Chinese Corporate Governance: A Precarious Balancing Act

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As with China's nagging regulatory inabilities in a host of more prominent policy areas, corporate governance has been continually beset by a similar brand of endemic structural obstacles. Legislation has not been scarce. Since 1992 some 300 laws and directives have been centrally adopted to lift Chinese corporate governance law—by letter at least—up onto an international standard. To this end, shareholder rights, director duties, fiduciary responsibilities, performance assessments and transparency requirements have all received some sort of formal codification. While it is difficult to deprecate salutary policy initiatives, intractably antagonistic interests, enforcement inabilities and an absence of political resolve have rendered reform efforts ineffectual.

The Chinese economy, while having undergone a remarkably swift, well executed transition from a centrally planned economy to a primarily market-oriented dynamic, is still plagued by extensive state presence in the corporate arena. Conservatively estimating, well over half the listed companies in Shanghai and Shenzhen are former state-owned enterprises (SOEs) that have been restructured and (semi)-privatized. These firms, however, differ primarily from their socialist antecedents less in terms of the proprietary than with respect to corporate purpose. Whereas the original SOE was intended to fulfill centrally mandated production requirements, today it is oriented to operate profitably. And while a percentage of shares are publicly tradable, the great majority remain government controlled (though after encouraging 2005 reforms, now increasingly tradable). Zhou and Cheung estimate that government and "legal person" controlled shares accounted for 37% and 28% of total shares respectively in 2002, while public investor shares accounted for about 35%. Even with relatively egalitarian voting rights, government proxies are able to "influence decision making of [the] board of directors easily. "

SOEs, whose inherently awkward governance raises questions—especially in the banking/financial sector—as to fiduciary integrity, further compound and pressurize their governance dilemmas in offering tradable, public shares. Indeed, some have argued that the listing of these state-owed enterprises has effectively precluded any significant value-informed market dynamic and instead created a casino-like speculative venue in which rumors of government asset injections and friendly related-party transactions constitute a frightenly large role in informing market movement. The Mainland bourses today house a widely regarded asset bubble.

Corporate governance concerns are bound to surface. Publicly owned companies beholden primarily to government interests and secondarily to common shareholder interests are unable to practically adopt or execute a governance strategy designed to protect even the most basic firm or private interests (i.e., profitability). 2005 corporate and security reforms, designed to realign the interests of the investor and invested, granted tradable status to a selection of previously non-transferable, non-tradable state shares. While nominally significant, however, faith in the transformative powers of market discipline, the same that has fueled the SOE IPO fad of the last several years, is ultimately misplaced. In a country with shallow capital markets, where the government effectively monopolizes financial intermediation and public officials are politically and economically reliant on directing SOE operations, substantive change—no less than a shift in agency—is not so easily induced. The International Finance Corporation notes that critical management decisions need not necessarily even move through the standard governance structures: "the state will typically exercise its influence through alternative channels…where the institutions of the Party, including the personnel department of the local Party and the Party Committee within the enterprise, provide a well-established and formal structure for decision-making that by–passes the shareholders' meeting and the board of directors. "

The China Securities Regulatory Commission (CSRC) has provided such anemic enforcement of regulations and governance standards that Beijing has encouraged the overseas listing of some companies (notably PetroChina in New York) to ensure quality, sustained compliance and consequently greater access to capital. Flagging enforcement aside, further strengthening the role of the board of directors, especially independent directors, could likely be a worthwhile policy initiative. Talented, principled directors would themselves provide and supplement the kind of decentralized governance enforcement that is scarce today. And because "the board is [often] seen as either a meeting of senior management or as a meeting of major shareholders", directors must embrace their role as fundamentally detached from and a restraint on a company's senior management .

Remnant SOE corporations in China that have publicly equity financed themselves—regularly with spectacular success—risk treading on exceedingly ambiguous moral ground. Should they continue to function as party proxies and heed government directives, they not only betray their fiduciary obligations but also pave the way for potentially seismic market damage. It is the faith in a convergence of interests between firm and investor upon which sound markets are built and until China is able to achieve this unity, problems will persist.