



Governance of State-Controlled Listed Companies in China: The Current Situation and Policy Suggestions

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Governance of State-Controlled Listed Companies: Current Situation and Policy Suggestions

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Special Features of the Governance of State-Controlled Listed Companies in China

1. Weak distinction between *government* and *company* impacts the 3 crucial areas of recruitment, incentives and oversight. Board operations lack independence and efficiency.

- There has been no fundamental change in the traditional practice of appointing government officials to leadership positions in SCLCs. A majority of Board chairs and CEOs hold civil service ranks. The market for management personnel is underdeveloped and market-based mechanisms for management selection have not been put in place.
- The procedures and mechanisms for deciding executive remuneration in SCLCs are still heavily influenced by civil service management and government intervention.
- The government generally does not govern SOEs on the basis of ownership functions and reliance on a strong Board.

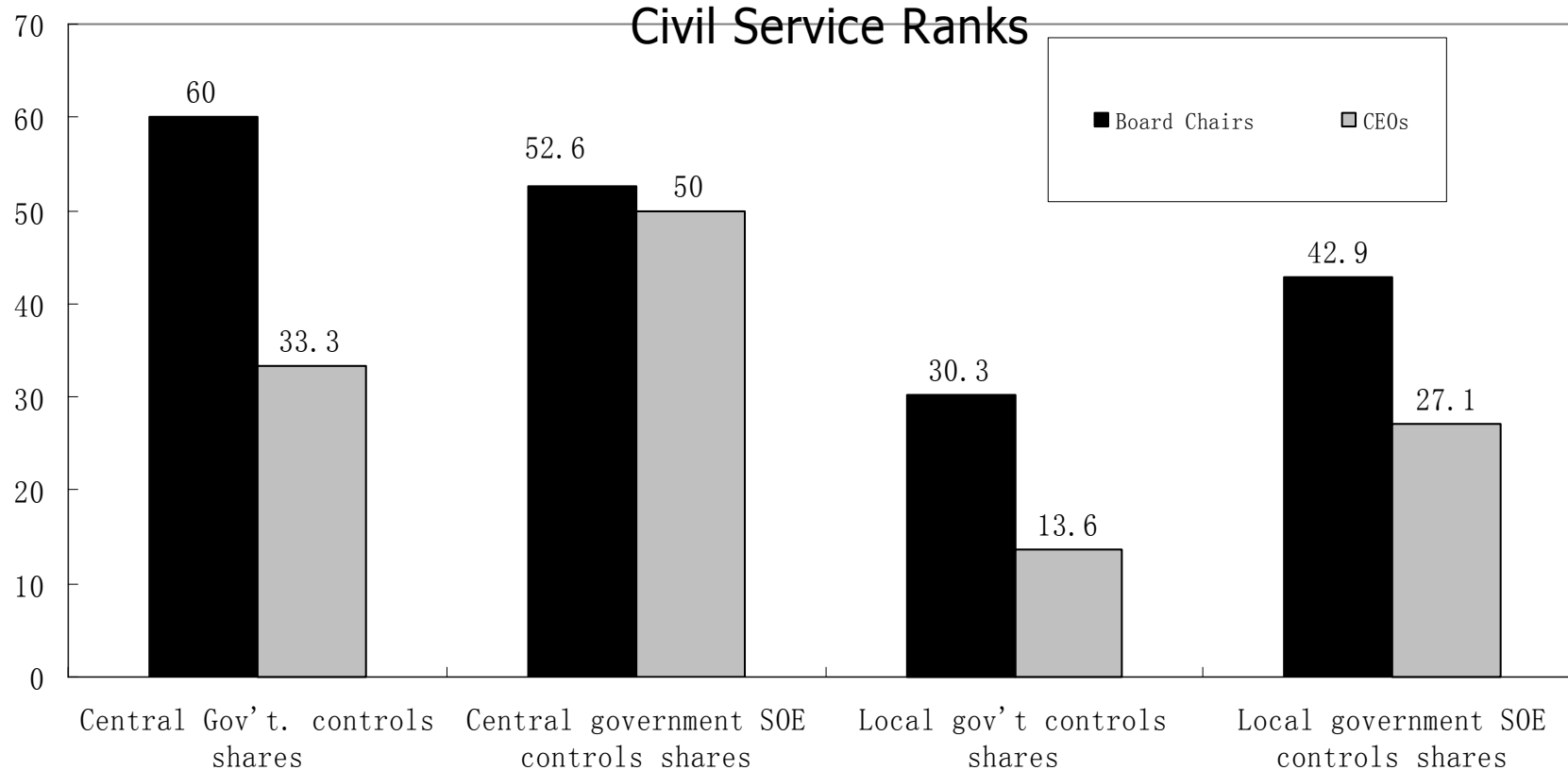


Special Features of the Governance of State-Controlled Listed Companies in China

- **In some companies, the Board, the Supervisory Board, independent directors, professional committees, etc. often exist in name only.**
 - Independent directors lack independence as 90% are nominated by the majority shareholder.
 - Professional committees are basically unable to exert any effect.
 - Features such as effective assessment of board members and long-term incentive mechanisms are lacking.
 - Boards and supervisory boards lose their effectiveness, in particular because they do not become the centres of company operations and do not bear ultimate responsibility for these.

Special Features of the Governance of State-Controlled Listed Companies in China

% of Board Chairs & CEOs of Listed Companies holding Civil Service Ranks



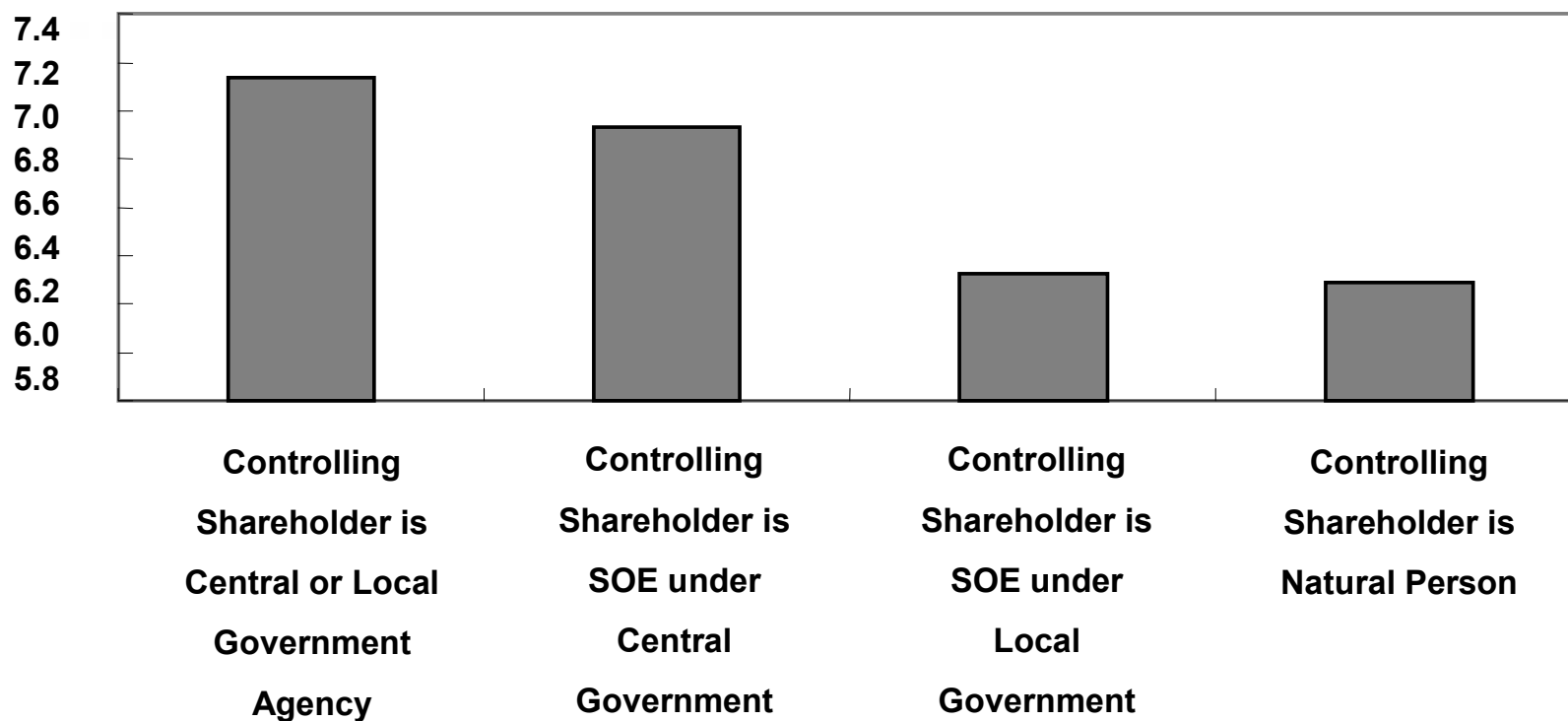


Special Features of the Governance of State-Controlled Listed Companies in China

2. *Tunneling & Propping* relations often exist between the State as controlling shareholder and listed companies
3. Different listed companies in which the State is controlling shareholder have different characteristics, market positions and management performance. There are thus differences in the economic relationships that prevail between the controlling shareholders and the listed companies, and in their proxy oversight activity. This leads to clear disparities in governance efficiency.

Special Features of the Governance of State-Controlled Listed Companies in China

Comparison of Quality of Governance in Listed Companies of Different Types





Progress in the Governance of State-Controlled Listed Companies in China

- 1. Great progress has been made in reform of State assets management systems**
- 2. The Split Share Structure Reform is essentially complete**
 - Equity incentives
 - Reorganization of State assets, injection of quality assets and market listing 'as a whole'



Progress in the Governance of State-Controlled Listed Companies
in China

- 3. Amendment and refinement of the Company Law, the Securities Law and the Criminal Law have provided a suitable legal framework to improve governance of State-Controlled Listed Companies.**



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

The Government must push modernization of governance methods in SOEs:

1. Professionalization

State Assets Management and Professional Governance and Operation of State-Controlled Businesses. This involves:

- Clearly and transparently defining the scope of authority, the roles and the responsibilities of SOE stakeholders; separating the state's ownership functions from its functions in the regulation of industry and in setting industrial policy; separating oversight functions and State-asset commercial management from policy-making with respect to State assets; ensuring that the institutions exercising the ownership rights of State shares in listed companies do so through professional organizations and personnel and according to professional standards – thus fulfilling the duties of State shareholders and managing State assets in such a way as to avoid that the internal operations and day-to-day management of SCLCs become subject to government interference, and to ensure that these companies are genuinely independent commercial entities operating according to market principles.



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

The Government must push modernization of governance methods in SOEs:

1. Professionalization

- The State has 2 main requirements of the management and control of State assets – one is to retain control of enterprises that are the lifeblood of the people's economy, the other is to obtain the greatest long-term benefit from State capital. With respect to the first, the State should establish share-holding ratios for various industries and their key enterprises, while for the second, State asset management agencies should refer to the principles and methods espoused by experienced international institutional investors to manage and assess State capital benefits. This task can be carried out by departments set up for this purpose within these agencies, and a part of the State capital can be assigned to national social security funds. At the same time, it now appears essential that the shares of some listed companies that the State does not wish to control should be entrusted to and handled by investment fund management companies. The governance standard of SCLCs can thus be improved by categorized and stratified management of State capital.



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

The Government must push modernization of governance methods in SOEs:

1. Professionalization

- – Institutions involved in State assets management should govern SCLCs through strong and fully empowered BODs. Open, transparent, uniform and rational procedures should be put in place for the nomination of Board members and executives, with these occurring in conditions of voluntary disclosure and external oversight. Persons thus selected will be notable for their professional abilities, integrity and performance, and will be able to adapt to the workplace demands of listed companies and the challenges they face.
- Institutions involved in State assets management should vigorously promote rational governance mechanisms within SCLCs; perfect checks, balances and internal controls; boost the independence, efficiency and collective leadership of Boards; and prevent ‘dictatorship’ by a single individual in collusion with persons inside the company. In order further to ensure the performance of these Boards, these institutions should also require better and more systematic rules of order for Board meetings and other activities, and insist that these be adhered to.
 - Central Huijin is a valuable experiment, but when compared to Singapore’s Temasek Holdings in terms of professionalism, specialization, etc., one sees considerable room for improvement.



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

2. Marketization

This can be taken to mean that State-owned holding companies and State-Controlled Listed Companies should address the recruitment, incentivizing and oversight of management according to the rules and requirements of the marketplace; similarly, the government should approach the disposal and management of State assets according to the same rules and requirements.

- ▶ This involves putting in place measures for performance evaluation that are market-oriented, systematic and rational; sound policies for remuneration; and dynamic incentive plans (including stock) for top executives that reflect such factors as a company's achievements, market value evolution and competitiveness, as well as incentive levels in the industry and in companies of the same size.



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

3. Transparency

- There is a need to strengthen transparency and job-linked accountability in the state assets management system overall, and to perfect oversight of the institutions (or pertinent government agencies) responsible for this management and which perform the functions of ownership.
- A high degree of transparency involves state-controlled businesses moving progressively towards operational and management information disclosure, and external audit mechanisms, consistent with the standards of listed companies, and using XBRL, etc. to put in place corporate reporting systems. Entities exercising the ownership rights of State shares in listed companies (State holding companies or State assets management agencies) should disclose in a clear manner their policies with respect to the State shares they hold.



Policy Suggestions for Perfecting the Governance of Listed State-Owned Enterprises

4. Implementing the Rule of Law

Shifting the methods of corporate governance from heavy reliance on administrative control and government intervention towards market-based mechanisms also requires being able to rely on oversight being conducted according to the law and the law being duly executed. In this way can a just system of the rule of law be established.



Thank-you!