Chinese-Style Corporate Governance: The Problem of Overlapping Control by Insiders and Large Shareholders in the Process of Business Management

KAWAI Shin'ichi

I. The Issues at Hand

1. The Characteristic Features of Chinese-Style Corporate Governance

According to the research to date, corporate governance among the companies listed on the stock exchanges in mainland China has been characterized as follows.

1) Large shareholder control. Shareholding in many of the listed companies that were formerly state-owned enterprises (SOEs) is concentrated in a few hands; namely, those of government agencies and existing state enterprises. These large shareholders are therefore in a position to influence company management though overwhelming control of the proceedings at shareholders' meetings.

2) Insider Control. By "insiders" we mean company managers and employees who have infiltrated and taken over the board of directors, enabling them to exercise de facto control over how the business is managed.

The formation of this type of control has been attributed to underdeveloped interest on the part of shareholders towards company assets, their unconcern and lack of incentive towards controlling business management and the gradual expansion and concentration

* This article is based on the combination and revision of Kawai 2003a and 2004.

Modern Asian Studies Review, Vol.1, No.1 (Mar. 2006): 22–46

of management's autonomy over business operations through SOE reforms implemented since the 1980s.[1]

3) The coexistence of SOE corporate governance, characterized by management participation by the Communist Party leadership, staff and workers congress and labor unions, and joint stock company governance, exercised by shareholders, the board of directors and auditors. A combination of both forms has been sought in the management of newly founded joint stock companies, and this is true for listed companies without exception.

The above characteristics reflect the "path-dependent" process of SOE reform in China;[2] Almost every listed company went through the transformation from a SOE into a joint stock concern. Since the 1980s, managerial autonomy within SOEs has differed by degree and gradually increased in the process of reform. Consequently, the managers of many SOEs ended up gradually taking de facto hold of residual control, and more and more room was created for those managers to control decision-making as enterprise insiders. The reorganization of SOEs into joint stock companies added even more impetus to that process.

In addition, whenever a SOE was reformed into a joint stock company, it was the most common practice to separate a part of the healthy assets from the original SOE to form the basis of a joint stock company [Xia, Donglin 2000]. The original SOE would retain the rest of the assets and also become the new firm's parent company. Many of the listed companies formed in this manner continued to utilize much of their parents' managerial resources, which obviously led to very close ties between to the two organizations.

2. The Problem

We accept that the research producing the above three characteristics is accurate in its findings. However, the structural relationship between large shareholder control and insider control has yet to be analyzed sufficiently. If we assume that shareholders and insiders

---

[1] A summary of the research done in China on insider control can be found in Kawai 2002a and 2003: Introduction, pp. 8-29.

[2] This has been pointed out by Sun, Ninghua 1998 and Yin, Desheng 2000, among others.

form two distinct groups of actors, then differences must exist between the types of control they wield over their enterprises. The discussion to date on the subject has tended to conclude that these two distinct groups exist side-by-side, in the sense that there are many listed enterprises that are controlled by their shareholders and many others that are controlled by insiders. There are many such cases, but in the present article we will argue that in the majority of the companies listed on the Chinese stock exchanges, the two groups actually overlap.[3]

A report issued by the Shanghai Securities Exchange relates that large shareholder control and insider control converge to be what they call "control by key men," a type of managerial control [Shanghai Stock Exchange 2000b], and thus lumps both groups into a single category. This is a typical example of the little concern paid in the conventional research to the mechanism created by overlapping governance involving the two groups. The present article is one attempt to fill such a gap through an empirical examination of that mechanism and the intimate relationship that exists between listed companies and their parent enterprises. Here we will first focus on the aspects of management composition in listed companies, and then shed light on business transactions and profit distribution, whose history has just begun and has been studied very little.

II. The Structure of Stock Ownership and Control by State-Owned Corporations

1. Large Shareholder Control

Since about 90% of all the companies listed on the stock exchanges in mainland China were formerly SOEs, the stock ownership structure is focussed upon top shareholders, beginning with central government agencies.

For example, as shown in Table 1, the percentage of stock owned by leading shareholders comes to 46.5% on the average,

---

[3] The first attempt to propose such an overlapping structure of shareholders and insiders was a presentation at the 9th Annual Conference of Japan Scholarly Association for Asian Management held at Keio University in October 2002 [see Kawai 2003a].

Table 1 Stock Ownership Percentage of the Five Leading Shareholders in a Sample of 922 Listed Companies, 1999

(%)

Rank	Average	Median	Variance	Minimum	Maximum
Top	46.54	44.67	897.89	2.29	88.58
Second	8.22	4.83	112.89	0.08	41.26
Third	3.22	1.91	13.05	0.02	24.75
Fourth	1.85	1.07	4.62	0.02	16.7
Fifth	1.22	0.71	1.91	0.01	11.86

Source: Wei, Gang 2001, p. 49.

while the second leading shareholder owns a mere 8.2%. The 58.0% concentration of ownership by the top three shareholders is extremely high when compared to Japan, where concentrations of 50% and above are regarded as a condition of family-run businesses. In China, 569 businesses with a corresponding ownership structure are now in operation and occupied 67% of all listed companies in 1998.[4]

2. Typology of Controlling Shareholders and State Ownership

The first characteristic feature of listed companies in China is the division of the stock market into circulating and non-circulating securities, and the further division of the former into A and B categories. Secondly, the amount of non-circulating securities (i.e., the percentage of state- and corporation-owned shares) comes to two-thirds of the total stock issued, a figure that has remained fairly stable over time. However, of this total the percentage of state-owned shares, which has tended to increase since 1998, came to 51% of the total at the end of 2002, while shares owned by corporations (including SOEs) declined to just over 19% of the total during the same period. Therefore, we can assume that the top shareholders of listed

---

[4] Of course, we are not arguing that over two-thirds of listed companies in China are "family-run," although some do exist, but in very small number and should be considered exceptional now.

companies are dominated by state agencies and state-owned corporations.Table 2 shows empirically the composition of shareholders controlling listed company circulating securities as of the year 2000.

Next, Table 3 is a time series view of stockholder units (including proxy owners) holding state-owned securities in terms of units.

By units, we mean that these types of securities are not held by a particular government agency as a whole, but rather scattered among various ownership units. What should be noted here is 1) the percentage of stock owned by the State-Owned Assets Administration Bureau (SAAB), the major state-owned stockholder, has been gradually declining, and 2)many state-owned group companies (the nuclei of enterprise groups) and state-owned asset management companies (SAMC) exercise ownership (including proxy ownership) of state-owned stock. The number of SAMC units with proxy ownership of state-owned stock increased up through 1997, and then began to decrease.

Table 2 Type, Structure and Holdings of Listed Company Controlling Shareholders: 2000

(%)

Type	Category A (940 Companies)	Category B (942 Companies)
State-owned Assets Administration Bureau (or Auditing Section)	9.5	10.3
State-owned Assets Management Company	6.9	6.6
State-Owned Enterprises & Stockholding Companies	62.9	60.2
Non-Bank Financial Institutions	0.3	0.2
Group-Owned Enterprises	5.6	5.8
Private Enterprises	8.6	8.2
Foreign Investment	0.7	0.9
Individuals	0.2	0.7
Other (Proprietorships, Corporations)	4.9	5.8

Source: Ma, Qingquan ed., 2001, p. 59.

Table 3 Stockholder Units of State-owned Securities by Number and Percentage

	1995	%	1996	%	1997	%	1998	%	1999	%
Group, Consolidating & Stock Holding Companies	46	18.9	106	31.9	179	35.8	243	42.6	375	55.5
Companies, Factories	12	4.9	—		31	6.2	82	14.2	56	8.3
SAAB	66	27.2	100	30.1	131	26.2	119	20.6	110	16.3
SAMC	35	14.4	47	14.2	71	14.2	89	15.4	78	11.5
Fiscal Bureau	8	3.3	13	3.9	10	2.0	10	1.7	11	1.6
Multiple Unit Ownership	13	5.3	6	1.8	33	6.6	63	10.9		
Enterprise Management Sector	5	1.2	20	6.0	5	1.0	11	1.9	5	0.7
Local Government Agencies	1	0.4	1	0.3	2	0.4	—			1
Other	—		—		5	1.0	—		8	1.2
Unknown	59	24.3	39	11.8	33	6.6	21	3.6	32	4.7
Totals	243	100.0	332	100.0	500	100.0	577	100.0	676	100.0

Sources: China Listed Company Report, each year, Ho, Jun 1998, p. 52, Kawai 2003, p. 53.
Note. SAAB: State-owned Assets Administration Bureau, SAMC: State-owned Assets Management Company

On the other hand, SOEs units with direct and proxy ownership of state-owned securities increased steadily to over 55% of the total by 1999. (Their stockholding percentage is shown in Table 2). It is by virtue of holding state-owned securities both directly and by proxy that SOEs and state-owned corporations have become important controlling shareholders in listed companies.

III. Large Shareholding vs. Insider Control

1. The Relationship Between Controlling Shareholders and Directorships

How does insider control relate to the large shareholder control we have referred to? Table 4 shows the number of listed company directors that have been either elected or dispatched from among their shareholders.

What the Table indicates is that 80% of listed company directorships come from their shareholding corporations and that 53% of them are their top shareholders.

Furthermore, we also know that the percentage of directors representing the holders of state-owned securities among the total directors is generally higher than the percentage of stock owned by the holders [Wang, Zhongjie 2002: pp. 31-31], and therefore, the holders of state-owned securities exercise relatively more influence over decisions (one person, one vote) made by the board of directors. This leads to the conclusion that holders of state-owned stock, in

Table 4 Shareholding Directors of 942 Companies

(#; %)

Type		Number per Company	% of Derectorship
Ranking Shareholders		6.68	80.7
	Top	4.41	53.3
	Second	1.08	
	Third	0.51	
	Forth	0.3	
	Fifth	0.22	
Financial Institutions		0.29	3.4
Investment Institutions		0.12	1.3
Affiliates (Suppliers, Distributors)		0.19	2.3
Non-Affiliates		1.06	12.3

Source: Same as Table 2. p.60.

particular top shareholders, generally have control over the listed company's directorship.

So how does insiders control come in? An important clue is provided by He Jun [1998], who made empirically clear that the higher the percentage of stock held by a company's top shareholder, the higher the percentage of insider (i.e., company manager and/or employee) participation in its directorship. (See Table 5.) He's implication is that top shareholder control goes hand in hand with insider control.

2. SAAB and SAMC as Controlling Shareholders

Examples of the State-Owned Assets Administration Bureau (SAAB)[5] or the State-Owned Assets Management Company (SAMC)[6] dispatching representatives to sit on the board of directors

Table 5 Shareholding Concentration and Insider Participation Rates of 530 Companies: 1996

Ownership % of Top Shareholder	0~10	10~20	20~30	30~40	40~50	50~60	60~70	70~80	80~
No. of Companies	6	22	70	75	72	69	62	30	0
% of Insider Directors	45.5	45.0	57.1	59.1	72.0	76.9	83.5	93.1	—

1. Insider % = Percentage of company employees on board of directors. 2. Average number of directors per company: 9.7; average insider directors: 6.5.
Source: He, Jun 1998, p. 54.

[5] Established in 1988 as an independent body under the jurisdiction of the State Council, SAABs have also been set up on the local level. However, under central government reforms of 1998, central SAAB was discontinued and its duties absorbed by the Fiscal Department. In 2003, the State-owned Assets Supervision and Administration Commission (SASAC) was set up as an independent body with ownership rights over central level SOEs.

[6] SAMC was founded with 100% state-owned capital as a pure joint stockholding company with the purpose of holding and utilizing state-owned assets (stock and other securities).

The policy intent behind the founding of SAAB and SAMC was to separate the management of state-owned assets from their employment. It was also intended that SAMC be an intermediary between the government and enterprises in order to separate administration from business management.

of listed companies are very rare. For example, of the 78 listed companies of which it was the top shareholder at the time of stock listing, SAAB chose to send representatives to only 18 (23%) of them, and in such cases dispatched no more than 2 people (maximum of 18% of the total directors).[7] On the other hand, the insider participation rate in the directorship of the same 78 companies is on the average 69% (max. 100%, min. 27%). Such an unbalance indicates very little say on the part of state-owned stock holders in the decision-making process of the companies they own and the existence of information asymmetry between SAAB and directors of listed companies, verging on ignorance on the part of the former concerning how the companies are run. As to the reasons for such a state of affairs, the top shareholders are government bureaucrats who, among many administrative duties, don't have a preferred interest in increasing the worth of the state-owned assets of their listed companies, and also since their income is not related in any way to company performance (profits), there is no real incentive to get involved in supervision [Zhang, Weiying 1999].

SAMC is itself a pure stock holding company specializing in securities and asset management. Therefore, it is presumed that SAMC has stronger interests in their assets than government bureaucrats; but in fact, the number of representatives it has dispatched also comprised a low percentage of its companies' directorships, although not as low as the case of SAAB. For example, SAMC as the top shareholder of 51 listed companies at the time of stock listing deemed to send directors to only 21 (41%) of them, to the tune of one person each, resulting in a mere 7-14% participation rate in their directorships.[8] It is this lack of interest and participation on the part of state-owned stock shareholders in the listed companies whose stock they control that makes it relatively easy for insider control over corporate management.

3. State-Owned Enterprises as Controlling Shareholders

On the other, state-owned companies which are both proxy hold-

---

[7] Compiled by the author from each company's stock exchange applications and stock offer pamphlets in the Juling network database (http://www.genius.com.cn).

[8] ibid.

ers of state-owned stock and direct holders of state-owned corporate stock, are in many cases both the founders of the listed companies whose stock they control. Such a parent-subsidiary relationship is the reason why they dispatch a much larger number of representatives to sit on the boards of directions of their listed companies. For example, in 1998, of 315 such companies, there were 150 persons serving jointly as board chairmen of both parents and subsidiaries (47.5% of the total) [Kawai 2003a]. In 2001, the same situation existed in 332 companies (37.3%) out of a total of 889 listed companies. Moreover, out of 707 companies whose stock was controlled by SOEs, 175 (24.8%) directorships were chaired by presidents of the parent companies.[9]

Besides such cases of joint ownership and management control, there are many board directors of listed companies who have come from SOEs. For example, according to one survey of 257 companies listed on the Shanghai Stock Exchange,[10] 73-76% of their directors (excluding independent directors) had been previously employed at former SOEs. Table 6 shows the same survey's results concerning directors' careers.

The figures of 58% executive directors designated, 69% of other executive directors and 48% of directors who had worked at the state-owned parent company clearly indicate parents' deep involvement in the management of listed companies. This fact is also true for the origins of management positions other than company directors. Many executive managers in listed companies come from their state-owned parent company when the stock company was organized.

Furthermore, the history of the listed company is still in its infant stages, beginning for the most part in 1992. Therefore, their so-called "insiders" are also newcomers, most of whom cut their teeth while employed at state-owned enterprises. It is not surprising, then, that these directors and managers would be closely connected to their company's controlling shareholders, which leads us to wonder if the management of the controlling shareholder (i.e., parent company) should be considered "outsiders." By denying a dichotomy between "insiders" and "outsiders," it would become necessary

---

[9] Faren Zhili Jiegou Wenjuan Diaocha Ketizu 2001, p.68.
[10] Tenov, Stoyan and Zhang, Chunlin w/ Brefort, Loup 2002, p.90.

Table 6 Careers of 257 Listed Company Directors

(%)

Past Career	Exective Officer chosen by shareholders	Other Exective Officer	Non-Exective Officer
Company Employee At time of stock listing	78	87	32
Parent Company Employee	58	69	16
Parent Company Manager	32	27	9
Related Government Bureaucrat	8	6	10
Previous Holding Company Experience	48	26	53
Management Experience in the Same Industry	18	14	19
Management Experience in a Different Industry	18	14	32

Source: Stoyan Tenev and Chunlin Zhang w/Loup Brefort 2002, p.91.

to understand the relationship between large shareholder control and insider control as more integrated than antagonistic in character, more like the equivalent relationship between ownership and management characteristic of a family-owned and run enterprise group. This is what we meant here by "overlap," and it is our opinion that the case of such overlapping control between owners and managers is true for the majority of listed companies. Parent state-owned companies have a stronger control, rather than the loose, unconcerned attitude of SAAB and SAMC, in their relations with the managers of the listed companies they own.

Insider control in China can be termed "managerial control" as well, but not in the sense of the term as defined by A. Berle and G. Means. First, in most of China's listed companies, ownership by shareholders (of state-owned stock) and management are not separated, but rather integrated or unified into a single entity. Secondly, despite most of the remaining listed companies being owned by government agencies and asset managing corporations, the disinterest in or weak control by these owners has given rise to the necessity of insider control.

IV. Owner-Manager Integration as Seen from Affiliate Transactions

Due to the fact that companies listed on the Chinese stock exchanges were formed with mainly capital assets taken from the SOEs that founded them, it is probably true that this capital composition strongly determines the nature of transactions conducted between listed companies and the parent organizations that own them. Here let us look at the intimate relationship created between the two in terms of affiliated transactions, which are related to direct and indirect trade among affiliated corporations and persons.[11]

1. Listed Companies and Affiliate Transactions

The number of listed companies that have disclosed having conducted transactions with their affiliates came to 609 (84% of the total) in 1997, and 949 (93.6%) in 2000, 619 in 2001 and 606 in 2002.[Zhu Baoxian and Miu Haiying 2001, Huang Benyao 2003] The ratio of the amounts of the transactions to gross sales differs according to the type of business. During 2002, the finance & insurance industry ratio was 160%, social services 120%, broadcasting & culture and mining over 70%, electricity & gas and construction & manufacturing over 50% and information, transportation and commerce over 30% each. Whenever industry organization-related affiliation is close or vertically integrated, like in such manufacturing endeavors as metals, power, mining, petrochemicals and machinery,

[11] The rules of the Shanghai Securities Exchange define "affiliated corporations" as (1) a corporation that exercises absolute control over a member's stock, (2) a top shareholding corporation that does not control over 50% of the member's stock, but controls over 50% of the votes at shareholders' meetings, and/or (3) a corporation belonging to the same enterprise group in the capacity of (a) a group subsidiary, (b) a group controlling the appointment of over 50% of the member's directorship, (c) a corporation for which the member controls between 20 and 50% interest, and/or (d) a corporation in which a person is acting as its legal proxy under Article II.

the degree of affiliated transactions would be expected to be relatively high.

1) Composition of Affiliated Transactions

Table 7 is an overview of transactions conducted by listed companies with their affiliates during 2001 and 2002.

Table 7 Overview of Listed Company-Affiliate Transactions: 2001, 2002

(100 million yuan; %)

	2001				2002			
Transaction Type	Number	%	Amount	%	Number	%	Amount	%
Raw Materials Purchases and Labor Procurements	99	7.2	175.63	10.8	118	8.5	263.51	16.4
Raw Materials Sales and Labor Supply	94	6.9	169.55	10.5	140	10.1	255.82	16.0
Asset Transfers	200	14.6	410.43	25.3	155	11.2	176.14	11.0
Asset Purchases	104	7.6	90.88	5.6	32	2.3	288.10	18.0
Stock Investment	381	27.9	342.43	21.1	407	29.4	300.34	18.7
Stock Purchases	142	10.4	84.07	5.2	122	8.8	38.64	2.4
Asset Replacement	80	5.8	144.62	8.9	96	6.9	120.36	7.5
Security Provision	20	1.5	38.31	2.4	53	3.8	63.19	3.9
Commissioned Management Services	21	1.5	14.19	0.9	37	2.7	23.15	1.4
Leases	47	3.4	4.27	0.3	74	5.3	57.66	3.6
Other	180	13.2	148.67	9	151	11	16.04	1.1
Totals	1368	100	1623.05	100	1385	100	1602.95	100

Source: Huang, Benyao, 2003, pp. 49-52.

The actual content of these types of transactions is quite diverse and includes sale and purchase of finished and unfinished products, sale and purchase of stock and other assets, labor service dealings, agency and lease contracts, capital loans, provision of guarantees and security, commissioned management services, technological transfer, and payment of top management salaries, all with the intent of cutting transactions costs, stabilizing transactions, standardizing product quality and reducing taxes.

Regarding the structure of affiliate transactions, the income-expenditure balances of the listed companies during 2001 show the three major categories of raw material and labor-related transactions losing 610 million yuan, asset transactions gaining 31.95 billion yuan and stock transactions losing 25.84 billion yuan, while there are no concrete figures on the rest. However, there is other data showing a total of 112.9 billion yuan in listed company payments to and 42.5 billion yuan in income from affiliates during that year. [Yang Wei 2002]. During 2002, the same three categories came to 770 million, -11.19 billion and -26.17 billion yuan, respectively, resulting in a total spending deficit of 38.63 billion yuan. Regardless of the other categories, it should be clear that listed companies pay more to affiliates than they receive, indicating a relationship of transactional asymmetry and pure outflow from listed companies, who seem to be acting like "cash withdrawal machines" for affiliates. This idea is supported by the debt-credit relationship with affiliates, which in 1999 showed 107.89 billion yuan in net debt owed to listed companies by affiliates (161.28 billion in listing company lending vs. 53.39 billion in borrowing) and in 2000, 63.62 billion outstanding (88.62 billion vs. 25.0 billion).

2. The Position of Affiliates in Transactions with Listed Companies

To begin with, Table 8 shows the importance of parent companies in yearly transactions involving their listed companies in terms of percentage of the number of transactions, number of affiliated companies and the amount of the transactions.

The role played by parent companies in the three categories (55.8% and 47.2% of listed companies transactions, 73.2% and 65.8% of the companies, 70.9% and 72.9% of the amount of the

Table 8 Percentage of Listed Company's Transaction with parent company in its Total Affiliate Transactions: 2001, 2002

(%)

	2001			2002		
Transaction Type	% of Number	% of Companies	% of Amount	% of Number	% of Companies	% of Amount
Raw Materials Purchases and Labor Procurements	49.5	59.7	61.1	30.5	41.6	16.2
Raw Materials Sales and Labor Supply	61.7	73.6	85.0	30.7	43.9	42.0
Asset Transfers	59.5	64.2	85.6	56.8	60.5	65.0
Asset Purchases	63.5	67.9	63.9	71.9	68.0	95.0
Stock Investment	53.3	62.0	62.7	51.8	63.3	22.2
Stock Purchases	47.2	52.7	54.9	43.4	48.9	51.5
Asset Replacement	62.5	70.8	63.2	59.4	62.6	63.7
Security Provision	50.0	60.0	78.9	32.1	41.7	69.2
Commissioned Management Services	57.1	60.0	54.0	37.8	42.4	13.3
Leases	63.8	64.3	52.6	63.5	70.0	33.3
Other	55.0	—	65.1	43.0	—	—
Totals	55.8	73.2	70.9	47.2	65.8	72.9

Source: Huang, Benyao 2003, pp. 49-52.

transactions) clearly shows the extremely close relationship between the two. This is also true of the debt structure involving listed companies and their affiliates, as shown in Table 9. The Table shows the

Table 9 Composition of Listed Company Net Credit Balance with Affiliates

(10,000 yuan; %)[12]

Type of Affiliate	1999		2000	
	Net Credit Outstanding	%	Net Credit Outstanding	%
Controlling Parent Companies	3348348.5	31.0	2107769.4	33.4
Subsidiaries	1582830.0	14.7	532900.1	8.4
Affiliates With Same Parent	3165466.0	29.3	664485.0	10.5
Companies With Same Managers	853879.0	7.9	141599.3	2.2
Founders Other Than Controlling Shareholders	349498.8	3.2	51949.2	0.8
Affiliates of Affiliates	406557.6	3.8	365518.4	5.8
Companies belonging to Shareholders	-6819.1	-0.06	67669.9	1.1
Jointly Managed Companies	475118.5	4.4	99359.8	1.6
Serially Managed Companies	565344.6	5.2	226085.4	3.6
Highly Influential Companies	48784.6	0.5	2063734.0	32.7
Totals	10789008.6	100.0	6321070.4	100.0

Source: Duan, Yalin 2001.

net credit balance of listed companies with their affiliates in 1999 and 2000.

Here the top three debtors—parent companies, affiliates with same parent and subsidiaries—occupied the majority of credit issued by listed companies, despite the fact that credit transactions seemed to be expanding and diffusing to “influential companies” outside the

[12] Net Credit balance is the difference between the sum of assets (cash, money due on account, other yet received income, prepayments, dividend and interest income) and the sum of debts (money paid on account, unpaid bills of exchange, advances, other payables, dividend and interest payments).

parent-subsidiary loop.

What is important for the discussion here is that parent companies enjoy the largest share of listed company's net credit, again reflecting a transaction structure characterized by very close relationships both between listed companies and their affiliates and within enterprise groups. This can also be called interdependency, but in general, parents (controlling shareholders) and other affiliates rely on listed companies to supply them with capital funds.

3. Owner-Manager Integration Seen Form Profit Distribution

One characteristic feature of how profits of listed companies in China were distributed during the 1990s was the adoption of a no-dividend payment policy in many cases, as shown in Table 10.

While the Table indicates some fluctuation from 1994 on, the majority of the companies listed chose not to distribute their profits by means of dividend payments, and this practice was on the increase up to 1999. In addition, the fact that cash and stock divi-

Table 10 Forms of Dividend Payment Among Listed Companies: 1992-99

(Company, %)

		1992	1993	1994	1995	1996	1997	1998	1999
Cash Dividends		14	54	135	103	129	185	218	254
	%	26.4	29.5	44.4	28.8	24.3	24.8	25.9	26.8
Stock Dividends		26	63	47	86	192	133	112	58
	%	49.1	34.4	16.1	24.1	36.2	17.8	13.3	6.1
Cash/Stock Dividends		25	93	98	70	46	35	32	31
	%	47.2	50.8	32.2	19.6	8.7	4.7	3.8	3.3
No Dividends		15	24	24	77	139	374	485	556
	%	28.3	13.1	8.2	23.8	26.2	50.2	57.0	58.7
No. of Companies		53	183	304	357	530	745	840	947

Source: Lan, Faqin 2001, pp. 125-126.

dends were being purposely restricted is proven by Table 11, in which only 10% of the companies were unable to pay dividends due to operating in the red; that is, the overwhelming majority could have paid dividends if they so desired.

They chose rather to issue additional stock assigned to shareholders along with a no-dividend payment policy, thus retaining surplus cash and expanding capital within the group [Kawai 2001]. This is another practice that family-owned and run enterprises in Japan have in common with listed companies in China. Since many listed companies were still in their formation or growth stages during the 1990s, there was a tendency to look toward the long-run in developing and expanding scale and give priority to accumulating surplus profits internally instead of paying out dividends to their sharehold-

Table 11 Profits Earned by Companies No Paying Dividends

		1998		1999	
Profit and Loss	Companies Suffering Losses	75	16.7	27	10.1
	Companies Breaking Even	6	1.3	0	0
	Companies Earning Profits	369	82.0	241	89.9
Profit per Share(yuan)	Over 0.4 Yuan	17	3.8	39	14.5
	Over 0.3 to 0.4 Yuan	34	7.6	36	13.4
	Over 0.2 to 0.3 Yuan	45	10.0	70	26.1
	Over 0.1 to 0.2 Yuan	94	20.9	47	17.5
	0.0 to 0.1 Yuan	34	7.6	49	18.3
Capital Increase by Allotting Shares to Shareholders	Allotted shares with No Dividents	111	24.7		
	No Allotted, No Dividents	339	75.3		
No. of Companies With No Dividends		450	100%	268	100%

Source: 1998 data from Shanghai Securities Daily,11 May 1999; partial 1999 data from China Securities Daily, 29 April 2000. 1999 data shows part of listed companies.

ers. They also chose to issue additional stock assigned to shareholders, which is an inexpensive way of procuring large blocks of capital funds.

This choice of how to distribute profits was strongly supported by controlling shareholders, who completely agreed with their managers that priority should be given to the sustained growth of their listed companies. Proposals presented on the subject by boards of directors were overwhelmingly (often unanimously) accepted at shareholders' meetings. This was only rational for controlling shareholders from parent companies who considered their listed companies as "cash dispensers," into which all of their profits would be retained as sources of capital for long-term growth with no-dividend payment policy. On the other hand, there is no doubt that the no-dividend policy both hurt the interests of smaller, general stockholders and stunted the development of capital markets. These shareholders did have the right to take legal action and demand reparations, but there are very few cases of such litigation being filed. This is because most of these shareholders (especially individual investors) were interested more in the possibility of short term capital gains in stock price fluctuation than receiving dividends.

V. Summary and Prospect

1. Summary

In the above discussion I think we have amply shown that the overwhelming majority of companies listed on the Chinese stock exchanges have boards of directors on which sit many representatives dispatched by their parent companies-cum-controlling shareholders and also have managerial staffs with many members that formerly worked at their parent companies, leading us to conclude that most listed companies in China are controlled by the managerial resources of their parent companies in the public enterprise sector and form relationships so close as to border on the formation of a single unified entity. In short, it is parent companies that are the real "insiders" controlling listed companies , and it is in this way that controlling shareholder and insider control overlaps, much like the overlap occurring in family-owned and run enterprises. On the other hand, in the case of shareholder control exercised by government agencies, like SAAB and SAMC, shareholder representation among listed company directors is small and participation in everyday management weak, resulting in almost no overlap between shareholders and insiders and thus a clearer division between ownership by state-owned agencies and management by insiders.

We have also shown that management characterized by shareholder-insiders overlap is very closely related to the interests of parent companies in such aspects as business transactions and profit distribution. As for "internal" transactions with not only parent companies, but with other affiliates as well, we found listed companies functioning as transporters of capital funds to them. On the other hand, listed companies rely on their affiliates as raw material suppliers and product customers, and it cannot be denied that affiliates would also come to the aid of listed companies in danger of failing. Therefore, we should characterize their relationship as interdependent.

We have also seen that management by insider control tends to give priority to increasing capital and investing for expansion through such measures as paying out no dividends in order to retain profits internally, measures that are strongly approved by parent companies. Such measures work to enforce the close ties between listed companies and their parents, and together with transfers of capital in transactions to affiliates and no-dividend policy, form a system of mutual enhancement between the two.

2. New Issue: The Code of Corporate Governance

In January 2002, the China Securities Regulatory Commission (CSRC) and State Economic & Trade Commission jointly issued its code of corporate governance, the first attempt in China to set norms for listed companies. It should be noted that the code was aimed at overcoming the above-mentioned single entity relationship with parent companies and put them on an independent footing. The code focused on five major issues facing listed companies in achieving independence: managerial resources, assets, finance, corporate structure and general business.[13] These codes can also be interpreted as public recognition of the overlapping structure that exists in the cor-

[13] Concerning the drafting and character of these codes, see Kawai 2002b.

porate governance of listed companies discussed in this article. One important issue in the efforts toward independence is how listed companies can break up their single entity managerial and transactional relationships with their parents as efficiently as possible. However, due to existing close interdependent and mutual complementary relationships between the two, merely cutting the ties between them in some mechanical, statutory fashion is by no means desirable.

The overlapping structure of corporate governance has resulted in reducing informational asymmetry and agency costs between listed companies and their affiliates. This same overlap has also kept down the cost of transactions with affiliates in addition to stabilizing them. Moreover, the relationship makes it easier to transfer and reorganize managerial resources efficiently and organize a rational division of labor and cooperation in production and general business operations [Li Minghui 2002]. The aspect of asymmetric profit redistribution within the single entity relationship between parents and subsidiaries discussed here makes it even more difficult to separate the two. In other words, if another framework for a rational relationship to replace the existing one is not articulated, coercive measures threaten to cause both dysfunction and inefficiency on various fronts.

On the other hand, no one can deny that overlapping corporate governance has its drawbacks. For example, the close single entity relationship characterized by principals and their agents poses the possibility of ambiguity in the managerial responsibility of listed company insiders, especially when the principal and agent are the same person as in the meaning of the term "key-man control" [Shanghai Stock Exchange 2000b]. The risk of such ambiguity in the midst of strong overlapping insider control is high. Listed company managers are by no means immune from the moral hazards being posed by their state counterparts.

3. Prospects

Will the overlapping structure of large shareholder and insider control be a temporary or persistent phenomenon in the management of listed companies in China?[14] This depends on a number of conditions. First, there is the degree to which state-owned stock is diffused, which in turn depends on the degree to which China's securities exchanges are deregulated and opened to foreign players. In May 2001, the Chinese government decided to allow the sale of state-owned stock, but due to unanticipated declines in stock prices, was forced to suspend the policy that October, then rescinded it altogether in May of the following year. In November 2002, a decision was made to open a portion of state-issued stock to foreign investors; however, despite such efforts at liberalization, the percentage of state-issued stock owned by top shareholders has not changed, and the percentage occupied by state-issued stock within the total pool has recently been increasing. Therefore, even if the long-term trend is advancing towards the diffusion of stock ownership, there is very little hope for any sudden short-term developments in that direction.

Secondly, the establishment of the State-Owned Assets Supervision and Administration Commission (SASAC) in May 2003 was aimed at the Commission taking on the burden as a powerful owner of large scale state-owned enterprises at the central government level; and similar commissions are in the process of being set up on some local levels. The SOEs earmarked for supervision by SASAC are group companies that control an enterprise group and under whom listed companies exist as subsidiaries and subsidiaries of subsidiaries. One issue facing SASAC is to what extent it will be able to supervise and reform management practices in these group companies; that is to say, change the structure of governance overlap in the management of listed companies for the better. From past experience, neither SAAB nor SAMC possessed the capability to change that structure; the more systematized that structure becomes in determining relationships among affiliates, the more difficult the task of reforming it.

Finally, there is a question of to what extent listed companies will be separated from their state-owned parent enterprises. Even though separation will no doubt progress with the implementation of corporate governance standards, no sudden short-term developments can be expected as long as transactions connecting the two entities need to be reproduced in a systematic manner. Taking into consideration the above three conditions, we can only conclude that the task of dismantling the overlapping structure of corporate governance in China will be completed, if ever, over the long term.

References:

Chinese and English sources;

Duan Yalin. 2001. "Empirical Analysis of Listed Company Capital Utilized by Affiliates." *Zhongguo Zhengjuan Bao* [China Securities Daily], December 14.

Faren Zhili Jiegou Wenjuan Diaocha Ketizu. 2001. "Studies on the Management Structure of Listed Companies: Analysis based on the Results of a Questionnaire Survey of 1124 Listed Companies." In *Zhongguo Zhengquan Shichang Fazhan Qianyan Wenti Yanjiu 2001* [Research on Advanced Issues of Chinese Securities Market Development], vol.1, ed. Ma Qingquan. Chinese Finance Publishing House.

Fei Jiahang. 2003. "Analysis of Trade Between Listed Companies and their Affiliates: 2002." Development Research Center of the State Council.
http://www.drcnet.com.cn/DRCNet.Channel.Web/September4, 2003.

Fu Ruyin, ed. 2003. *Zhongguo Shangshi Gongsi Chengbai Shizheng Yanjiu* [Studies on the Success and Failure of Listed Companies in China]. Fudan University Press.

He Jun. 1998. "Empirical Analysis of the Structure of Listed Company Management." *Jingji Yanjiu* [Economic Research Journal], no.5.

Huang Benyao. 2003. "Management Problems in Trade Between Listed Companies and their Affiliates." *Shenzhen Stock Exchange, General Research Institute Report*. No.0073.

Lan Faqin. 2001. *Zhongguo Shangshi Gongsi Guli Zhengcelun* [*Profit Strategy of Listed Companies in China*]. East China Normal University Press.

Li Minghui. 2002. "Corporate Legal Norms Related to Trading with Affiliates." *Zhongguo Gongye Jingji* [*China Industrial Economy*], no.4.

Li Weian, ed. 2001. *Zhongguo Gongsi Zhili Yuanze yu Guoji Bijiao* [Managerial Principles of Listed Companies in China: An International Comparison]. Chinese Economy and Finance Publishing House.

Lu Tong, ed. 2002. *Corporate Governance Reform: China and the World*. Economic Management Publishing House.

Shanghai Stock Exchange. 2000a. "Results and Analysis of a Questionnaire Survey of Listed Companies." *Shangshi Gongsi* [*Listed Company*], no 12.

------------. 2000b. "Management Policy of Listed Companies (Call for Papers)." November 2000. http://www.se.com/zlzy/htm

Sun Ninghua. 1998. "New Institutional Analysis of the Structure of State-Owned Enterprise Management." *Shanghai Jingji Yanjiu* [Shanghai Economic Research Journal], no.1.

Tam Onkit. 1999. "The Development of Corporate Governance in China." In *Corporate Governance and Enterprise: Reform in China Building the Institutions of Modern Markets*. Edward Elger, Stoyan Tenov, Zhang Chunlin, and Loup Brefort. World Bank and the International Finance Corporation, 2002.

Wang Zhongjie, ed. 2002. *2002nian Shangshi Gongsi Dongshihui Zhili Lanpishu: Xianzhuang,Wenti and Sikao* [2002 Bluebook on the Boards of Directors of Listed Companies: Present Situation, Problems and Analysis]. China Economy Publishing Co.

Wei Gang. 2001. *Zhongguo Shangshi Gongsi Guli Fenpei Wenti Yanjiu* [Studies on Profit Distribution among Listed Companies in China]. North East Finance University Press.

Wu Shukun, and Xi Youmin. 2001. *Gongsi Zhili yu Zongguo Qiye Gaige* [Corporate Management and Enterprise Reform in China]. Machine Industry Publishing Co.

Xia Donglin. 2000. "The Effectiveness of Shareholders' Meetings for Listed Companies in China." *Kuaiji Yanjiu* [*Accounting Research*], no.3.

Xu Gang. 2000. "The Major Forms and Influence of Trade Between Listed Companies and their Affiliates in China." *Shangshi Gongsi* [*Listed Company*], no.9.

Yang Wei. 2002. "Insights into Trade Between Listed Companies and their Affiliates: 2001," *Shangshi Gongsi* [*Listed Company*], no.4.

Yin Desheng. 2000. "Insider Control System in State-Owned Enterprises: Formation, Present State and Future." In *Gongsizhi yu Guoyou Qiye Zaisheng* [*Corporate Institutions and the Revival of State-Owned Enterprises*]. Wan Jieqiu and Zhang Huiming. Fudan University Press.

Zhang Weiying. 1999. *Qiye Lilun yu Zhongguo Qiye Gaige* [Enterprise Theory and Its Reform in China]. Beijing University Press.

Zhu Baoxian and Miu Haiying. 2001. "Introduction to Trade Between Listed Companies and their Affiliates in China." *Jingji Guanli* [Economic Management], no.18.

Japaneses Sources

Imai Kenichi. 2000. "Chinese Problems of Corporate Governance." In *Gendai Chugoku no Kozo Hendo Vol.2* [Structural Change in Contemporary China Vol.2] *Economy: Structural Change and Marketization*, ed. Nakagane Katsuji. Tokyo University Press.

------------. 2001. "Ownership Structure and Corporate Governance in Listed Companies." In *Chugoku Kigyo no Shoyu to Keiei* [Ownership and Management in Chinese Enterprise], ed. Marukawa Tomoo. Institute of Developing Economies.

Kawai Shin'ichi. 2000. "Issues Regarding Corporate Governance of State-Owned Enterprises: The Case of Listed Companies." *Chugoku Keiei Kanri Kenkyu*, no.1.

------------. 2001. "Dividends and the Interests of Shareholders in China's Listed Companies." *Aichi Keiei Ronshu*, no.144.

------------. 2002a. "Insider Control in Chinese Joint Stock Companies." *Aichi Keiei Ronshu*, no.145.

------------. 2002b. "The Drafting of Chinese-Style Corporate Governance Standards." *Keiei Sogo Kagaku*, no.79. Aichi University.

------------. 2003a. "Chinese-Style Corporate Governance: The Managerial Structures of Insider Control." *Ajiya Keiei Kenkyu*, no.9.

------------. 2003b. *Chugoku Jyojyo Kigyo—Naibusha Shihai no Gavanansu* [Companies Listed on the Chinese Stock Exchanges: Corporate Governance by Insiders]. Sodosha.

------------. 2004. "Corporate Governance of Listed Companies in China." *Gendai Chugoku*, no.78.