



Policy Dialogue on Corporate Governance in China

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*by
Shao Ling, Deputy Director,
State Council's State-Owned Assets Supervision and Administration
Commission*

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I am very pleased to have been invited to the conference "Policy Dialogue on Corporate Governance in China". First of all I should like to offer, on behalf of the State Council's State-Owned Assets Supervision and Administration Commission and in my own name, our sincere regards and cordial greetings to our guests attending the conference, our leaders and friends, old and new.

The issue of corporate governance and the related issues of the separation of ownership rights and managerial powers have been with us for the past two or three hundred years. Following the introduction of the reforms and the opening-up of the Chinese economy and especially since 1993, when the authorities decided on the direction to be taken by the reforms leading to a modern enterprise system, the issue of corporate governance has gradually "come to the surface", and a general consensus has been reached on the importance of improving the structure of corporate governance.

Although the issue of corporate governance as it arises and evolves in China contrasts strongly with what we observe in developed market economies, we all face the same tasks when considering corporate governance as it impinges on such issues as the exercise of agency by mandate following the separation of ownership rights and managerial powers, investor diversification, the professionalisation of management, the fixing of salaries and bonuses according to market norms, the systematic protection of the rights and interests of small and medium-sized shareholders and the introduction of safeguards for mutual interests throughout society. It therefore makes practical sense to draw on international experience when discussing how to tackle the question of corporate governance in China.

So I shall now discuss a few views relating to the topic assigned to me by the sponsors of this Conference.

1. First, though, let me take this opportunity to tell you something about the State Council's State-Owned Assets Supervision and Administration Commission.

While China has been engaged in the process of reform and opening up and its economy continues to grow at a fast pace, the State sector has also been developing rapidly. However, for a long time the question of how to administer State-owned assets has remained effectively unresolved. There has been no separation between the functions of social and public management exercised by the government and its function as investor in State-owned assets. The function of investing in State-owned assets is shared out among many different departments. This not only prevents the State from effectively carrying out its responsibilities as investor in State-owned assets. It also encourages government interference in the administration of enterprises. In order to radically alter this state of affairs, the Communist Party at its Sixteenth National Congress called for the setting-up of a system of State-asset administration, in which central government and local governments carry out their respective responsibilities of investor on behalf of the State, vested with uniform owners' rights and interests, entitlements, duties and responsibilities, and asset management, personnel management and area management are duly integrated.

Reforming the administration of State-owned assets forms a major part of the task of further reforming China's economic system.

The State Council's State-Owned Assets Supervision and Administration Commission was created in April 2003, in accordance with the Plan for an Organisational Reform of the State Council adopted at the First Session of the Tenth National People's Congress. The Commission is a directly subordinate special body empowered by the State Council to carry out on its behalf its responsibilities as investor and to supervise and administer enterprises' state-owned assets. Its main duties are:

- (i) within the limits of the powers conferred by the State Council and in accordance with the provisions of the Companies Act of the People's Republic of China and other laws and administrative regulations, to carry out its responsibilities as investor and to guide and promote the reform and reorganisation of the State-owned enterprises (SOEs);
- (ii) to represent the State on the supervisory boards at some large-scale enterprises;
- (iii) in accordance with the legal procedures, to appoint, dismiss and appraise senior executives of the enterprises and assign rewards and penalties on the basis of performance;
- (iv) by means of statistics and audits, to monitor the extent to which the value of the State-owned assets being supervised and administered has been maintained or enhanced;
- (v) to draft laws and administrative regulations on the administration of State-owned assets and lay down related rules and regulations; to direct and supervise the administration of local State-owned assets in conformity with the law.

The scope of supervision and administration exercised by the Commission extends to the State assets of non-financial enterprises belonging to the central government. At present there are in all 187 enterprises directly supervised and administered by the Commission. The nature of the latter's relationship with these enterprises is like that of an investor with the enterprises in which it invests. The Commission carries out, in accordance with company law and the Provisional Regulations on the Supervision and Administration of Enterprises' State-Owned Assets and other laws and regulations, the responsibilities of investor and is vested with owners' rights and interests. But it does not directly intervene in the management of the enterprise's production.

Once the formation of the new Commission was essentially complete in May 2003, it actively began work on reforming the system of State asset administration. This includes drawing up laws and regulations relating to the administration of State-owned assets, instituting appraisals of the managerial performance of centrally-owned enterprises, instituting asset inventories and capital audits and, in a pilot scheme, publicly recruiting and selecting senior managerial staff for the enterprises. At the same time it continues to press ahead with the reform and development of the SOEs and provides reinforced guidance on the standards to apply when reorganising enterprises.

2. The chief items on the Commission's reform agenda for 2004

The creation of a body to supervise and administer State assets will gradually enable the investor to play its proper role. Its responsibility for maintaining and enhancing the value of State-owned assets requires that in the area of policy the Commission should consider making adjustments to the overall organisation and structure of the State sector, encourage the reform and reorganisation of the SOEs (especially the centrally supervised and administered enterprises), optimise the distribution of State-owned assets, increase the competitiveness of the SOEs and the State's capacity to exercise control in the national economy. This year, attention will centre on reforming the system of administration of State assets and further reforming the SOEs, with special emphasis on promoting the following areas of activity:

- (i) improving the laws and regulations relating to the supervision and administration of State-owned assets and, in conformity with the law, safeguarding owners' rights and interests and all lawful rights and interest of the enterprises invested in;

(ii) accelerating the pace of reform of the shareholding system, so that it can as soon as possible become the main form of centrally-run enterprises; with the main focus on reform of the system of ownership rights, bringing about investor diversification by, for example, standardising the arrangements for market flotation, Chinese and foreign joint ventures, mutual equity participation etc; and adjusting and optimising the structure of ownership rights;

(iii) accelerating the introduction of a sound modern enterprise system, which as soon as possible is to form the standard structure of corporate governance (this includes the setting-up of proper boards of directors at solely State-owned companies); continuing to investigate ways and methods of recruiting managers at enterprises suitable to an economy moving over to market principles; and accelerating the introduction of staff selection mechanisms appropriate to a modern enterprise system.

(iv) improving the system for appraising managerial performance at centrally-run enterprises;

(v) accelerating the pace of separation of the main and subsidiary businesses and reorganisation of the subsidiary business and, when effecting the separation in the various cases, performing a social function;

(vi) settling corporate closures and bankruptcies and stepping up the pace of corporate reorganisation and adjustment;

(vii) actively initiating the joint reorganisation of centrally-run enterprises and steadily encouraging adjustments to the distribution structure of the State sector; accelerating the pace of nurturing and developing a number of large and internationally competitive groups of companies and enterprises.

3. The Commission's ideas on corporate governance

In what follows I intend to discuss some views on the question of corporate governance in the context of the work being undertaken by the Commission.

(i) Improving the structure of governance of listed companies from the point of view standardising the behaviour of controlling shareholders.

Reform of the system of State-owned companies and enterprises and the market flotation of their shares are important elements in the reform of China's SOEs. They also represent an important part of the process of establishing a modern enterprise system. For over ten years many SOEs have implemented a reform of their corporate system. A succession of large State-owned enterprises, including Zhongguo Shiyu (petroleum), Zhongguo Shihua (petrochemicals), Zhongguo Liantong (communications), Zhongguo Yidong (mobile phones), Zhongguo Dianxin (telecoms), Baogang (steel) and Zhongguo Liye (aluminium), representing total assets of RMB 100 billion, have successfully been floated on the international or domestic market, thus raising development funds, and have introduced new systems and mechanisms. However, looking at the situation as it is now, corporate governance at China's listed companies still suffers from a series of problems that urgently need resolving. For example, with regard to shareholder equality and the protection of the interests of small and medium-sized shareholders, a small number of listed companies are controlled by big shareholders and lack independence, which seriously harms the interests of the other investors. On the question of disclosure of information and transparency, there are still listed companies that do not properly disclose information. The separation of powers between the internal board of directors, supervisory board and managers and the checks and balances at some listed companies are ineffective, with the result that we have "insider control".

In order to tackle this situation and these problems, we have taken a number of measures over the past few years to improve corporate governance at listed companies. In March 1999 the State Economic and Trade Commission and the Securities Regulatory Commission jointly issued their "Ideas concerning the further promotion of standards for overseas listed companies and an intensification of the reform process". These call, first of all, for overseas listed companies to establish a system of proper outside directors and independent directors. In August 2001 the Securities Regulatory Commission issued a "Guide to the establishment of a system of independent directors at listed companies", which proposes the introduction of a system of independent directors at domestic listed companies, in order to increase the independence of companies' boards of directors. In early 2002 the Securities Regulatory Commission and the State Economic and Trade Commission jointly issued their "Criteria for corporate governance at listed companies". In the same year both bodies in consultation launched a nation-wide study of the establishment of a modern enterprise system for listed companies.

In a situation where equity is relatively concentrated and the Chinese State is the controlling shareholder at most listed companies, the behaviour of the State as controlling shareholder is crucial to improving the system of corporate governance. For this reasons we are endeavouring to restrict irregular behaviour by the State as controlling shareholder, making this one of our priorities in supervising and administering State assets and an important part of process of establishing a modern enterprise system for the SOEs. For example, in August 2003, in consultation with the Securities Regulatory Commission we issued a "Notice on certain issues relating to standards for regulating listed companies' dealings with related funds and external guarantees offered by listed companies". Also, we plan, by e.g. setting up a system of penalties for bad faith, to induce the State as controlling shareholder to become a controlling shareholder that observes good faith and meets its legal liabilities. At the same time, on the basis of the general lessons learned from past experience, we have clarified what is required of a comprehensive re-organisation of the SOEs. An enterprise that meets the conditions must, as far as possible, undergo a complete re-organisation, so that there are no "remnants" left behind. If "remnants" are unavoidable, then we should seek methods of completely separating the redundant part from the new company, so as to prevent the latter from being hampered or encumbered by the remnant and to enable it to operate independently and regularly.

(ii) Setting up and improving boards of directors and a sound structure of corporate governance at solely State owned enterprises

Among the enterprises directly overseen by the State Council's State-Owned Assets Supervision and Administration Commission, there are a number of large enterprises operating in industries and areas that are essential to the economic life and security of the nation. These may, under the law and regulations, take the form of a solely State-owned enterprise. There are also some enterprises where, owing to objective constraints, it would be difficult at the present time to introduce a diversified investor structure. These will for the time being have to remain solely State-owned. At the moment most of these solely State-owned enterprises or companies do not have boards of directors, but are run under a "managing director responsibility system". The survival of this type of set-up causes a number of problems. Firstly: the policy-making and executive functions at the company are merged, there is a high degree of power concentration and policy-making lacks checks and balances. Secondly: while the supervisory board appointed by the State Council is relatively effective in overseeing whether the managers of the solely State-owned enterprise carry out their duties in accordance with the law (including whether the financial statements present a true picture of the enterprise), the supervisory board is unable through participation in major decisions to prevent "insider control".

Thirdly, a body that supervises and administers State-owned assets is a body that performs the responsibilities of investor. If the company does not have a board of directors and the supervisory organ deals directly with the management, not only do the functions of supervision and administration become very costly, but an undesirable situation can arise in which the body overseeing the State assets exceeds its powers and interferes in the running of the enterprise's production. If these problems are to be resolved, it is necessary, as a matter of urgency, to improve the system of corporate governance, so that they can be prevented and overcome systemically.

In order to set up a mechanism that involves collective decision-making and individual accountability and ensures that responsibility can be traced, the board of directors must be responsible to the shareholders. On the basis of the relevant provisions in company law, our next step will focus on strengthening and improving the boards of directors at solely State-owned companies. Among our objectives we intend:

- (a) to give practical expression to the functions of the board of directors and reinforce the directors' responsibilities; according to the different circumstances of each company, to draw up practical and workable rules on the scope and content of major decision-making; to clarify the division of functions and powers between the board of directors, the chairman of the board and the managing director and to develop to the full the board of directors' functions in the areas of strategy management, risk control etc. The board of directors must faithfully, diligently, prudently and meticulously carry out their duties and assume their respective responsibilities and to the best of their ability safeguard the shareholders' interests. In this respect we need to further define the general requirements;
- (b) to establish a system of outside directors. It is clear from practical experience that, if the members of a board of directors are entirely made up of company insiders and there is a high degree of overlap between directors and managers, it is difficult for the board of the directors to properly carry out their activities and they become redundant. Outside directors are therefore essential. If a board of directors is made up jointly of outside and inside directors (who may also be known as non-executive and executive directors), the outside directors must have suitable professional experience or specialist expertise and they must have sufficient time and energy to carry out their duties;
- (c) boards of directors should set up specialist committees and amplify the rules on the activities of boards of directors, and the specialist committees should exploit the full potential of outside directors; proper arrangements should be introduced for board of directors' meetings; a board of directors' office should be set up to act as the unit permanently responsible for the work of the board of directors and a board of directors' secretariat should be created to manage the work of the office.

We also need to consider staff members serving on the board of directors and supervisory board. The staff have a major stake in solely State-owned companies and their rights must be embodied more effectively in the governance structure. This is a stipulation of China's Companies Act. It is also in line with the OECD's Principles of Corporate Governance.

In order to coordinate with the reform measures described above, if the bodies supervising and administering State-owned assets as shareholders, under the provisions of the companies Act and the Provisional Regulations on the Supervision and Administration of Enterprises' State Assets, supervise and administer the solely State-owned companies in which they invest, then they embody the functions and powers of company board and directors.

This is a very important change. In order to do this, the bodies supervising and administering State assets will need to set up an internal operations system, linking the carrying-out of the responsibilities of investor with the work of the board of directors, and they will assess or review and approve the outcome and set up a system of recruitment, evaluation, appraisal and awards and penalties for directors that is suitable to a modern enterprise system. At the same time, at companies that meet the conditions, they will, in conformity with the laws and regulations, authorise the companies' board of directors to exercise some of the functions and powers of the investor.

Fundamentally, corporate governance is about balancing the interests of investor, management and labour. This is an on-going task. Perhaps nowhere in the world will we find a uniform, perfect or immutable model of corporate governance. In fact, for economic, social, historical and cultural reasons, the corporate ownership and corporate governance models found in each country differ greatly. However, there are some general rules applying to corporate governance. With China's entry into the World Trade Organisation and the gradual opening-up of the Chinese market, China's domestic enterprises, by drawing on international rules, are establishing and improving their own corporate governance. Not only is this an inevitable choice. It is also an urgent priority. I hope that conferences like today's will play a part in accelerating this process.

I wish the conference every success and a fruitful outcome! Thank you.