyu Hu, Ph.D.

Center of China Studies

Tsinghua University

Beijing 100084

P. R. China

anganghu@tsinghua.edu.cn

hugy@em.tsinghua.edu.cn

Phone: 8610/6277-3826

Fax: 8610/6277-3826

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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

Introduction

During the last twenty years of the 20th century, China began a profound economic reform. The country's economy has changed from a planning-oriented one into a market-oriented one. In this era of reform, China's achievements were widely recognized. China's reform, nonetheless, continues to touch deeper levels of that country's economic system. State-owned companies began to turn from a government's manufacturing units into competitors in the same market. Non state-owned economy developed fully too, and showed powerful potential. But meanwhile, the same as those countries with a market economy as well as countries where a market economy just came into formation, Chinese companies—as the micro actors of modern economy, have encountered problems in corporate governance. These problems become more complicated because of a yet completed economic reform.

After China's gaining access to the World Trade Organization, and particularly due to the implications of the Chinese Communist Party's 16th 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.

Corporate Governance in China: A Process Full of Difficulties

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. China's economic system reform, which began in 1978 and focused on cultivating market players and establishing a market system, is essentially a unprecedented movement in which the whole national economy is thrown into an open market.

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). 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

[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)

country.

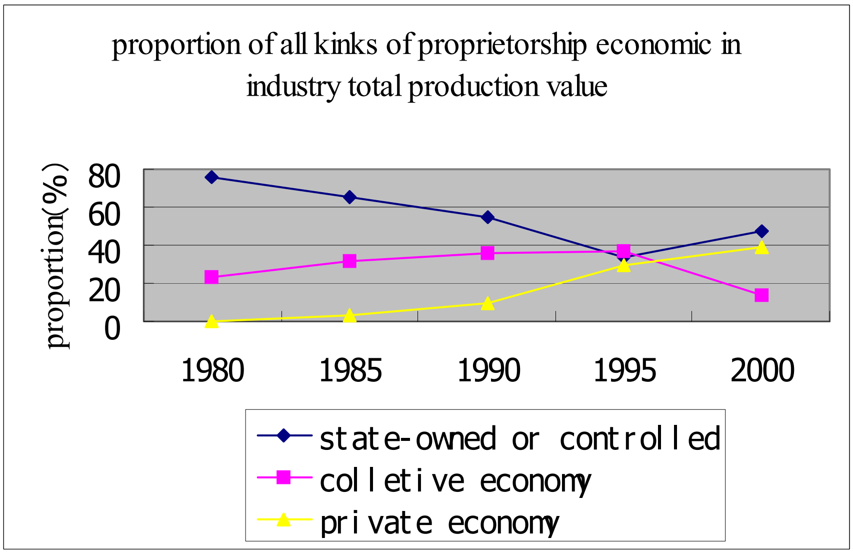

Figure 1. Distribution of Variously Owned Economies in China's Total Industrial Production

Source: Chinese Industrial Economy Statistical Yearbook (2001)

Note: In 2000, statistics was based on the state-owned and large-scale non-state-owned industry enterprises (annual sales reached 5 million RMB *yuan*). The 2000 dada is thus different from those for other years.

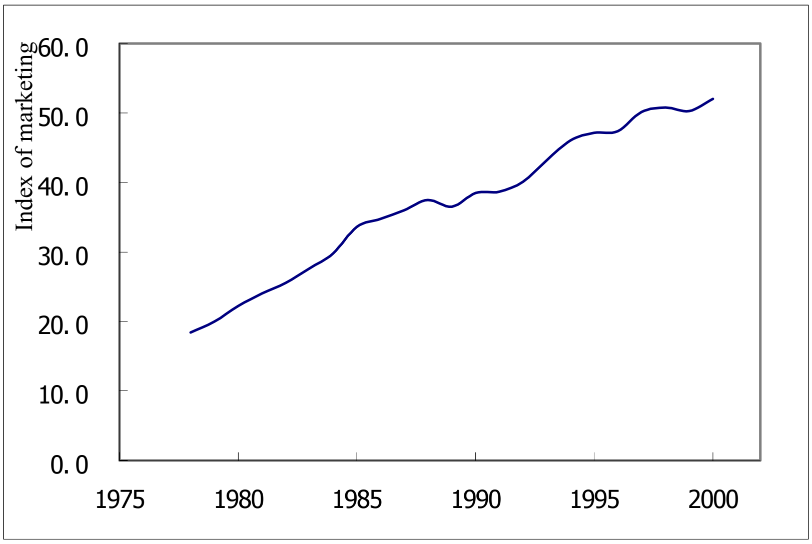

Figure 2. The Evolution of Market in China

Source: Wu Qungang (2002).

Corporate governance in China results from the interaction of many elements.[2] The nature of China's economic reform and the diversification trend of the ownership of Chinese enterprises make patterns of corporate governance in China different from what is popular in the world. At the same time, from an internal point of view, corporate governance in China is very complex.[3] According to the ownership and control pattern, we can classify Chinese corporate governance into five different types.

Corporate Governance Among State-controlled Enterprises

The ownership of state-controlled enterprises primarily belongs to state shareholders. This kind of enterprises includes：state-owned public enterprises, state-owned enterprises, state-controlled limited enterprises. A company governance of state-owned enterprises closely relates to the country's economic system reform. Its development can be distinguished into the following stages.

The Original Stage（Before the End of 1978）

Before the 3rd plenary meeting of the Chinese Communist Party's 11th congress in 1978, the majority of Chinese enterprises were entirely-people-owned。Every production element should be allocated by the state; also, market should be allocated by the state. State-owned enterprises had no decision making power. In the internal of those enterprises, equalitarianism prevailed.[4] No incentive system existed. And no corporate governance structure existed either.

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[2] North holds that the institution theory composed of state theory, proprietary theory and ideology can comprehensively explain the reasons for the evolution of state and organization forms. The goal of the state is to set the rules of the game, mainly taking the form of deciding the ownership on the market of factors and products and achieving rent maximization.

[3] There are mainly two corporate governance models globally. One is the market-oriented model in countries of relatively decentralized share distribution such as U.K. and the U.S.A., the other is the network-oriented model in countries of relatively centralized share allocation such as Germany and Japan. The characteristics of the U.K. and U.S.A. model are: share holding is relatively more distributed, financial market is quite developed, the market for corporate control (such as corporate acquisition, takeover and bankruptcy) is very active. And the characteristics of German and Japan's model are: share holding is more centralized and the essential participation of versatile bank in corporate control issues.

[4] Equalitarian is destructive, not only because it is unable to provide anybody with any signal, which by itself can provide an individual with opportunities to select the direction of efforts, but also because it kills the inspiration factors which should have been able to facilitate freedom-loving people to follow moral rules---what equalitarian asserts is that it is impossible for anybody to be better than others. (Hayek, 1999)

The Primary Stage（1979-1992）

After reform in 1978, China began to empower state-owned enterprises. In the year of 1985, Chinese government increased its enterprises' decision-making power in ten areas. Until 1992, this kind of reform reached a peak with fourteen areas of decision-making allocated to state-owned enterprises. During the primary stage, the production and operation duty system and the contract duty system became popular, and the right of production and operation in a company was handed over from the government to the enterprise. Operators were stimulated. But still, the biggest problem in this stage, was the mixture of government and corporate management. Other problems included the absence of limitation on the enterprises' operating forces.

The Transitional Stage（1992-2002）

In October 1992, the 14th congress of the Chinese Communist Party set up the targets of socialism market economy of China. In November 1993, the 3rd plenary meeting of the 11th congress passed "Decisions about Establishing a Socialism Market System by the Congress of the Chinese Communist Party." In this white paper, China announced its interest in establishing a modern corporate system, which emphasizes transparent ownership, separation of power and responsibility, separation of government and management, scientific management. The relationship of power and responsibility between state and enterprises became more and more tangible. Because of the capital investment, state takes its rights and interests, meanwhile, it shoulders responsibilities due to its role in enterprises' debts. According to the law, an enterprise operates independently and assumes sole responsibility for its profits and losses. Government no longer intervenes in the operation of an enterprise. In 1997, the 15th congress of the Chinese Communist Party advocated to carry through the formal corporate transformation in the frame of modern corporate system to make a company become the qualified artificial person and market player. The significance of this event also lies in that it abandoned some long established criterion, which judged a company's socialism property by the proportion of the state-owned economy. In 1999, the 4th plenary meeting of the15th congress emphasized the reconstruction of Chinese enterprises' property body. The main characteristics of the transitional stage are innovation of system.

Converging Stage（2002 - ）

After China's gaining access to the World Trade Organization and Chinese Communist Party's 16th congress, China's economic system reform goes into a new stage. Chinese economy should converge with the global economy. At the same time, Chinese enterprises should participate in market competition rigorously according to the international regulation（Table 1）.

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.
Converg-ing 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, non-circulative stockholders take the holding position. Now, among all the Chinese public companies, about 65% hold the state as their No.1 stockholder, which take over 40% stock share of each company. Since many Chinese public companies have transformed from the old state-owned companies, once the subsidiary successfully lists IPO, the parent company would take the public company as money drawing machine. It harms the assets of the public company,. This should kill public companies, and violate the rights and interests of the middle and small stockholders. (2) Restriction system is invalid. The board of directors and the general managers of the state proprietary stock companies are appointed by the State Department or the other government departments. Chairman of the board of director often pluralizes general manager, and the board of directors overlaps with the management. So, the function of decision making of the board of director could not separate from the executing function of the management. At the same time, internal directors (supervisors) becomes the majority of the board of director, this directly results in the invalidation of the control system. The proprietorship of state stock is clear,[5] but we could not find the owner of the companies. Insider control thus becomes serious. (3) Incentive system becomes invalid. The compensation system was not attractive to a company's management. The management member of the state-owned enterprises was unitary. There lacks a pool of outside professional managers. Even though the right person might be chosen, the low level of compensation, the unitary compensation system, and the lack of an incentive system with long term attraction still cause a lot of relative problems. All these characteristics of the corporate governance of China's state-owned enterprises governance lead to inefficient production and operation (Figure 3).

[5] Aoki argues that if each factor except for entrepreneurship confronts with a perfect competitive market, the maximization of the surplus after rewarding all the production factors with prices decided by the market will be in line with the internal efficiency allocation. Only at this point is it meaningful to identify the "owner" of an enterprise and the entrepreneur. In China's current transforming economy where there is no perfect competitive factor market, it makes more sense to see an enterprise as a collective entity of a variety of economical assets including human resources, invisible assets, organizational assets, financial assets and physical assets (Aoki, 1994)

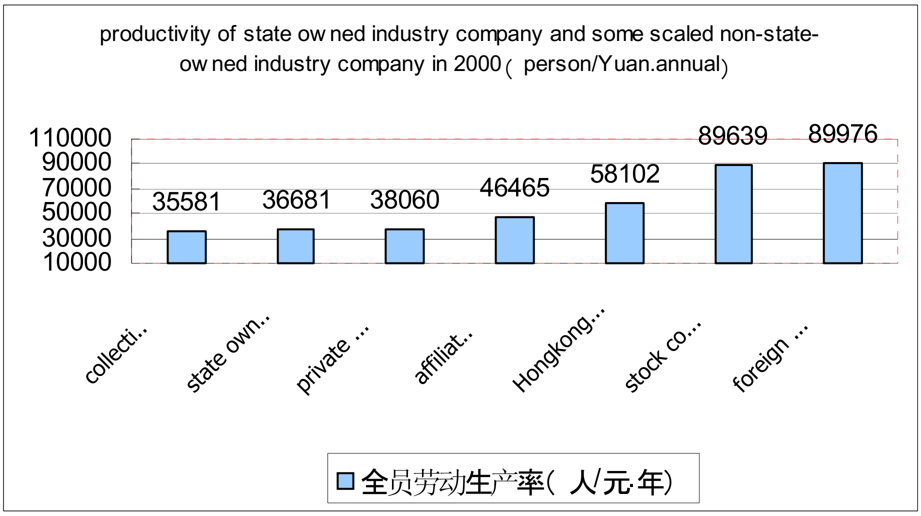

Figure 3：Productivity of State-owned Non-state-owned Industrial Companies

Source：Statistical Yearbook of China（2001）

Note：The average productivity = industrial value added/average persons engaged。Industrial value added should be counted based on the price of the year. State-owned enterprises include: non-corporate economy organizations in which all assets belong to the state, state individual proprietorship enterprises and state-owned affiliated enterprises.

Corporate Governance in Family Business

Family system is a necessary stage in the growth of enterprises. It is a dynamic process . After reform in China, private economy and individual economy develop a lot. In the private economy, we can find plenty of family businesses. Besides, family business can be found in collective enterprises[6]。

Characteristics in the corporate governance of family businesses include : (1) few persons take control. The internal governance system is the result of balancing all the family members. The head of the family business takes all the key power of the business. Family members take responsibilities in production, supply and sales, and at the same time they are responsible for the management of employees, capital and material. The directors and management often come from the same family. Even it sets up the board of directors, the meeting of shareholders is nominal and the owner of the private company still plays the role as the tzar. (2) Property right and operation

[6] This is because in the 1980s and early 1990s, some private enterprise got registered as enterprises of a collective nature to avoid institutional risks, which was called “wearing a red cap”.

right integrate. The restriction for the management is not the main problem. The incentive system can be divided into two types. For the majority of management members, who come from the family itself, incentive system does not base on the outside market system. On the contrary, for the few engaged managers from outside, family business often provides better compensation, or even provides some stock of the business to deal with the long term incentive dilemma. In some way, the family oriented internal governance resolves the incentive problem for the management.(3) The control right of the business has direct impact on the governance system. The family business should face serious competition from product market, capital market and labor market at the same time. So, market systems, such as bankruptcy, merger and purchase, and reorganization should play an important role in the competition.

The power structure of family business is the result of its internal financing or limited financing approach during its initiative period (Table 2). Any research on ethics in this field makes no sense[7]. Nowadays, proprietorship of family business becomes the focus. There are two problems needed to be settled down. First, proprietorship in some family businesses is not clearly defined. When the saving assets should be re-allocated among the family members, conflict arouses. For the collective enterprises that hope to be listed in the stock market, the cost of proprietorship defying is very high. The second problem involves the dominance of one shareholder. Especially, after listed in the stock market, to release business information honestly becomes very important. In fact, faith-related problem has got people's attention (for example, some public businesses listed on Hong Kong stock market, such as (0932.HK), (0682HK), (HK0285)). If the above two problems can not be solved, private enterprises would not grow up.

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.

[7] Webber considers activities of the organization as a process of mass participation. Mass is a scale that goes beyond private connections. Instead of private connections such as strain and geo-relations, organizations must rely on super-individual abstract rules, which are deemed by Web as the supportive system of capitalism. (Hayek, 1999)

Artificial Person Control-based Corporate Governance

Now, among all the Chinese public companies, about 31% hold the artificial person as their No.1 stockholder, which take over 25% stock share of each company. Governance in this kind of company is different from the state-owned enterprises, and the difference is bigger with family businesses. Characteristics of corporate governance in artificial person controlled companies include: (1) Ownership relatively concentrates. Ownership relatively concentrates in companies of the following types - affiliated companies, artificial person proprietorship stock companies, and limited companies. (2) Valid internal governance system. Compared with state-owned stockholder, artificial person stockholder plays a more active role in an company's internal governance. So, few artificial person stockholders will pursue short-term investment interests in the market. Artificial person stockholder will actively take part in the decision making of the board of directors. In the artificial person oriented governance pattern, artificial person stockholder could directly control a company's operation through the board of directors. (3) Emphasis on incentives to the management. (4) Corporate control exists in market.

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. In this kind of companies, general manager often appointed by the Chinese partner, and the chairman of the board of directors often come from the other partner. The members of board of directors consist of two partners. During the negotiation period about the joint venture's building up, the chairman of the board of directors was appointed. The board of directors should report to the parent company while accepting the supervision by the parent company. The parent company owns the right to dismiss and replace the directors. The parent company could not only appoint general manager and vice general manger directly, but also could appoint the manager who supervises the key departments of a company. The general manager of the joint venture takes real power, while the chairman of the board of director exists in name only. The character of dependence of the board of director is obvious. This arouses behavior distortion of the high management. Besides, the chairman of the board of directors should be put into an embarrassing dilemma; he or she could not take the responsibility to supervise the management.

Transitional Corporate Governance

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

From April 1999, China began to set up four asset management corporations. They are Cinda、Orient、Greatwall、Huarong[8]. These 4 AMCs purchased part of the bad assets from the bank. Accordingly, they take the stock share of the companies that owed the bank, and the other rights which belong to the creditor. The AMCs play the role as a transitional stockholder for a company in debt. This condition will not take long because theoretically the AMCs will exist for about 10 years.

Transitional corporate governance also includes the initiative companies that were supported by the venture capital. Among them, high technology companies become the majority. The risk investment companies entrust venture investor to invest in the initiative companies, and got the stock share of a company. After a company's IPO or be purchasing, the risk investment company should quit its control from a company. So, the governance in the venture capital supported initiative companies is also transitional. From 1980s, the venture investment (also called initiative investment) developed to some extent, but still with a low speed. Until now, there are only 200 investment institutions all over China, and their venture capital just reaches 40 billion RMB *yuan*. Many of these investment institutions got the government's support.

Until now, the productivity of transitional corporate governance is not ideal. This is perhaps because of the multiple relationship of entrust-agent. As stockholders, AMCs are assured by the government finance, so they are highly motivated to kill time. At the same time, the state-owned enterprises only want to escape the debt. Building up modern corporate system has no attraction to them. Commonly, debt gives more impresses to the management than stock rights. So, government demands its AMCs to quickly complete reorganization of a company in debt through auction,

[8] On Nov. 26, 2002, the Ministry of Foreign Trade and Economic Cooperation formally approved the establishment of the First Joint Asset Management Corp., a joint venture between Huarong and Morgan Stanley, and Rongsheng Asset Management Corp., a joint venture between Huarong and Goldman Sachs. Chinese side inputted as shares bad creditor's right, and the foreign partners injected 10% bad creditor's right accounting cash. The shares were split 50% to 50% between Chinese and foreign sides. The joint-ventures' board of directors is composed of people from both sides. It has the ownership of the bad loans. And as to the creditor's right invested into the joint venture, he creditor has changed to the new venture and the previous debtor still need to fulfill the payment obligation, regardless of the nature and legal status of them. The new joint venture enjoys the right to take back and dispose the debt as authorized by the laws, but it cannot go beyond its right as a creditor and intervene in the operation of the enterprise. The time frame of the joint venture is 7 years.

discount sale, sub-letting etc. Government does not hope the AMCs to become a long-term stockholder of any company. If not, the hard restriction to the debtor (the creditor's rights in bank) will become a soft one (the stock share in the AMCs). And this will change the AMCs into a real state-owned enterprise. As to companies of the other kind, the American style limited partnership which was proved valid has not got its legality in China.[9] More than that, because of the incompleteness of the quit system for the venture investment, the multiple entrust-agent relationship among capital provider, venture investor, and the initiative corporate become more and more complex.

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).

[9]According to the sources of capital, there are three venture capital models: limited partners (U.S.A.), bank as the principal body (Japan), state venture capital company(west Europe). Limited partners are composed of general partnership and limited partnership. The former consists of pension fund(provide for the aged), big companies, donation funds, investment banks, bank holding companies and rich individuals. Investment from limited partnership takes up to 99% of total capital, and will have about 80% of the profit, bearing limited responsibility. Investment from general partnership is about 1%, they operate the investing and takes about 20% of the profit. However, they have unlimited responsibility. Limited partners is not a legal person and need not to pay revenue tax. In Japan 52% of the venture capitals are from various commercial bank and insurance companies, and 25% from security companies. In west Europe state owned venture capital companies are the principal body of investing. The mainly provide guarantee for loans, low (or zero) interest loans, or directly provide subsidies to enterprises. Judging from current situation, the U.S. model is the most successful. China's Law of Partnership Enterprises does not allow institutions as partners. Both the Insurance Law and the Corporate Law set stringent restrictions on the investment activities by institutions.

	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 got 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

From Evolution to Progress: A Foresight of Corporate Governance in China

Although Chinese economy has experienced a rapid development in the past twenty years, the efforts to solve the problem of corporate governance structure have just begun. The reason is that the task of reform is more arduous, the problems are sharper and the conflictions are more complicate in the period of the latter part of the transitional era and the converging era. As for equity structure, the equity is too centralized in corporations controlled by state or family, so the problems of corporate governance structure in these kinds of corporations are not the power balance between the strong operators and weak shareholders, but the relationship between the strong shareholders and the weak shareholders. On the other hand, the absence of the owner of the state-owned corporations caused the phenomenon that the corporations are controlled by the insider, and led to lower management efficiency. While the shareholders in the corporation-owned corporations have the motive to govern, but the efficiency of governing is influenced by the juvenility of outside market and high transferring equity cost. The great problem of corporate governance of family-owned corporations must be considered. The pattern of corporate governance for transitional corporations has not been formed in China because of the non-grown up of the market.

The history has shown that a command-society based on distribution justice could not replace the function of the market to allocate resources on a basic level. The basis of the existence of the market based on commutative is to establish the rule and abide by the rule. It is the common challenge for the corporations that pursue the development in the market. Looking ahead, we will improve and enhance the following five aspects to improve corporate governance in China.

Defining the Government's Role

Two requirements for the government: firstly, the government should be a limited government, and be an arm's length type to concrete economic trade activities. But the limited government should also be effective, and play the role of referee in the market economy. That is the second requirement. The principal to deal with the dilemma is that the government should do what is appropriate and discard what is inappropriate.

In the product market, the government does too many things which is opposite to the world trend of relaxing the management to the product market. It is right to weaken the government's direct interference in the economic field in china, and the state-owned economy is exiting from non- key fields.

In the labor market, the government's administration is too wide and inflexible, which will delay the buildup of the totally flowing and high efficient human resources market and increase the market trade cost. Therefore, the supervision to the labor market should be relaxed.

In the capital market, the supervision should be enhanced. The information revelation is the key point in supervision. On one hand, to standardize the information revelation, and on the other hand, and also the most important one, to make the corporations take responsibility to their information revelation.

Diversifying Shareholding

It is raised in the 16^{th} Congress of the Chinese Communist Party's Report that "to construct the state-owned assets structure system that the central government and local government fulfill contributor's duty on behalf of the country respectively, hold owner rights interests and right, unite obligation, responsibility, integrate management between assets and persons”. According to the report, central government and local government will establish state-owned assets management organization respectively, local government will have the full right and interest as investor, and the reform thought of the state-owned economy “advances sometimes, retreat sometimes and do what is appropriate and discard what is inappropriate" will be reification. After the realization of the share ownership pluralism, the assets ownership will be clear, which will help form the owner’s efficient control in the process of corporate governance, because the corporations’ assets are owned by numerous owners (Wu, 1998). But in the process of the share ownership diversification, enthusiasm of local government should also be considered.

It can be foreseen that diversification of share ownership will improve the efficiency of state-owned enterprises’ corporate governance, no matter which manner is taken.

Opening the Capital Market, Fostering the Institutional Investor

There are some important transformations taking place in the Chinese capital market. It mainly includes the following aspects: (1) an increase of the opening speed**.** The corporations’ governing system will be improved after the representatives of non-state-owned investment subject enter the board of directors and supervisor of the company. Because the share ownership can be transformed, once the problems on the corporations management appears, foreign investors will vote with foot, which will increase the pressure of the senior management of the corporation. The opening policy will further stimulate the capital market development. (2) a transformation of “venture” into “investment.” In the past, the capital, as a valuable resource, was not fully utilized, and the efficiency was very low, because the venture held the capital market. Recently, with more and more international investors entering Chinese capital market and Chinese security market self-adjusting, the rational investment conception are coming into being gradually and the institutional investors will come back from" passive shareholder" to" positive shareholder. The validity of the capital market, the tool to allocate resource, will be improved greatly, and the non-performing governing corporations will be out form Chinese capital market.

Improving the Function of Board of Directors, Forming Effective Incentive and Restriction Mechanism

Introducing the independent director (non-executive) has already been proved an important means to guarantee a fair operation of board of directors by the western company. There is not a perfect standard to decide what the exact proportion is between directors and non-executive director in board of directors in the companies. Considering the particularity of ownership structure of most public companies in China, increasing non-executive director's dynamics will strengthen further, which is necessary to protect medium and small investors, and ensure the economic integrates before social credit system totally set up. How to guarantee the independent director's independent character? The most important is to define the standards further, including the independent director's reward, the quality and the right, responsibility and profit, to ensure the independent director's real independence on the economy, personality and interests, and promise to" work for its policy in its location ."

Involving Creditor in Corporate Governance

Building New Bank-Company Relationship

With the Japanese economic depression going on, someone thinks the efficiency of Japanese corporate governance involved by main bank was not as high as expected, but was just exaggerated. There is much doubt interior about the efficiency of corporate governance with bank involved in. They centralize in the following three aspects: (1) the involvement of commercial bank in corporate governance is selective，it is contingent governance based on bank loan. (2) The four main state-owned banks also face the hard mission to commercialize and have many problems in their intern governance. (3) The banking system in China has not yet become independent completely, for example, loan recombination proceeds from the government dictation.

But the situation has been changing. We can see it from the fact that the four main state banks are progressing to be the commercial banks that bear the loan risk themselves, and it is more and more essential for them to reinforce the supervise and control on the loan corporate. With the foreign financial organizations' entry to the market step by step, Chinese commercial banks are forced to improve the internal management so as to enhance their competitive. It is feasible for bank to appoint directors to involve the corporate governance, by which the corporate operation efficiency will progress.

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.

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