Mixed Ownership Reform and Corporate Governance in China’s State-owned Enterprises

Wang Jiangyu
Tan Cheng-Han SC
lawwjy@nus.edu.sg
lawtanch@nus.edu.sg

[October 2019]
Mixed Ownership Reform and Corporate Governance in China’s State-owned Enterprises

Jiangyu Wang and Tan Cheng-Han*

Abstract: This Article provides an early assessment of the impact on corporate governance of the most recent wave of SOE reform announced by the CCP in 2013, officially known as the mixed-ownership reform (MOR). It offers a comprehensive and detailed account of the background, policy and regulatory frameworks, and rationale of the MOR in light of the history of ownership reform in China. It also conducts empirical studies of the change in ownership and board composition in over 30 SOEs which have recently completed their MOR experiments, as well as, several case studies including China Unicom’s MOR. We observe that MOR’s impact on SOE corporate governance has been embodied in the “retreat of the state”, the “advance of the (Chinese Communist) Party”, and a limited yet emerging separation of power between the Party and the board in SOEs. On the rationale, we argue that the MOR programme is driven by three current beliefs of the Chinese Party-state on the future of SOEs in China. First, ownership and ownership reform matter. Second, sharing control, rather than dominance by a single state shareholder, improves both the efficiency and governance of SOEs. Third, the MOR was designed to develop partnerships or alliances between the state shareholders and strategic investors in order to help the post-MOR state enterprises improve their efficiency and enhance market opportunities.

* Jiangyu Wang is an Associate Professor at the Faculty of Law, National University of Singapore. Tan Cheng-Han is Dean & Chair Professor of Commercial Law at the School of Law, City University of Hong Kong. The paper was first presented at the Conference on Comparative Corporate Law & Governance: Asian and Global Perspectives 2019 jointly organized by the Centre for Asian Legal Studies and EW Barker Centre for Law & Business of the Faculty of Law of National University of Singapore and Vanderbilt Law School on 25-26 July 2019. Thanks to Dan W. Puchniak, Randall Thomas, Ron Masulis, and other participants at the aforesaid conference for helpful comments and suggestions. We also thank Kong Xiangchen for the excellent research assistance provided in tracing change in ownership and board composition of the Chinese companies studied in this article. The usual disclaimer applies.
INTRODUCTION

Ownership reform has been at the center of the economic reform programme of the People’s Republic of China (PRC or China) since the early 1990s,1 when the Chinese government decided to corporatize its state-owned enterprises (SOEs). This is understandable given the collectivization of property that was established after 1949 when the Chinese Communist Party (“CCP”) defeated the Kuomintang government. The PRC’s first Company Law was adopted in 1993 to facilitate the fulfillment of this objective2 by establishing a legal framework to convert traditional SOEs into “modern enterprises” which are corporate entities with a system of modern ownership and a governance structure in which the decision-making powers are jointly exercised by the shareholders’ meeting, the board of directors, the supervisory board, and the manager,3 very much akin to how modern corporations are governed in other jurisdictions.

In China’s historical transition from a soviet-style planned economy to a market-oriented economy, ownership reform serves two functions. First, the policy to initiate ownership reform in China represented a fundamental breakthrough in China’s socialist ideology. The planned “command economy”, which China established and practiced between 1949 and 1979, was underlined by the Marxist economic ideology that the state “owns the means of production, and therefore controls the economy, and determines what to produce and who will receive what products at what levels according to the state plan”.4 Any attempt to break the state’s monopoly in the economy would be considered as a serious political challenge to the socialist Party-state itself. In this respect, the CCP’s decision to launch ownership reform to transform the Chinese economy from complete public ownership to a mixed structure demonstrated a strong political will to depart from orthodox Marxist ideology. More significantly, it has offered legitimacy to all future mixed ownership reform initiatives which would not necessarily be considered ideological violations of China’s socialism. The upper limit for such ownership transformation is officially described in the CCP’s first decision in 1992 to establish a “socialist market economy with Chinese characteristics” under which the Chinese economy must be one that the public sector dominates and various types of ownership systems coexist.5

Second, ownership reform also generated institutional reform in China which created a common legal framework for both state and non-state business organizations, paving the way

---

2 JIANGYU WANG, COMPANY LAW IN CHINA: REGULATION OF BUSINESS ORGANIZATIONS IN A SOCIALIST MARKET ECONOMY 33 (Edward Elgar, 2014) 33. See also OECD, CHINA IN THE WORLD ECONOMY 433 (2002).
3 WANG, supra note 2, at 151-195. 
4 GUO, supra note 1, at 554-555. 
for corporatization and eventual privatization of SOEs. The adoption of the Company Law in 1993, as mentioned, is a milestone in such institutional evolution. The law provides a national basis for the establishment, organization and operation of “limited liability companies” and “joint stock limited companies” which are separate and self-responsible legal entities able to operate independently under the law.

The real effect of corporatization resulting from ownership reform on SOE governance has however been questioned. Two arguments have been advanced. In the first, Milhaupt and Zheng remind us of the need to look beyond ownership when studying Chinese state capitalism. They call for attention to be paid to the institutional environment in China which in practice makes the distinction between state ownership and private ownership less meaningful, as functionally, “SOEs and large POEs [privately owned enterprises] share many similarities in the areas commonly thought to distinguish state-owned firms from privately owned firms: market access, receipt of state subsidies, proximity to state power, and execution of the government’s policy objectives.”

In a related argument, Wang has identified the “twin governance structures” in China’s SOEs, one for legal governance and the other for political governance. The legal governance structure, featuring the shareholders’ meeting, the board of directors, the supervisory board and the management team, is installed according to the PRC Company Law and represents the convergence of Chinese corporate governance with Western corporate law norms, while political governance is “a CCP-dominated process that actually controls personnel appointments and decision-making in SOEs.” In such a case, as long as the board of directors is not given real power to run the company independently and the CCP organization is really in charge, the percentage of private ownership is more or less irrelevant in SOEs with mixed ownership.

Although both the aforesaid arguments are powerful in their own ways, it would be too simple to reckon that ownership is totally irrelevant in the study of corporate governance in Chinese SOEs, not merely because of the two general functions of ownership reform that were discussed at the beginning of this paper. More specifically, ownership cannot be ignored because corporate decision-making eventually has to go through the legal governance.

---

6 Though it has has famously been argued that China’s SOE reform is “corporatization, not privatization”, Donald C. Clarke, Corporatisation, not Privatisation, 7:3 China Economic Quarterly 27, 27-30 (2003).
10 Id. at 668.
12 Milhaupt and Zheng note that they “do not argue that corporate ownership is completely irrelevant in China or that Chinese POEs are identical in all respects to SOEs”. See Milhaupt & Zheng, supra note 9, at 669.
structure, and hence has to follow the rules concerning decision-making in the PRC Company Law, as a matter of both principle and formality. Ownership in a Chinese company, be it state-owned or privately-owned, necessarily places power with shareholders to vote on all corporate matters that fall within the province of the shareholders’ meeting, including the right through the voting process to select the directors and supervisors. This is true even in any corporatized SOE with a Party cell. The argument is simply that, to the extent the Chinese Party-state wants to control SOEs, it understands that any move to increase private ownership in SOEs will lead to the possibility that the private investor will demand more participation in corporate decision-making, which must be treated at least as a legal matter. In a nutshell, though ownership may be subject to important constraints in China, and there is indeed a need to look beyond ownership to consider Chinese state capitalism as a whole, it is still important to pay due consideration to ownership change in an SOE and analyze how such a change may impact corporate governance in SOEs.

It is in such a context that we aim to provide an early assessment of the impact on corporate governance of the most recent wave of SOE reform announced by the CCP in 2013,13 officially known as the mixed-ownership reform (MOR). The stated purpose of the MOR is to bring private sector investment and management into SOEs to improve the efficiency and governance of the state sector.14 Since 2016, China has launched four rounds of MOR reforms. The first three pilot reforms included 50 SOEs, covering seven key sectors including electricity, oil, natural gas, rail transportation, civil aviation, and telecommunications.15 The Chinese government nominated 160 SOEs for the fourth round of the MOR programme in May 2019, possibly in acknowledgment of the perceived success of the previous MOR reforms.16 An official source suggests that by 2018, a total of 2,880 SOEs conducted MOR, which included seventy per cent of the central SOEs.17 Xiao Yaqing, Chairman of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), expressed the hope that MOR would lead to breakthroughs in China’s SOE reform but still warned that the MOR programme was not about privatization of China’s massive public sector.18

---

13 See infra note 33 and accompanying text.
14 See infra note 54 and accompanying text.
18 See 肖亚庆(Xiao Yaqing), 混合所有制改革不是私有化, 不可能“一混了之”、“一混就灵” [Mixed ownership reform is not about privatization, and it is unlikely that it can resolve and close all the problems] XINHUA NET (Mar. 9, 2019), http://www.xinhuanet.com/politics/2019lh/2019-03/09/c_1210077198.htm (last visited Aug. 1, 2019) (press conference of SASAC at annual meeting of the National People’s Congress). See also Qu Hui and Han Wei, More State Enterprises Set for Mixed Ownership Reforms, CAIXIN GLOBAL (Mar. 29, 2019),
This paper proceeds as follows. Part I offers a detailed and comprehensive account of the background, proposed measures and policy features of the MOR programme in light of the history of China’s SOE reform. It also discusses two recent institutional changes in China’s SOE policy which have accompanied the programme, namely the classification of SOEs into commercial entities and public services entities, and the shift from asset management to capital management by inserting a layer between the government and the firms.

Part II looks at MOR in practice. It begins with a survey of the trending change in shareholder ownership, board composition, important board positions, and board powers,\(^{19}\) which is followed by several MOR case studies. Part III then discusses the change brought to corporate governance of SOEs by the policy and regulatory initiatives on SOE reform as well as the emerging practices in implementing the MOR programme. We observe several trends in the corporate governance framework of MOR firms. First, there is an obvious retreat of the Chinese state from SOE governance with the implementation of the shift from “asset management” to “capital management”. On the other hand, the retreat of the state is accompanied by the strengthened involvement of the CCP in SOEs, as the firms have been asked to institutionalize the role of the Party in their articles of association. We observe that there is a limited degree of separation of power between the Party committee and the board of directors. Based on this, we are of the view that MOR has set out a new model of corporate governance in some of China’s SOEs, which we style as a partnership-based, consultative governance model. That is, on the condition that SOE ownership is diversified to include substantial non-state ownership (with the state remaining a significant but not necessarily majority shareholder), decision-making power is shared between the Party organization and the board of directors (in which non-state shareholders appoint the majority of the directors).

Part IV attempts to understand the rationale of MOR from both theoretical and practical perspectives and, on this basis, explain the internal factors that motivate the Chinese Party-state to pursue MOR. We argue that the MOR programme is driven by three current beliefs on the future of SOEs in China. First, ownership and ownership reform matter. Empirical evidence about China’s economic reform consistently suggests partially privatized SOEs, or SOEs with mixed ownership, exhibit higher productivity, better performance and improved corporate governance than firms with complete or dominant state ownership. This is consistent with the strong economic literature worldwide that privatisation leads to efficiency gains.\(^{20}\) To the extent there are both ideological and rational constraints for China not to pursue full privatization of its state-backed economic entities at least at this stage, “[p]erhaps the ‘mixed economy’ is a decent model of industrial organization after all [in China]”.\(^{21}\) The

\(^{19}\) For example, whether the board of directors would be allowed to appoint senior executives.


second belief is that sharing control, rather than dominance by a single state shareholder, improves both the efficiency and governance of SOEs. Third, the MOR was designed to develop partnerships or alliances between the state shareholders and strategic investors in order to help the post-MOR state enterprises improve their efficiency and enhance market opportunities.

Part V concludes with several general remarks. In the main, it restates the central argument of this paper that MOR offers a practical approach at this stage of China’s development of defining the role and operation of SOEs in a single-party state within a socialist market economy.

I. THE TOP-LEVEL DESIGN FOR MIXED-OWNERSHIP REFORM: POLICY, MEASURES AND FEATURES

A. Historical Development and Recent Institutional Reform in China’s State Sector

The reform of China’s state economy has lasted for four decades since the late 1970s. The SOE system, established and developed during the planned economy period (1950s to 1970s), featured state enterprises being administratively controlled and directly managed by the government at various levels. In that system, a state enterprise, whatever it was called, was a work unit or danwei, which was part of the government with multiple roles and functions. From the beginning, SOE reform has been oriented to address the soft budget constraint problems, increase enterprise autonomy, and improve corporate governance, with the view to transforming SOEs into commercially viable entities. In this process, four modalities were used, at different stages of the reform, to achieve the aforesaid objectives: contracting, corporatization, ownership diversification, and creation of large enterprise groups.

The first stage of the SOE reform (1978-1992) introduced the contractual managerial responsibility system for the purpose of enhancing enterprise autonomy and granting market-based incentives to the state-appointed managers of the SOEs. Under the contractual system, an SOE was allowed to ride on a unique system of dual-track pricing and, on this basis, sign

24 See generally, NAUGHTON, supra note 22, WU, supra note 22, and TENEV & ZHANG, supra note 23, at 9-20.
25 China adopted a dual-track approach to price liberalization in its transition from a planned to a market economy in the 1980s and 1990s. The government maintained price controls and quotas to some extent under the planned track, through which “economic agents were assigned rights to and obligations for fixed quantities of goods at fixed planned prices and quotas”. A market track was established simultaneously to allow economic agents to
an agreement with the government agency in charge, through which the SOE ensured the government a fixed amount of profit, while retaining any surplus profit. Ownership reform emerged in the second stage (1992-2003), known as gaizhi (ownership transformation). Ownership diversification was the major theme in this period, leading to corporatization and a limited degree of privatization. The promulgation of the PRC Company Law aimed to create an institutional framework for the modern enterprise system and paved the way for reorganizing the SOEs into Western style corporations. After the CCP adopted the policy of “grasping the large, letting go the small” (zhuada fangxiao) in 1995, the Chinese government retained about 500 to 1,000 large enterprises, and restructured other SOEs through sale or lease. The third stage (2003-2013) carried on the corporatization programme and further institutionalized state-SOE relations with the creation of SASAC in 2003. SASAC’s emergence indicated for the first time that the Chinese state would behave as a shareholder in SOEs. The continuing reform of SOEs under SASAC also resulted in the creation of large enterprise groups brought about through consolidation and restructuring of SOEs leading to a significant reduction of the total number and a substantial increase in the average size of SOEs. Meanwhile, the Chinese government placed emphasis on dominance of state-ownership in strategic industries including, initially, high technology, nonrenewable natural resources, public utilities and infrastructure services, and national security.

From 2013, SOE reform entered its fourth stage, marked by a call for further action by a decision of the Third Plenum of the CCP in 2013. One of the breakthroughs of the decision was its emphasis on the critical role of the private sector in the Chinese economy in that “both public and non-public sectors are key components of the socialist market economy”. As Zheng has put it, this may represent “a major shift in official ideology away from the superior status of the state sector” and that “the Chinese government no longer insists on majority ownership, except for strategic industries”. In other words, as long as state assets transact at “free market prices”. Gradually, the price controls under the planned track was phased out. See Yingyi Qian, The Institutional Foundation of China’s Market Transition, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 1999 384 (Boris Pleskovic and Joseph E. Stiglitz eds., 2000).


29 This policy was formally approved as a state policy by the National People’s Congress in 1997.

30 SONG ET AL., supra note 27, at 352.

31 SONG ET AL., supra note 27 at 357-358.

32 SONG ET AL., supra note 27, at 356.


36 Ibid.
in the SOEs continue to grow, “it is no longer imperative to maintain majority state ownership”.  

The new wave of reform was put into operational policy design with the promulgation of a set of Guidelines adopted by the CCP in August 2015, which was followed by more detailed implementing measures issued by China’s State Council, together with a series of supplementary policies and measures promulgated by the National Development and Reform Commission (NDRC), SASAC and other relevant government agencies. The Guidelines have formed the new institutional background for the MOR programme. The following three new policy initiatives in the Guidelines are particularly worth noting.

First, Chinese SOEs, according to their nature, are to be classified into commercial SOEs (shangyelei) and public service SOEs (gongyilei). Table 1 displays the different types of SOEs, their assigned objectives, and the respective measures proposed to reform them.

Commercial SOEs would operate fully on a commercial basis with the for-profit purpose of enhancing efficiency and maximizing the valuation of state assets. Such firms are all required to be restructured into modern stock corporations with a view to being listed on a stock market in future. The state can be the dominant controller, a majority shareholder, or even a minority shareholder in these firms. On the other hand, the public service SOEs are expected to provide public goods and services in a price-regulated environment in order to enhance the Chinese people’s standard of living. Such firms can be solely owned by the state, and will be evaluated by cost control, product quality, operational efficiency, and capacity in delivering the requisite product or service.

(Insert Table 1 here)

Second, the role of the state owner in enterprises, exercised by SASAC at the central and local levels, will shift from “asset management” to “capital management”. Specifically, state capital investment/management companies will be established to serve as the state

---

37 Ibid.
38 中共中央、国务院关于深化国有企业改革的指导意见 [Guidelines of the CCP Central Committee and the PRC State Council to Deepen Reform of the State-owned Enterprises] (promulgated on 24 August 2015).
40 Supra note 38, at Part II.
41 Supra note 38, at Part II (4) and (5).
42 Supra note 38, at Part II (6).
43 Supra note 38, at Part II (6)
44 Supra note 38, Part IV. See also 改革国有资本授权经营体制方案 [Programme on Reforming the State Capital Authorization System], http://www.gov.cn/zhengce/content/2019-04/28/content_5387112.htm (issued by the State Council on 19 April 2019, Guo Fa [2019] 9 Hao).
shareholder in SOEs. SASAC, in turn, will become the state shareholder in such capital investment/management companies. The rationale for creating such state capital companies is to establish a firewall between SASAC and the SOEs so as to stop the “tendency for SASAC to become increasingly involved in the business operation of SOEs”. Arguably, this policy move brings China’s SOE supervision model closer to Singapore’s Temasek model. The Temasek model is intended to create a level of separation between the Singapore government and government linked companies so as to facilitate commercial decision making that is insulated from the dictates of government policy.

Third, the formation of the “modern enterprise system” is included as a key part of the reform, with the stated aim of establishing a modern corporation, preferably listed, with diversified shareholding and sound corporate governance. The policy statement on SOE corporate governance embodies a wide range of objectives, which is discussed in Section C of this Part. Suffice it to say that the corporate governance system proposed for SOEs in the Guidelines looks positive from the perspective of the convergence side of the global corporate governance debate, as it seems to allow board centrality and independence in corporate decision-making although, as discussed in a later section of this Part, these objectives have to be read in tandem with the prescribed role of the CCP in SOEs.

**B. The General Policy Design for Mixed-ownership Reform**

1. A Balanced Relationship between the State and the Market.

The MOR is supposed to be a state-driven process which however aims to take place in the marketplace, known as zhengfu yindao, shichang yunzuo. This follows the spirit of the Third Plenum Decision that, for the first time, advocated for “the market to play a decisive role in the allocation of resources” and the state would refrain from exercising excessive intervention.” The state promises to “respect” the principles of the market economy and allow the enterprises to be the central players in the MOR process. In addition, a vow is made

---

45 Numerous state capital entities have been established in recent years. China National Cereal, Oils and Foodstuffs Corporation (COFCO) and Chinese Investment Corporation (CIC) were the first pilot companies designated as state investment/management entities. The State Development & Investment Corp Ltd is the largest state-owned investment holding company for restructuring the state sector, but many capital investment and management companies have been established on a sectoral basis.


47 See Yu Hong, China’s Push for State-owned Enterprise Reform, EAI Background Brief No. 1083 i (2015) (noting the “proposal to establish state capital investment corporations is viewed as a Singapore-inspired quest, modelled on Temasek Holdings”).


49 Supra note 38, at Part III (7) and (8).

50 Supra note 39, at Part II.

51 Supra note 33, at Points 2 and 3. See also Sarah Y. Tong, China’s New Push to Reform the State Sector: Progress and Drawbacks, 16:3 China: Int. J. 35, 43 (2018).
to protect the property rights of all forms of ownership, enforce contracts, and encourage fair competition. On the other hand, the CCP has also stressed that the state sector should retain “dominance” (zhuti diwei) and play the leading role (zhudao zuoyong) by enhancing the “state sector vitality, controlling capacity and influence” in the Chinese economy. In this spirit, the general policy design of the MOR programme suggests that the state sector can involve private investment. The Third Plenum Decision confidently stated this objective as follows”

“A mixed economy with cross holding by and mutual fusion between state-owned capital, collective capital and non-public capital is an important way to materialize the basic economic system of China. It is conducive to improving the amplification function of state-owned capital, ensuring the appreciation of its value and raising its competitiveness, and it is conducive to enabling capital with all kinds of ownership to draw on one another's strong points to offset weaknesses, stimulate one another and develop together.”

On this basis, the CCP declared that it “will allow more SOEs and enterprises of other types of ownership to develop into mixed enterprises” and “non-state-owned capital to hold shares in projects invested by state-owned capital”, as well as “mixed enterprises to implement employee stock ownership plans (ESOP) to form communities of capital owners and laborers”.

2. Modes of Participation in MOR Firms

MOR has been planned to be conducted at two levels: the corporate group (parent/holding company) level, and the subsidiary level. The subsidiary SOEs are firms that engage in business, many of which are listed companies themselves. At the current stage, MOR is prioritized at the subsidiary level with the view of redefining the role of the state-shareholder, in this case the parent/holding company, to ensure it functions as a shareholder in accordance with the PRC Company Law. MOR at the parent/holding company level is permitted but will only be carried out on a larger scale at a later stage. The non-state capital allowed to acquire shares in SOEs includes private investors, collectively-owned enterprises, and foreign investors through a variety of means. Table 2 exemplifies the general, top-level designed requirements for the degree of state ownership in different MOR firms.
Specifically, MOR is achieved through any or a combination of the following modes of private participation:

1) The introduction of strategic investors who have extensive experience in reorganizing firms through investments in them and in addition to capital may provide management experience, industrial connections, market access, and experience with the stock market.\(^{61}\)

2) Investments made by Venture Capital Funds or Industrial Funds many of which have been established by the Chinese government at central and local levels.\(^{62}\) Known as state-controlled “guidance funds”, they are designed to use government-allocated “seed money” to attract and direct private capital to invest in strategic sectors and areas.\(^{63}\) In MOR projects with fund participation, an investment syndicate is organized in the form of a limited partnership, in which the guidance fund, as a limited partner,\(^{64}\) contributes 10 to 20 per cent of the total investment, and funds based on private or foreign capital make up the rest. The syndicate then invests, often through a special purpose vehicle (SPV), in SOEs which undergo MOR.\(^{65}\) In this way, the limited investment of state capital will have significant leveraging effect to lure a large amount of private investment into MOR firms.

3) Employee shareholding schemes (ESC) are also utilized whereby employees who have made substantial contributions to the SOE’s performance are allowed to acquire shares in the firm,\(^{66}\) for the purpose of creating “a community of common interest for the owners of capital and labor”.\(^{67}\) Chinese authorities only permit ESC in commercial SOEs in fully competitive areas.\(^{68}\)

---


\(^{62}\) Emily Feng, China’s State-owned Venture Capital Funds Battle to Make an Impact, FT (Dec. 24 2018) (noting “China has claimed that it has amassed Rmb12.5tn ($1.8tn) of state money across thousands of venture capital funds to achieve its goal of technological dominance by 2025”).

\(^{63}\) “Guidance funds” are defined as “policy funds which are established by the government but operate on market-based principles”, with the main purpose of “directing social capital to innovative investment”. See 关于创业投资基金规范设立与运作的指导意见 [Guiding Opinions on the Establishment and Operation of Guiding Funds for Innovative Investment], jointly adopted by the National Development and Reform Commission, Ministry of Finance and Ministry of Commerce, and promulgated by the State Council on Oct. 18, 2008, Point 1. See also SONG, supra note 26, at 48 (noting the guidance funds established in 2016).

\(^{64}\) China’s partnership law does not allow SOEs to be general partners. See Hehuo Qiye Fa (合伙企业法) [Partnership Enterprise Law] (China), Article 3.

\(^{65}\) See supra note 61, at 10.

\(^{66}\) Supra note 39, at Point 15.

\(^{67}\) Supra note 33, at Point 6.

\(^{68}\) 关于国有控股混合所有制企业开展员工持股试点的意见[Opinions on Practising Employee Shareholding Scheme in State-Controlled Mixed Ownership Reform Enterprises on Pilot Basis], jointly adopted by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), the Ministry of
Initial public offerings (IPOs) are an important mechanism that SOEs are encouraged to use. A key advantage of going public is that it provides a legal and governance framework and process to reorganize the SOE’s property rights and corporate governance into standardized, transparent structures. IPOs also offer an exit opportunity for strategic shareholders, as well as long-term incentives for employee-shareholders.

II. IMPLEMENTATION OF THE MIXED-OWNERSHIP REFORM: SEVERAL CASE STUDIES

In this part we examine how MOR is conducted in reality through four case studies: China Unicom, China Eastern Logistics, Sinopec Marketing, and Yunnan Baiyao. We look at the process of MOR in these cases, with a focus on the change in ownership, representation of state and private capital, and occupancy of important board positions.

A. Change of Ownership and Board Composition in MOR Companies: A General Survey

As previously noted, China has launched four rounds of mixed ownership reform, involving in total 210 SOEs, most of which are subsidiaries of centrally administered SOEs. Official statistics revealed that, in 2018, two-thirds of such subsidiaries were already firms which had finished MOR. In 2018, minority ownership equity in central SOEs was RMB7.2 trillion, amounting to 36% of the total market capitalization of these SOEs. According to SASAC, an overwhelming majority of the minority shareholders’ equity interests was generated through MOR.

In a typical MOR case at the subsidiary level, an SOE, often the holding company of a group, selects a subsidiary which owns an important unit of the group’s business, and sells a stake in that subsidiary to private/social investors, who may be allowed to possess about 30% to 45% of the subsidiary. Such MOR can be realized in the following manner: restructuring; IPO;...
Employee Stock Ownership Plan (ESOP); introduction of investment funds; introduction of strategic investors, or a combination of some of these. In selecting such private-sector investors, the SOE looks more at factors such as management experience, technology, or development of new products or markets, rather than financial investment. In any event, MOR will lead to substantial reduction of state ownership in the SOE concerned. Table 3 shows the change in ownership and board composition in 31 SOEs, which covers most of the completed MOR programmes in SOEs selected by the Chinese government for such reform.

(Insert Table 3 here)

B. MOR Case Studies

1. China Unicom MOR

China Unicom, China’s third-largest and the world’s fourth largest telecom operator (by number of subscribers), was among the first group of SOEs chosen by the Chinese government to undergo MOR. China Unicom implemented a controversial MOR through its Shanghai-listed subsidiary, China United Network Communications (CUNC). In August 2017 CUNC announced a sale of shares, representing 37% of the firm’s shares, to 14 strategic investors for RMB 78 billion (USD 11.7 billion). These investors, including several of China’s star firms such as Alibaba Group, Tencent Holdings, Baidu Inc., JD.com Inc., China Life Insurance, and a few private equity firms, can be classified into four categories: (1) Internet companies in China; (2) leading companies in industry verticals; (3) financial institutions; and (4) specialist funds.

As can be seen from Chart 1, before the implementation of MOR, the Unicom Group held 62.7% of the shares in CUNC, while the other 37.3% of the shares were held by public shareholders. After the reform, the Unicom Group’s shareholding decreased to 36.7% and the strategic investors held 35.2% of the shares. The remaining shares are held by employees as employee incentive shares (2.7%) and public shareholders (25.4%). China Unicom Group, while still the largest shareholder of CUNC became a minority shareholder after the MOR.

Chart 1: CUNC’s Pre- and Post-MOR Equity Structure

<table>
<thead>
<tr>
<th>Pre-MOR Shareholding Structure</th>
<th>Unicom A Share Company’s Post-MOR Shareholding Structure</th>
</tr>
</thead>
</table>

Supra note 38, at Points 9-15.

Table 4.
Strategic investors subscribed for about 9 bil new shares of Unicom A Share Company and purchased 1.90 bil shares of Unicom A Share Company from Unicom Group, representing in aggregate 35.2% of Unicom A Share Company’s enlarged share capital, at a price RMB 6.83 per share.

- Key employees were granted about 850 mil restrictive shares of Unicom A Share Company at a price of RMB 3.79 per share.
- Total consideration was about RMB 78 bil.

Source: China Unicom

The MOR led to the expansion of CUNC’s board of directors from 7 to 13 members, in which 5 are independent directors. Among the 8 non-independent directors, only 3 were appointed by Unicom Group. That is, the strategic investors, including China Life Insurance and the four tech giants, now appointed 5 directors to the board. According to CUNC’s filing, the new board composition was aimed at “establishing a corporate governance system based on healthy coordination and effective checks and balances”.

(Insert Tables 4 and 5 here)

2. Eastern Air Logistics

Eastern Air Logistics Ltd. (EAL) is the logistics arm of China Eastern Air Holding Company (China Eastern), one of China’s biggest airlines. It started MOR in June 2017, becoming the first SOE in the aviation sector to pursue such reform. Through the MOR, China Eastern sold almost half its equity stake in EAL to four strategic investors, namely Legend Holdings (20%...).
per cent), Global Logistic Properties (GLP) (10 per cent), Deppon Logistics (5 per cent) and Greendland Financial (5 per cent). China Eastern kept a 45 per cent stake in EAL. EAL’s key employees were granted 10 per cent of the firm’s ownership.  

EAL’s board of directors after the MOR comprised nine members, five of which were appointed by China Eastern, two by Legend Holdings, one by the Singaporean investor GLP, and the last one by the employee shareholders. This ensured the state controlling shareholder, China Eastern, a simple majority while leaving the non-state shareholders a veto power on the board on issues concerning corporate investment and budgets, according to EAL’s articles of association. In December 2018, EAL was entirely converted into a joint stock company, Eastern Air Logistics Co. Ltd., and added four independent directors to its board.

3. Sinopec MOR

China Petroleum & Chemical Corporation, popularly known as Sinopec, is a Chinese central SOE headquartered in Beijing and one of the world’s largest oil refining, gas and petrochemical conglomerates. Sinopec was included in the first batch of SOEs selected for MOR by Chinese authorities and hence was one of the earliest MOR cases. In September 2014, Sinopec entered into a capital contribution agreement with 25 domestic and foreign investors to sell 29.5849% of its shares in Sinopec Marketing Co., a subsidiary then wholly owned by Sinopec. After the MOR, Sinopec still held about 70% of the subsidiary’s total shares.

It must be noted that this MOR did not bring significant change in ownership in favor of private investment, because 6 of the strategic investors are state-owned companies (including China Life Insurance and China Tobacco) and 11 of the strategic investors are state-controlled asset management companies or private equity houses. Real private and foreign investors only acquired 9.826% of the total shares in the MOR. Moreover, critics have also pointed out that the 25 investors are sharing approximately 30% of the shares, and this means that each shareholder will hold no more than 2.8% of the shares. However, changes in board composition do show an early sign of the trend that a larger representation could be given to investors introduced through MOR, which in many later MOR cases appeared to be non-state investors. In the case of Sinopec Marketing, before the MOR all the seven directors were appointed by the parent company, Sinopec Corporation. After the MOR, Sinopec

---

78 Brenda Goh, *China Eastern Sells Stakes in Cargo Unit to Four Firms*, REUTERS (June 19, 2017), https://www.reuters.com/article/us-china-eastern-cargo-idUSKBN19A0WS. Of the four strategic investors, Legend Holding, parent of the personal computer giant Lenovo Group Ltd., is a private company, GLP is a Singaporean company, while Deppon Logistics and Greeland Financial are two private companies.


15
Corporation appointed four of the 11 directors on the board. However, all the other four non-independent directors were appointed by state-linked shareholders.

4. Yunnan Baiyao MOR

Yunnan Baiyao (YNBY) is a time-honoured pharmaceutical brand for traditional Chinese medicine based in Yunnan Province of Southwestern China. It existed, in legal form, as Yunnan Baiyao Group Co Ltd (“YNBY Group”) and its parent company Yunnan Baiyao Holdings (“YNBY Holdings”) under the umbrella of the Yunnan SASAC. Since 2016, YNBY Group and YNBY Holdings have undergone a two-stage MOR process.

In the first stage, two major strategic investors were introduced as new shareholders of YNBY Holdings. In December 2016, YNBY Holdings issued new shares to Fujian-based private company New Huadu Industrial Group (“New Huadu”), granting it 50 per cent of YNBY Holdings’ total ownership. In April 2017, the board of directors of YNBY Holdings was reconstituted and New Huadu and Yunnan SASAC each nominated two board members. The chairmanship of the board went to Wang Jianhua, who was the former chairman of Zijin Mining, a private company in which New Huadu had substantial ownership. The former chairman of YNBY Holdings, Wang Minghui, was subsequently appointed as the chairman of YNBY Group and the CEO of YNBY Holdings. To avoid a deadlock in decision-making, a second sale, totalling 10 per cent of YNBY Holdings’ ownership, was made in June 2017 to Jiangsu Yuyue Technology Development Co. (“Jiangsu Yuyue”), a private manufacturer of medical equipment. Consequently, the Yunnan Provincial Government and New Huadu each holds 45 per cent of YNBY Holdings’ total shares. Of the two strategic investors, New Huadu was expected to help establish market-based business models for Yunnan Baiyao, while Jiangsu Yuyue would help to improve the firm’s corporate governance. With a new board member nominated by Jiangsu Yuyue, the board of YNBY Holdings was expanded to five members. The first stage of YNBY Holdings’ MOR was thus completed, which resulted in several changes in its corporate governance, including, notably, the appointment of Chen Fashu, the founder and board chairman of New Huadu, as the board chairman of YNBY Holdings in July 2018. Moreover, senior executives of YNBY Holdings would no longer be treated as government officials but would become “professional managers” (zhiye jingliren) as if they were hired from the labour market.

The second stage of the MOR process involved the merger of YNBY Holdings into its listed subsidiary YNBY Group. The plan was announced in November 2018 and the merger was successfully completed through a share swap in July 2019. The Yunnan SASAC, New Huadu, and Jiangsu Yuyue now own 25.14 per cent, 24.37 per cent and 5.59 per cent of the shares of YNBY Group, respectively. The identity and information of board candidates of the new YNBY Group have been released in August 2019, pending an election in the near future.

82 Tables 7 and 8.
The new combined enterprise would be expected to have greater synergy in its business operations by consolidating YNBY Holdings’ financial resources and YNBY Group’s expertise in product manufacturing, marketing, research and development and human resources.\textsuperscript{84}

III. IMPACT OF THE MIXED OWNERSHIP REFORM ON CORPORATE GOVERNANCE IN SOES

This Part analyses the change brought to corporate governance of SOEs by the MOR programme. The change is being driven by both policy/regulatory initiatives and emerging practices in implementing MOR. On MOR firms’ corporate governance, the SOE Reform Guidelines set out a wide range of objectives that in summary aims to provide effective checks and balances, board independence, efficiency in decision-making, directorial accountability, and also Party control.\textsuperscript{85} The new governance framework has the following features:

a. The CCP is being institutionalized in the formal corporate governance mechanisms of SOEs.
b. The state/government has been asked to retreat from SOE governance and not to interfere with the day-to-day management at the firm level. A wide span of regulatory measures have been released to grant more autonomy to SOEs.
c. The SOE board is expected to exercise independent power in deciding issues concerning personnel appointments, performance evaluation and staff salary.

The puzzle for us is how to make sense of these apparently self-contradictory corporate governance objectives. We argue that, based on the recent general policy design for SOE reform, regulatory measures, and governance practices at firm level, MOR is likely to generate a partnership-based consultative governance model, in which Party leadership co-exists with a board without complete independence. Such a model will strengthen the Party committee’s involvement in corporate governance, but does not necessarily undermine the autonomy of the SOE in making independent decisions if the following conditions are met: (1) the Chinese government stays away from the management of the firm; (2) the role of the Party committee, institutionalized or not, does not emasculate the SOE in making decisions as a commercial entity as a whole; and (3) the board of directors is given a high degree of independence in making managerial decisions.

Our survey below indicates that, from policy and regulatory perspectives, the role of the Chinese government in SOEs is clearly undergoing dramatic transformation and the state has been asked to refrain from directly interfering in SOE management. The involvement of the

\textsuperscript{84} David Blair & Li Yingqing, Traditional Pharma Firm Futhers Reform Efforts, CHINA DAILY (Jan. 22, 2019), http://www.chinadaily.com.cn/a/201902/22/WS5c6f5c6aa3106c65c34eac72.html.

\textsuperscript{85} Supra note 38, at Point 8.
Party committee does not necessarily denote politicization of corporate governance in SOEs but instead there generally appears to be cooperation and a separation of power and responsibility in the relationship between the Party committee and the board.

A. The State Retreats: Capital Management to Enable Enterprise Autonomy

The essence of shifting from “asset management” to “capital management” requires the state to act generally as an owner of state capital and care mainly about the general direction of state investment and value appreciation of the state’s wealth in SOEs. This move involves redefining the role of the state as well as reasserting the autonomy of the SOEs to run their own businesses. Thus, from the state’s perspective, it means “separation of the state and enterprises” (zhengqi fenkai) and “separation of the state and capital”, as stated in the State Council’s reform plan on state capital. 86

Reform measures adopted since 2015 fairly suggest that the separation of the state (government) from the SOEs has been formalized from policy and regulatory perspectives. These measures form two major reform programmes: creating state capital investment and operation companies to add a layer between SASAC and SOEs and redefining the role and functions of SASAC, and adopting a negative-listing approach in passing autonomy to SOEs while removing power from SASAC. 87

1. Creation of State Capital Investment and Operation Companies and Redefining the Role of SASAC

Since SASAC was established in 2003 as the modern “ownership agency” of China’s state capitalism, it has been both the regulator of and the state investor in SOEs. 88 Flaws have been seen in both roles. As a regulator, its objective was very ambiguous. One may wonder whether there is any need for a regulator of SOEs, since no such specialized watchdog exists for privately owned enterprises. Probably for such reasons, SASAC is not treated officially as a ministry in China’s bureaucratic structure. Rather, it is called a “specialized agency directly under the State Council” (Guowuyuan Zhishu Tebie Jigou), 89 indicating it is not unequivocally regarded as a state regulator, although it has certainly exercised regulatory

---

87 国务院国资委以管资本为主推进职能转变方案[Programme of the State Council on Functional Transformation of the Role of the SASAC to Capital Management], issued by the General Office of the State Council on 27 April 2017, Part II:3, http://www.gov.cn/zhengce/content/2017-05/10/content_5192390.htm (providing that the SASAC would not directly regulate the behavior of the state shareholder in listed companies).
88 WANG, supra note 2, at 652-653. See also Barry Naughton, The Transformation of the State Sector: SASAC, the Market Economy, and the New National Champions, in STATE CAPITALISM, INSTITUTIONAL ADAPTATION, AND THE CHINESE MIRACLE 46, 48 (Barry Naughton and Kellee S. Tsai eds., 2015).
powers in terms of making policies and conducting institutional consolidation for SOE reform since its creation. But, as an owner, it was not put in the position to properly exercise the two main functions of ownership: receiving dividends and voting as a shareholder. That is, SOEs do not pay dividends to SASAC, and SASAC did not hold the appointment power for senior positions in SOEs because the appointment power was exercised by the CCP in practice.91

The 2015 SOE Reform Guidelines proposed to redefine SASAC-SOE relations by adding an additional layer between SASAC and the SOEs with the creation of state capital investment and operation companies (SCIOs).92 The SCIOs are either state capital investment companies (SCIs) or state capital operation companies (SCOs).93 Established under the auspices of SASAC or directly under the government, the SCIOs are authorized to act in the capacity of the state shareholder in state-invested firms.94 The SCIOs are required to behave as a shareholder in accordance with the PRC Company Law and related regulations, and participate in the governance of the SOEs through nominating directors and supervisors and voting in shareholders’ meetings.95 In addition, they are expected to be financial investors mainly concerned with financial returns rather than management.96

The role of SASAC is thus modified to be the special agency authorized by the State Council to function as the ultimate state investor to manage state capital and oversee state investments.97 It is the state shareholder in many of the SCIOs. However, it is now neither a regulator which performs public administrative functions, nor a shareholder in the SOEs. It is explicitly disallowed by the State Council to interfere with the independence and autonomy of SOEs.98

90 NAUGHTON, supra note 88, at 59.
91 NAUGHTON, supra note 88, at 59-61.
92 Supra note 38, at Point 13.
93 The state capital operation companies (SCOs) are entrusted to manage state capital, i.e. state shareholding in companies, with the view to maximizing the value of state assets. They are expected to serve as financial investors in SOEs or non-SOEs which operate on commercial basis. State capital investment companies (SCIs) are basically industrial investment funds which invest on behalf of the state in sectors “relating to national security or the commanding heights of the national economy” presumably for the purpose of promoting industrial policies. See 国务院关于推进国有资本投资、运营公司改革试点的实施意见 [Opinions of the State Council on Implementation of Pilots of State Capital Investment and Operation Companies], adopted by the State Council on July 14, 2018, Guo Fa [2018] 23 Hao, Part II:1, http://www.gov.cn/zhengce/content/2018-07/30/content_5310497.htm.
95 Supra note 93, at Part II:5.
96 Supra note 94, at Point 9. One of the two centrally created state capital operation companies is China Reform Holdings Corp. Ltd., known as “Guoxin”. Surveying the investment practice of Guoxin, Barry Naughton observed that Guoxin exercised “a financial ownership stake in many firms without having the additional regulatory and command-and-control functions that SASAC had”. See Barry Naughton, State Enterprise Reform Today, in CHINA’S 40 YEARS OF REFORM AND DEVELOPMENT 1978-2018 375, 387 (Ross Garnaut, Ligang Song and Cai Fang eds., 2018).
97 Supra note 87, at Part I.2.
98 Ibid.
2. **A Negative-List Approach to Grant Autonomy to SOEs**

One of the mysteries about state-business relations in China is what oversight powers SASAC has over SOEs. As noted, SASAC was launched as an ownership agency with “the core mission to carry out the government’s functions as investor and owner of state assets, and thus separate these tasks from the government’s role as public manager of society as a whole”.\(^{99}\) Before the recent round of SOE reform, SASAC’s original duties included: (i) functioning as the state investor in SOEs; (ii) representing the state on the supervisory board of large SOEs; (iii) appointing, dismissing and assessing senior executives;\(^{100}\) (iv) monitoring the change of value in state assets in SOEs; (v) drafting regulations and rules on the administration of SOEs; and (vi) directing and advising SOEs under local ownership.\(^{101}\) This ambiguous portfolio demonstrates that SASAC was powerful, even though SASAC rarely exercised such powers. Quite ironically, the 2017 SASAC Reform Programme, which was supposed to grant enterprise autonomy back to state firms, tellingly revealed how all-embracing and intrusive SASAC’s powers were in theory.\(^{102}\) For instance, the Programme displayed 43 items which represented the powers to be given to SOEs, of which 26 items concerned the powers which SASAC had given up.

Furthermore, through the Reform Programme SASAC decided to authorize the boards of central SOEs to exercise powers including formulating the firm’s five-year plan for strategic development and the annual investment plan, appointing the members of the firm’s managerial team, evaluating their performance, determining their salaries, and approving the gross payroll of the firm, among others,\(^{103}\) indicating that these powers were originally held by SASAC in theory.

In April 2019, the State Council decided to adopt a negative-list approach (qingdan guanli) to transfer to SOEs authority to exercise powers which belonged to them according to the PRC Company Law and would no longer be within SASAC’s province.\(^{104}\) The essence of the approach is that SASAC would produce a list of powers and responsibilities (quanli zeren qingdan) which would inter alia specify which powers will be returned to the central SOEs. More importantly, the SOEs will hold the residual powers, i.e. any power which is not included in the list will be regarded as, by default, belonging to the companies rather than SASAC.\(^{105}\) The guiding principle for the list is that the SOEs will eventually regain, through the list, the autonomy legally conferred upon them by the PRC Company Law and other laws.\(^{106}\) Under the list, the state shareholders’ reach does not go beyond the board of

\(^{99}\) *Supra* note 8, at 316.

\(^{100}\) Note this was more of a power in paper as the appointment power for senior positions in an SOE is always exercised by the CCP.

\(^{101}\) OECD, GOVERNANCE IN CHINA 311 (2005).

\(^{102}\) *Supra* note 87.

\(^{103}\) *Id*. at Part III of the Appendix.

\(^{104}\) See *supra* note 86, at, Part II.2.

\(^{105}\) *Ibid*.

\(^{106}\) *Ibid*. 

20
directors, and is explicitly not allowed to touch on the management of the companies. The first negative list, the SASAC Power Authorization List (2019), gave 21 powers back to central SOEs. Significantly, the SOEs have been allowed to decide on issues concerning MOR of subsidiaries, asset restructuring of subsidiaries, shareholding change in non-listed subsidiaries, bond issuances, hiring of managerial personnel on market-based principles, approving the dividend distribution plans of subsidiaries involved in high-tech industries, extension of business to other areas, etc.

**B. The CCP Advances: The Role of the Party Organization in SOE Governance**

The retreat of the Chinese government from SOEs, as discussed above, must be understood in tandem with the fact that the role of the Party in SOEs has been strengthened and institutionalized in the new round of SOE reform. Though the Party committee (Dangweihui) is always a significant part of an SOE’s corporate governance according to official CCP policy as well as the PRC Company Law, in reality while the CCP had “maintained representative committees inside SOEs for decades they were often moribund bodies” SOE reform since Chinese President Xi Jinping took power in 2012 has however witnessed the revived role for Party leadership in the formal corporate governance mechanism of SOEs. The SOE Reform Guidelines officially required “legalization of the status” (jadinghua) of the CCP committee by mandating that “Party-building work” be included in the SOEs’ articles of association and the legal status of the CCP is explicitly provided in the enterprise’s corporate governance structure. Significantly, the “leadership system” in the SOE will follow the principle of “two-way access and cross-holding of positions” (shuangxiang jinru, jiaocha renzhi), which means candidates appointed by the Party organization in the SOE will be allowed to hold positions on the board of directors, the supervisory board, and the management team, while members of the aforesaid corporate governance institutions may be selected to be leaders of the Party organization in the firm. In particular, the Guidelines demand separation of the chairman of the board of directors and the general manager (CEO), but suggest that the chairman of the board of directors and the Party secretary in the company may be the same person.

Numerous Chinese SOEs, including those listed in Hong Kong, have made provision for the role of the CCP in their company constitutions, or articles of association. The relevant

---

107 Ibid.
109 Ibid.
110 Ibid.
111 WANG, supra note 11.
112 Ibid.
113 Ibid.
114 Ibid.
115 Jennifer Hughes, *Chinese Communist Party Writes Itself into Company Law*, FT (Aug. 14, 2017), [https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247af8](https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247af8). Reportedly, at 288 of the 3314 companies
articles, which were added to the corporate constitutions by special resolutions of the shareholders’ meetings, often described the Party committee as playing a core role in “an organized, institutionalized and concrete way” and “providing direction [and] managing the overall situation”.116 Significantly, it was a change that placed “the party, rather than the Chinese state, at the heart of each [SOE]”.117 The provisions in the Articles of Association of ICBC offer a standard formula to illustrate this change.118

**Article 13** In accordance with the relevant regulations of the Constitution of the Communist Party of China and the Company Law of China, organizations of the Communist Party of China (hereinafter the “Party”) shall be established; the Party Committee shall play the core leadership role, providing direction, managing the overall situation and ensuring implementation......

**Article 52** The Committee of the Communist Party of China of Industrial and Commercial Bank of China Limited (hereinafter the “Party Committee”) shall be established within the Bank. The Party Committee shall consist of one secretary, two deputy secretaries and several other members. The chairman of the board of directors of the Bank and the secretary of the Party Committee shall be the same person, and one deputy secretary shall be designated to assist the secretary in carrying out Party-building work. Eligible members of the Party Committee can join the board of directors, the board of supervisors and the senior management through legal procedures, while eligible members of the board of directors, the board of supervisors and the senior management can also join the Party Committee in accordance with relevant rules and procedures. Meanwhile, commissions for discipline inspection shall be established in accordance with relevant requirements.

**Article 53** The Party Committee shall, in accordance with the Constitution of the Communist Party of China and other internal laws and regulations of the Party, perform the following duties:

1) **Ensure and supervise the Bank’s implementation of policies and guidelines of the Party and the State, and implement major strategic decisions of the Central Committee of the Party and the State Council, as well as important work arrangements of higher-level Party organizations;**

2) **Strengthen its leadership and gatekeeping role in the management of the process of selection and appointment of personnel.....;**


116 Ibid.
117 Ibid.
3) **Support the shareholders’ general meeting, the board of directors, the board of supervisors and the senior management of the Bank in performing their duties in accordance with law and support the Congress of Employees in carrying out its work;**

4) **Assume the primary responsibility to run the Party comprehensively with strict discipline.....and support the Party discipline inspection commissions in earnestly performing its supervisory responsibilities;**

5) **Strengthen the building of the Bank’s grassroots Party organizations and of its contingent of Party members......and unite and lead officials and employees bank-wide to devote themselves into the reform and development of the Bank;**

6) **Other material matters that fall within the duty of the Party Committee.**

The role of the Party in SOEs has always been the least understood feature in SOE governance. A 2017 survey of foreign institutional investors by the Asian Corporate Governance Association disclosed that 61 per cent of the 152 foreign fund managers surveyed indicated they did not find a “clear and accountable” role of the CCP in listed companies, but 21 per cent was not even aware of the Party committee’s existence in the firms. The aforesaid lengthy provisions do not provide sufficient clarity for outsiders to understand what exactly the Party organization does in SOEs. However, based on our examination of the policy and regulatory measures as well as amendments to the articles of association of listed SOEs relating to the role of the CCP within these SOEs, the following points with respect to the role of the Party committee in SOE governance have become fairly clear: (i) the role of the Party committee should be provided in the articles of associations of SOEs; (ii) following the principle of Party Control Cadres in the political system of China’s Party-state, the Party committee reserves the authority to recommend and select top level personnel for the firm; (iii) there should be cross-holding of offices by Party committee members and members of the firm’s senior personnel; and (iv) the Party committee should lead and strengthen the Party-building work in the firm. What is unclear now is to what extent and at what stage the Party committee is involved in the firm’s decision-making, and whether this involvement undermines the firm’s ability to make decisions on a commercial basis.

C. **Separation of Power between the Party and the Board**

With the above discussion about the extensive and growing power of the Party committee in SOEs, it would sound somewhat ironic to start any conversation about “board independence” in Chinese SOEs. As alluded in the previous discussions, the official documents issued by the CCP Central, the State Council and ministries of the Chinese government in relation to the recent round of SOE reform, including MOR, have raised two apparently contradictory objectives, namely to ensure that the board is able to exercise its powers of management

---


120 *Supra* note 38, at Point 8.
and to allow the Party organization to “play the role of political core” in the SOE and exercise powers in personnel appointment and other matters.  

It is thus obvious that the Party-state has established two “supremes” in corporate governance, since both the board of directors and the Party organization are prescribed to be the decision-making bodies in the SOEs. The question then is whether there is any separation of power, or at least division of labour, between the two. On personnel management, official policy suggests the Party committee should be in charge of forming the “leading body” (língdào bānzì) of the SOE, understood as a group of top leaders of the firm including the chairman of the board, the general manager (CEO), important deputy general managers, key senior executives, and important Party committee leaders. The essence of this policy is that the board of directors is allowed to appoint members of the managerial team (who are however not members of the leading body), including the middle level corporate officers such as leaders of the various departments in a company. The board is also the principal body involved in the day to day management of the SOEs even though there may overlapping appointments in the Party committee and the board.

**D. An Emerging Partnership-based Corporate Governance Model?**

The MOR, together with other related reforms launched by the Chinese Party-state in recent years, has brought certain changes, some of which are rather fundamental, to the corporate governance structure in Chinese SOEs. We argue that all the reforms are pushing SOE governance towards a partnership based, control-sharing model, especially in MOR firms, in which the Party representatives work together with private investors and share the authority to govern.

First, MOR has resulted in significant reduction of state ownership in MOR firms. Although the state still remains the largest shareholder and is usually in a controlling position, we observe a clear tendency toward less state ownership concentration in MOR
enterprises, measured by the transfer of roughly 15 per cent to 45 per cent of state-owned equity to other investors, though some of these investors may be state entities.

Second, through the reforms, the boundary between the Chinese government and SOEs has been noticeably drawn and the separation of power herein is more institutionalized. SOEs are evidently acquiring more enterprise autonomy from the Chinese state because of the negative-list approach, and explicit provisions on the separation of power between the state and SOEs which provide that the state shareholders shall exercise their rights and powers in accordance with the Company Law and other relevant laws like any other shareholder. This significant move paves the way for Chinese corporate law, which is still ownership-neutral, to apply more or less equally to SOEs and private firms. As ownership in a firm is proportionally associated with power and influence, the shrinking state ownership in the MOR enterprises has made it possible – and even necessary in many cases – for a coalition-based governance structure to be established for the state shareholders and private shareholders to share power.

Third, the participation of the Party committee in SOEs has certainly been more institutionalized in the sense that the role of the Party is now clearly required to be provided in the articles of association. This is certainly not positive news for those who wish for complete separation of the Party-state from the SOEs. The flipside of this change is that clarifying the role of the Party committee in the articles of association can improve transparency in SOE governance. More significantly, the division of labor between the Party committee and the board of directors has been clarified, which leaves room for the board to maintain a limited degree of independence in making personnel decisions, in addition to the business operation decision-making powers which already fall within the purview of the board.

Fourth, the MOR practice of several significant SOEs demonstrate that shareholder representation on the board of directors has been improved, and power-sharing among shareholders in the shareholders’ meeting and board of directors has begun to occur. The fact that the state shareholder maintains a less than simple majority in representation on the board, coupled with a certain degree of independence reserved for the board in the new setting with more institutionalized and transparent participation of the Party committee, makes it not only possible but also inevitable for the controlling state shareholders to share power in decision-making with other shareholders in SOEs with more diversified ownership structures.

IV. UNDERSTANDING MIXED-OWNERSHIP’S IMPACT ON SOE GOVERNANCE: THE BENEFIT OF SHARING CONTROL

125 See Interview: ‘Moving Party committees in front of the curtain (noting the amendment of articles of association in relation to the role of the CCP “means that the Party committee moves from behind the scenes to the front of the curtain, increasing transparency”), supra note 119, at, at 49.
In this Part, we offer explanations about some of the reasons behind the MOR drive. We argue that, among other reasons, the MOR is inspired by the benefits of improved corporate governance and performance in SOEs through sharing of control between the controlling state shareholder and large non-state shareholders (or even other state shareholders in some cases).

This rationale starts with the conventional wisdom that ownership matters. As Grossman and Hart (1986) argued, the value of ownership in a firm lies in the benefits of control which are not able to be enjoyed by outside investors through contracts. That is, “contractual incompleteness” entails that, because it is either impossible or too costly “for one party to specify a long list of the particular rights it desires over another party’s assets”, 126 it may be optimal for that party to purchase all the rights not specified in the contract. That is, ownership “is the purchase of these residual rights of control”, 127 which has positive efficiency consequences as compared to the permanently incomplete contracts. Thus, ownership always matters because it brings about the benefit of control, and change in ownership often leads to adjustment in control rights. This is certainly the case in the Chinese context, evidenced characteristically by the provisions in the PRC Company Law which, in principle, allocate voting power on the basis of equity ownership in a firm. 128

Burkart, Gromb and Panunzi (1997) however tell us that ownership structure involves a trade-off between control and managerial initiative, and “a concentrated ownership structure induces high levels of monitoring and control but renders management less active”. 129 In other words, dominant control of ownership may reduce incentives and results in inefficiency. Pagano and Roell (1998) suggest that, from the viewpoint of an initial owner who takes into account “his own future private benefits”, he would choose to have the ownership of the firm “sufficiently dispersed to ensure the optimal degree of monitoring”, often through going public. 130 On the other hand, Gomes and Novaes (2000) identified “sharing control”, which occurs when a single shareholder cannot make unilateral decisions in a company, as a new corporate governance mechanism. 131 They maintained that, in a firm with multiple controlling shareholders, the disagreements among those shareholders may prevent major corporate decisions from harming minority shareholders, thus improving corporate governance while preserving private benefits of control. 132 This is because the control is still shared within the control groups which can internalize firm value to a greater

---

127 Ibid.
128 See WANG, supra note 2, at 156-160.
132 Id. at 1.
extent than in a situation where shares are sold largely to minority shareholders.\textsuperscript{133} Furthermore, because of the ex-post bargaining problems among controlling shareholders, sharing control “provides a compromise between the excessive monitoring of an outside investor who does not internalize the private benefits, and the excessive discretion of an unchecked controlling shareholder”.\textsuperscript{134}

Over-monitoring problems and under-monitoring problems exist in Chinese SOEs, though they come from the same controlling shareholder, the state. Tan and Wang (2007) observed that there are two types of idiosyncratic problems in China’s SOEs.\textsuperscript{135} The first one, the under-monitoring problem, stems from the phenomenon of “strong managers, weak owners” caused by the dominant position of state shareholding coupled with the absence of state monitoring in SOEs. As the state was little more than an abstract owner, it had to act through appointed agents, which in many cases were civil servants and government officials whose interests were not always aligned with the state, leading to a situation where “the principal is virtually non-existent” and a model of insider control which is called guanjianren kongzhi (key-person-control).\textsuperscript{136} In this under-monitoring model, such a key person, who is usually the SOE’s general manager (chief executive officer or CEO) or the chairperson of the board of directors, becomes “the super-sovereign and the sole commander of the company”.\textsuperscript{137} The key persons would disregard the property rights of the company as well as that of both the state and non-state shareholders in the SOE.\textsuperscript{138} The rampant corruption in SOEs demonstrated that, in many firms, SOE key persons were out of control even from the hands of the state and represented only their personal interests rather than being a loyal agent to the state. As Chen Gang (2015) pointed out, Chinese President Xi Jinping’s anti-corruption drive against SOEs in the 2013-2014 period, in the form of the inspection of 14 major SOEs by the CCP’s Central Commission for Discipline Inspection, witnessed the fall of over 70 SOE executives who were found to be involved in “accepting bribes in procurement, buying and selling of official positions, wining and dining at public expense and assisting relatives in starting business with returns”.\textsuperscript{139} The behavior of these key persons certainly harmed the interests of the minority shareholders, but they also undermined the interests of the controlling state shareholder. In short, the dominant but abstract position of state ownership in SOEs caused, in many cases, an under-monitoring problem which left the companies in the private hands of a few individuals.

There are also problems resulting from over-monitoring and excessive intervention from the state shareholder at the expense of the SOEs and its minority shareholders. Tan and Wang (2007) observed that “[m]any SOEs are debt-ridden enterprises ‘repackaged’ for listing and

\begin{footnotesize}
\begin{enumerate}
\item Id. at 1 and 2.
\item Id. at 2.
\item Id. at 150.
\item Ibid.
\item Ibid.
\item Chen Gang, China’s Graft Busters Target State-owned Enterprises, EAI Background Brief No. 1058, Sep. 9, 2015, East Asian Institute, National University of Singapore, at 1-2.
\end{enumerate}
\end{footnotesize}
continue to be controlled by their parent companies who, having successfully seen to their IPO, look towards them as cash cows for ready milking”.\textsuperscript{140} Tunneling by controlling shareholders is pervasive in both SOEs and privately owned companies (POEs).\textsuperscript{141} Further, the over-monitoring problems caused by the parent also bred weak managerial incentives in some instances because the appointments to managerial positions in SOEs were politically determined.\textsuperscript{142}

The MOR, which is essentially partial privatization, thus offers a practical solution to the under-monitoring and over-monitoring problems in Chinese SOEs by establishing a partnership-based, sharing of control governance model. Through the MOR, non-state social/private capital is introduced into the SOEs to effect ownership change and diversified board composition by giving non-state shareholders a larger representation on the board. This change is tied in with other institutional changes which further strengthen control-sharing as described above, including shifting the regulatory philosophy of the state shareholder from asset management to capital management and the release of powers from SASAC to SOEs.

Findings in the empirical and econometric literature on corporate governance in China consistently support the idea that Chinese SOEs with a certain degree of mixed ownership produced the most optimal performance results in the current political setting, which arguably strengthened the Chinese Party-state’s political will to promote the MOR. An earlier study by Sun, Tong and Tong (2002) surveyed the firm performance of all companies listed on the Shenzhen Stock Exchange (SZSE) and Shanghai Stock Exchange (SSE) and found a positive co-relationship between government ownership and firm performance.\textsuperscript{143} In other words, “partial government ownership has a positive impact on SOE performance”.\textsuperscript{144} The authors however discovered that the relationship was nonlinear and followed “an inverted U-shape pattern”.\textsuperscript{145} To wit, “100% government ownership is not good, but no government ownership is not good either. The optimal government ownership may be somewhere in between”,\textsuperscript{146} though the authors did not address what was the “optimal” percentage of state ownership. In any event, as Jefferson and Su (2006) suggested, the conversion of SOEs to shareholding companies incorporated under the Company Law “contributes to overall increase in both current productivity and innovative effort”.\textsuperscript{147}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{140} \textit{Supra} note 135, at 150-151 (noting a listed SOE, Luoyang Chundu, had to bankrupt because its parent company borrowed and not repaid RMB 330 million after its IPO in 1998).
\item \textsuperscript{141} Guoping Li, \textit{The Pervasiveness and Severity of Tunneling by Controlling Shareholders in China}, 21 China Econ. Rev. 310, 311 (2010) (noting “tunneling by controlling shareholders is widespread and severe”).
\item \textsuperscript{142} Cyril Lin, \textit{Corporatisation and Corporate Governance in China’s Economic Transition}, 34 Econ Plann 5, 7-8 (2001).
\item \textsuperscript{144} \textit{Id.} at 22.
\item \textsuperscript{145} \textit{Id.} at 19.
\item \textsuperscript{146} \textit{Ibid.}
\end{itemize}
\end{footnotesize}
More recently, Liu, Beirne and Sun (2015) observed that “partial privatization which leads to mixed ownership can be an optimal form of privatization in the context of China’s political system which is characterized by state capitalism” in investigating the performance of 1,184 firms in China which underwent ownership transformation over the period 1997 to 2003. The authors concluded that ownership restructuring, particularly that which brought private investment to state firms, was the most appropriate approach to reforming SOEs and also enabled firms to gain favourable synergy gains from both the government and private sector.

Apart from benefiting from sharing control, it is increasingly clear that the MOR also functions as industrial policy for the Chinese state to make use of private resources – which include not merely capital – to help SOEs grow stronger. The more important resources are the technologies, talents and market networks owned by the potential private strategic investors. In the case of China Unicom’s MOR, the intention was announced at the planning stage of the MOR that China Unicom would choose to sell stakes to potential shareholders, which were referred to by China Unicom as “cooperation partners” (hezuo huoban), on the condition that they could complement China Unicom’s business, especially in the Internet industry. Soon after, China Unicom announced strategic cooperation plans with Alibaba and Tencent, China’s Ecommerce giants which were also the leading private investors in the Chinese Unicom MOR programme. The agreement with Tencent was presented as the “first major business cooperation with strategic investors after China Unicom’s MOR was approved”, in which the two shareholders of post-MOR CUNC committed to cooperate and share resources to build a new Internet industry ecosystem platform.

V. CONCLUSION

There is a body of literature that has found that in general the profitability and efficiency of resource allocation in SOEs are lower than in private firms. This recognition has led to

149 Id. at 212.
attempts by various countries from time to time to reform their SOEs, China being only one example. However, the reform of SOEs is not without its challenges. For example, Musacchio, Ayerbe, and Garcia (2015) explored the challenges that certain Latin American countries faced when attempting to reform their SOEs. In particular the authors pointed to the corporate governance problem and the fiscal governance problem. To overcome these problems, they advocated that governments should design governance mechanisms that rely on the market, on ex ante administrative controls, or on hybrid solutions. The mechanisms should be designed on a case by case basis that suit the circumstances.\textsuperscript{154} Similarly, Clo et al (2015) found from their study of the reforms in ten major Italian SOEs from 2004 to 2013 that listed SOEs that operated in liberalized markets gained higher profits and dividends while unlisted SOEs operating in non-competitive markets that are compelled to maintain an informal public mission often incur economic losses.\textsuperscript{155}

Similarly, the MOR programme is the Chinese government’s attempt to further expose its SOEs to market forces, while at the same time subject governance to greater scrutiny and supervision. In the absence of large institutional investors across China’s capital market, the strategic investors can play such a role. Indeed the scale of their investment in the SOEs, coupled with their accountability to their own shareholders, provides them with the incentive to monitor management. Arguably, their ability to do so is enhanced by the board seats that many of the strategic investors hold, unlike many institutional investors. As Table 3 shows, of 33 SOEs surveyed, 16 have outside directors that constitute a majority of the board. It must also be recognized that many if not all the strategic investors have strong links to the Party state itself. This is true not only for the state-owned strategic investors but the large private ones as well given that links with the Party state have hitherto been important for commercial success. It will therefore be much more difficult today for powerful managers to abuse their positions for personal gain.

At the same time, the clearer mandate within the corporate constitution of the party committee potentially acts as another check on management abuse as one of the key roles of the committee is to ensure discipline on the part of Communist Party members which is still an essential requirement for advancement to the higher levels of management. Through its control of personnel appointments and responsibility for discipline, it is in a position to remove senior managers who abuse their positions. This aspect of the MOR programme can be seen as a logical extension of President Xi Jinping’s drive to root out corruption within the party-state.


While the desire for SOE reform appears strong, it remains to be seen how such reform tendencies can be sustained and institutionalized as opposed to being the personal initiative of the current, strong, leader. In countries with a competitive democratic system, the need to establish legitimacy at each election cycle can act as a constraint on the ruling party of the day. This certainly was the Singapore experience in the 1950s and 1960s where a weak People’s Action Party (PAP) government relied on sound economic management, including the management of Singapore’s SOEs, to deliver tangible benefits to the public and thereby cemented its support over time. This narrative on the part of the PAP, coupled with the need to win a mandate every 4 to 5 years, continues to act as a constraint on the PAP. It is not clear that the Chinese Party state, which is itself above the law, faces sufficient institutional constraints to ensure a deep rooted commitment to good governance as a whole of which management of its SOEs is a subset.