CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN CHINA

System Arrangements of the Corporate governance of the Chinese State-owned Enterprises and Companies

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BEIJING, 18 - 19 JANUARY 2000
The goal of Chinese state-owned enterprises reform is to establish modern enterprise system. Corporation system is an effective form of the modern enterprise system. The Corporation Corporate governance is the core of the Corporation system. That is why the perfection of the corporation corporate governance is very significant for the deepening of state-owned enterprise reform and the establishment of modern enterprise system. Here I want to share some of my personal views on this topic.

I. Active deepening of the Diversification of Shareholders

The diversification of shareholders is conducive to the formation of standard corporation corporate governance. There has been great progress in the reform in the diversification of shareholders since the Reform and Opening up to the outside. But in general, the degree of the diversification of shareholders is still not high. This is reflected in the following two aspects: 1. There is still a great part of the reformed enterprises that have not implemented the diversification of shareholders. For example, among the 2066 reformed enterprises in the pilot program of establishing the modern enterprise system organized by various regions and departments, 31.7% have been reformed into corporations fully owned by the state, the total asset of which is 49% of that of all the reformed enterprises. 2. In the enterprises reformed into corporation with multi-shareholders, most of them are absolutely controlled by the state-ownership. For example, among the 1412 enterprises reformed into limited liability companies with multi-shareholders or limited liability stock companies in the pilot program of establishing the modern enterprise system organized by various regions and departments, 65.7% are companies absolutely controlled by the state-ownership. So, it is imperative to take measures to actively deepen the diversification of shareholders.

Apart from three kinds of enterprises, no enterprise shall be reformed into corporation completely owned by state-ownership in general. They are: 1. Enterprises have to be monopolized by the state. 2. A few big-sized enterprises having conditions to be the main body of state-ownership and the state-owned capital management and operation companies or state controlled companies reformed from former governmental authorities. 3. Subsidiary companies completely owned by the two above-mentioned enterprises.

In the industries concerning national security or naturally monopolized, industries providing important public products and services, pillar industry and important and pillar enterprises in the high-tech industries, except in the fields that prohibit non state-ownership's participation in the management, where complete state-ownership or absolute control by the state-ownership shall be implemented, the form of comparative control by the state-ownership shall be allowed.

On the basis of standard operation, the state shareholder shall be allowed to transfer state-owned shares in various forms according to the specific situation. Except the industries and fields where state-owned economy shall be in control, the transfer of state-owned shares shall not be limited by state control or state participation in the ownership. In enterprises that have appropriate conditions, the transfer of state-owned shares shall give due consideration to the bringing the strategic investment.

Concerning the shares owned by the capital management and operation companies that were originally transferred from the debts of the state-owned enterprises, We should encourage the capital management and operation companies to transfer them to the non state-owned legal person or natural person at home and abroad on the basis of sticking to the relevant state principles in adjusting the structures of state-owned economy.

Earnestly sum up the experiences in the pilot program of workers-shareholding and workers-shareholding meeting implemented in some areas, actively deepen the reform in this regard on the basis of formulating the standard methods. We should stick to the principles of share-holding on a voluntary basis and shareholder taking risks and prevent the loss of state-owned asset and the short-eyed over-pursuance of dividends.

II. The State Shareholder Fully Perform its Authorities

It is the basis and impetus for the effective operation of the corporations’ corporate governance that the shareholders fully perform their responsibilities. The prime problem for the state holding enterprises to perfect their corporate governance is that the state shareholders shall fully perform their responsibilities. The usual method of reforming the system of state-
owned enterprises is to reform some productive and operative entities into limited liability companies and limited liability stock companies with multi-shareholders and let the former enterprises to be the state shareholder of the reformed companies. In practice, some big state-owned enterprises can effectively perform the shareholder's rights and shoulder relevant responsibilities of the reformed companies that they hold shares. Thus, we should give authority to those big state-owned enterprise that meet the required conditions, let them operate the state-owned assets of the companies that they hold shares and make them state shareholders.

In order to clarify the state shareholders, we should continue to explore the method in some regions to reform the former competent governmental departments into state-owned asset operation companies or state holding companies. There are two problems in practice that we should pay attention to: 1. We should ensure that these companies themselves can perform all the rights and responsibilities of shareholders. If the companies do not have the rights of taking benefit from asset, making important decision, and choosing managers or can not make final decisions, these companies can only be a redundant layer between corporations and the government. 2. The companies should adapt to the request of strategic restructure of state-owned economy. Most of these companies are established on the basis of the industries of the region, which are easy to be influenced or restricted by the social aims or industrial fields in the region. If not properly dealt with, it is easy to fossilize the structure of the state-owned economy.

In some of corporation-system enterprises with multi-shareholders, the state-owned shares are directly hold by the government. Although in most circumstances, there is only one governmental department in industrial or trade registration and attending the shareholders meeting in these corporations, different authorities of state shareholders are performed by different departments respectively. If there is no condition or no need to set up an organization in the government to perform the shareholder's authorities in a unified way, the responsibilities of different departments that perform shareholders' authorities should be clarified and implemented in accordance with their authorities enjoyed, according to the request of establishing the modern enterprise system. A system of mutual understanding shall be established to coordinate the different shareholders to perform their authorities respectively.

Not only the body should be very clear, but also the authorities of state shareholder shall be fully performed. The fully performance of the authorities enjoyed by the state shareholders faces two urgent tasks: one is to really perform the authority of supervision on the directors and managers through the representative in the corporate governance of the company, the other is to establish the incentive mechanism for the directors and managers. The state shareholders should not only fully perform their authorities, but also the responsibilities. Without the fully performance of the responsibilities, it is very hard to guarantee in system that the state shareholders fully and responsibly perform their authorities and lead to the lack of pressure from the shareholders to the directors and managers. So for the state shareholders to fully perform their authorities, it is the most important to set up a responsibility system that urge the state shareholders to keep and add the value of state-owned asset.

III. Further Improve the Corporate governance of the Corporations

The corporate governance of the corporations stipulated in the Corporation Law of the People's Republic of China has gone through 6 years of practice. From the perspective of practice, at least in the following aspects measures should be taken to improve the corporate governance of the corporations.

1. Ensure the Authority of the Supervision Committee

In the planning economy system, state-owned enterprises are the affiliates of the government and they have no rights to decision. That is why the reform of the state-owned enterprise started from the "empowerment and surrender of profits". But as the decision-making power gradually granted to the enterprises, the problem of lacking effective supervision on the managerial level has emerged. This problem has gotten even worse in recent years, not only reflected in the factory-system enterprises that has not be reformed, but also in some corporation system enterprises controlled by the state shareholders. The reason
of this problem is the inadequate role of the supervision committee for the corporation system enterprises.

In practice, the post of supervisor in the corporation controlled by the state shareholders normally are taken by staff within the enterprise and in most cases, the post of president of the supervision committee are taken by the staff within the enterprise, who is under the leadership of the directors and managers in his ranks both at work and in the Party. This system makes it very hard for the supervision committee to fully perform its authority. The solutions are: For corporations of complete state-ownership, dispatch supervision committee from outside. For corporations controlled by state shareholders whose supervisors must be the representatives from the government shareholder, the supervisors should be public servants with certain qualifications. For corporations controlled by state shareholders that request the representative of the legal person of state shareholder to take the post of supervisors, the supervisors must not be the staff within the corporations. One of the qualifications for these outside supervisors is that they themselves and their relatives have never been employed (including full time and part time) in the corporation.

In order to strengthen the administration of the supervisors coming from public servants, the supervision bureau should be set up in the government above the municipal level, which is responsible for the dispatch, administration, evaluation of the supervisors and formulating relevant laws and regulations to standardize the procedures, rules and responsibilities.

It is very important to perfect duties of the outside dispatched supervision committee or supervisors in the system. The suggestion are as follows: Except there are special local laws and regulations for corporations listed abroad, it must be the outside dispatched supervision committee or supervisors to decide and employ the accounting companies to audit the corporation's accounting. It must be ensured in some form that the staff of the corporations can report to the outside dispatched supervisors the actions of the directors and managers that harm the corporation's interest and they will not be revenged. It must be ensured that the outside dispatched supervisors have the power to investigate independently the events in which the directors and managers possibly harm the corporation's interest.

The money needed by the supervision committee to perform its duties must be ensured in system. The sum should be decided by the shareholders meeting. It can also be left undecided beforehand and reported to the shareholders meeting once a year. The actual spending of the supervision committee can be reimbursed in the corporation only with the approval of the convener of the supervision committee within the scope and amount provided. None of the directors, managers or financial people shall intervene the approval procedure or give approval.

2. Readjust the Structures of the Decision Body and Executive Body in the Corporations.

Separation of the decision body, executive body and supervision body is a form of the institutional structure of the legal person of the corporation. This form is complete in separation of powers. The checks and balances by the decision body to the executive body are effective if the checks and balances in multi-shareholder system are fully developed. There are many examples in Chinese practices. But for corporations completely owned by the state or controlled by the state-ownership, the checks and balances of the decision body to the executive body are not that clear.

For the state-owned asset operation corporations, management corporations and a group of big state-owned enterprises with such characters, the decision functions are predominant generally. Most of the executive functions are usually undertaken by their subsidiary companies controlled by them. For these enterprises, there will be a high efficiency and low cost with the combination of the decision body and executive body. For companies with few kinds of production or operation or companies with relatively small scale, the combination of decision body and executive body is conducive to the improvement of operation efficiency and the reduction of high-rank managerial posts and the cost of their labor. So, it is suggested to improve the current system and arrangement and allow the corporations to decide themselves the separation or combination of the decision body and executive body.

3. Improve the Personnel Structure of the Board of Directors
Whether with combination or separation of the decision body and executive body, it should be clarified by the system that some directors are executive directors while others are non-executive directors. Executive directors should take specific managerial duties of the corporation (that is the functions of the executive body), but it is not proper for them to take part-time post in the headquarter. For corporations with separation of the decision body and executive body, the chairman of the board of directors should only be non-executive director and can not simultaneously take the post of corporation manager. The manager should be from the executive directors. In order to avoid high-degree overlapping of the decision people and executive people, the number of non-executive directors should not be less than 50% of the number of all the directors. For corporations with combination of the decision body and executive body, the system of group decision must be implemented on the precondition that the supervision board can fully play its functions.

In order to improve the checks and balances of multi-shareholders and change the situation that all the directors in some corporations absolutely controlled by the state-ownership are dispatched by the state shareholder, the system of voting on behalf of other shareholders or cumulative voting system can be implemented to ensure the rights of small shareholders through group action and ensure there are directors representing small shareholders, or it can be stipulated that there should be at least 1 director dispatched by non-state shareholders on the condition that the management rights of the state shareholder to the corporation are not affected.

The situation in some corporations that most directors are from the staff of the corporation should be changed. The system should stipulate that most non-executive directors are people outside of the corporation(some non-executive directors should be the representatives of the employees), such as representatives from main creditor banks and specialists from the society. The outside and independent director system should be implemented. In this system, the independent director is a person that he himself and his relatives never hold any post (including part-time post) in the corporation and he has no interest in the corporation. The system will endow him with some special powers and responsibilities so as to ensure his independent performance of some duties of director.

4. Implement the System that All the Executive Directors Can Represent the Corporation While Dealing with other Parties

In the factory system, factory director is the legal representative of the enterprise. In line with it, the decision body and executive body of the enterprise are combined and the system that factory director assume full responsibility is implemented. With consideration of the transfer from the factory system to the corporation system, the Chinese law stipulates that the chairman of the board of directors is the legal representative of the corporation. There are fundamental differences between the corporate governance of the corporation and that of the factory. In the corporation system, the decision body and executive body are separated. The manager, though not the legal representative of the corporation, has important powers by law, such as presiding the production, management and operation of the corporation. The result of his performance of duties is very important for the corporation. The chairman of the board of directors is the legal representative of the corporation, but his powers by law are only presiding the shareholders meeting and convening and presiding the meeting of the board of directors. (In limited liability stock companies, the law endows him with more powers of inspection of the implementation of the resolutions by the board of directors and signing the stocks and bonds of the corporation.) Moreover, the law stipulates that only with consent of more than half of all the directors, resolutions can be passed in the board of directors. This system arrangement makes a sharp contrast between the manager who is not the legal representative but with great powers and the chairman of the board of directors who is the legal representative with very limited powers. Some new problems arisen from this contrast with the extension of the corporation legal representative system, such as: sometimes the power of representation of the corporation is needed in the production or operation process, but it is very hard to be classified as the chairman's duty. Some provisions in laws and regulations concerning the responsibilities and punishments of the legal representative of the corporation should not be undertaken by the chairman. In order to solve the above-mentioned
problems and adapting to the request of group decision of the board of directors, the provision that the chairman is the legal representative of the corporation should be cancelled and the system that all executive directors can represent the corporation in dealing with other parties should be implemented.