

Minority Shareholder Protection in China's Top 100 Listed Companies [#]

by
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ABSTRACT

Economists such as Rafael La Porta and his colleagues have argued that the legal environment for the protection of minority shareholders and mechanisms for restricting the expropriation of minority shareholders will be important in determining the size and extent of a country's capital markets. In China, the protection of minority shareholders is officially regarded as a major regulatory objective of those responsible for controlling the securities market. This is especially so in regard to Chinese listed companies. In practice, the position of minority shareholders in these companies is not well protected. This article reports on findings from an empirically based study of corporate governance in China's top 100 listed companies. The study examined a broader range of corporate governance issues including the problem of minority shareholder protection. Major challenges in achieving better protection for minority shareholders arise from the size of the majority block holdings held by the State in most Chinese listed companies, the low priority that is in practice given to the protection of minority shareholder interests by controllers (as reflected in the high number of related party transactions), the perceived sense of powerlessness of minority shareholders, the inadequacy of civil remedies that are available under PRC company and securities law to seek to protect minority shareholder interests and the weak position of independent directors in these companies. These challenges are the subject of this article.

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The team undertaking the research was led by Roman Tomasic and Neil Andrews from Victoria University and Jane Fu from Deakin University. Significant support for the project was also provided by project research officers Jenny Jian Rong Fu, Wusheng Zhang and Chenxia Shi as well as by Xinting Jia of the Centre for International Corporate Governance Research.

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1. Introduction:

A country's legal mechanisms for the protection of minority shareholders has been seen by economists as an important indicator of the success of these markets in attracting capital and that "countries with poor investor protections indeed have significantly smaller debt and equity markets."¹ The protection of "minority shareholders"² has largely been a half-hearted project in Chinese corporate governance practice.³ This governance project illustrates the gap that often exists between China's economic "laws in the books" and the "law in action." This is a dichotomy that socio-legal scholars have long pointed to.⁴ In the Chinese context, the limits of the rule of law have been explained by China scholars, such as Stanley Lubman and others, by reference to metaphors (such as that of the "bird in a cage") describing a Chinese legal system of rule by law (rather than the rule of law). Law in China continues to be closely controlled by the State.⁵ This may also be said of the shareholding structure in China's listed companies that in many respects

¹ R La Porta, F Lopez-de-Silanes, A Shleifer and RW Vishny, "Law and Finance", NBER Working Paper 5661, 1993 at p 35. Also see L Porta et al, "Legal Determinants of External Finance", NBER Working Paper 5879, 1997; and R La Porta, F Lopez-de-Silanes and A Shleifer, "Corporate Ownership Around the World", NBER Working Paper 6625, 1998.

² Minority shareholders are generally referred to as "public shareholders" in China; this is to distinguish them from the holders of majority state owned blocks of shares. A distinction should also be made between "public shareholders", who tend to be individuals and "strategic shareholders", who tend to be large foreign corporations with holdings typically of around 5% to 10% (although recent changes have allowed individual foreign banks to acquire up to 20% of Chinese mainland banks and 25% of these holdings can be held by a number of foreign banks). Finally, reference should also be made to foreign institutional investors who have recently been allowed to acquire holdings of domestic "A shares" in Chinese companies under the Qualified Foreign Institutional Investor (QFII) scheme. A distinction should be made between different classes of traded shares that has been used over the last 15 years; this is primarily the distinction between so-called "A shares" and "B shares" (Chinese shares listed for sale in Hong Kong were known as "H shares"). "A shares" were to be traded in Chinese currency and were only available to Chinese citizens; in contrast "B shares" were to be used by Chinese companies as a way of raising hard foreign currency and were traded in US dollars and initially were reserved only for purchase by foreigners, but became available to locals in 2001. However, trading of "B shares" on the Shanghai Stock Exchange accounted for less than a quarter of 1% of local currency shares traded in 2005. The Shanghai Stock Exchange has recently signalled that the distinction between A and B shares may soon be abolished: see further, Bloomberg, "Shanghai B shares reach sell-by date", *The Australian Financial Review* 19 January 2006 at p 16; see further, CE Walters and FJT Howie, *To Get Rich in Glorious: China's Stock Markets in the 80s and 90s*, New York, Palgrave, 2001 and S Green, *China's Stockmarket: A Guide to its Progress, Players and Prospects*, London, The Economist, 2003. This article will however focus primarily upon minority shareholdings in Chinese companies held by individual shareholders.

³ Minority shareholders are poorly protected in a number of countries in East Asia, in addition to China; see further, S Claessens et al, "Expropriation of Minority Shareholders: Evidence from East Asia", available at: <http://ideas.Repec.org/p/wbk/wbrwps/2088.html>. Also see generally, La Porta et al, "Investor Protection and Corporate Governance" available at http://post.economics.harvard.edu/faculty/shleifer/papers/ip_corpgov_paper.pdf.

⁴ See generally, RL Abel, "Law Books and Books About Law", (1973) 26 *Stanford Law Review* 175-228.

⁵ SB Lubman, *Bird in a Cage - Legal Reform in China After Mao*, Stanford, Stanford University Press, 1999; Also see: R Peerenboom, *China's Long March towards Rule of Law*, Cambridge, Cambridge University Press, 2002; and PB Potter, *From Leninist Discipline to Socialist Legalism*, Stanford, Stanford University Press, 2003; and JF Chen et al, *Implementation of Law in the People's Republic of China*, The Hague, Kluwer Law International, 2002.

it is also constrained by ideas that have their roots in the experiences of state owned enterprises and the “cage” of China’s once planned economy.⁶

This gap between rhetoric and reality may be illustrated by the fact that whilst many Chinese companies have adopted the trappings of western companies, (such as the preparation of glossy annual reports, the use of articulate corporate investor relations and communications departments and campus like corporate headquarters), their corporate governance practices often leave much to be desired.⁷

Some Regulatory Rules on Minority Shareholder Protection: PRC corporate regulators and Stock Exchange officials often speak optimistically about the importance of minority shareholder protection, whilst acknowledging that there are significant hurdles that face minority shareholders seeking to assert their rights within the current corporate system.

For example, Chapter 1 of the *Code of Corporate Governance for Listed Companies in China* issued in 2001 by the China Securities Regulatory Commission (CSRC) proclaims the following general principles regarding the protection of minority shareholders in listed companies:

- “1.A listed company shall establish a corporate governance structure sufficient for ensuring the full exercise of shareholders’ rights.
2. The corporate governance structure of a company shall ensure fair treatment toward all shareholders, especially minority shareholders. All shareholders are to enjoy equal rights and to bear the corresponding duties based on the shares they hold.
3. Shareholders shall have the right to know about and the right to participate in major matters of the company set forth in the laws....
4. Shareholders shall have the right to protect their interests and rights through civil litigation or other legal means in accordance with laws and administrative regulations....”

⁶ In this regard, see further, Jin-Qian Qiu, *Ownership Structure, Corporate Governance, and Institutional Shareholders: The Case of Chinese Listed Companies*, Beijing, Law Press, 2005.

⁷ A comprehensive discussion of these corporate governance practices is beyond the scope of this short article, but reference can be made to longer studies such as those by the Shanghai Stock Exchange, the Chinese Academy of Social Sciences (CASS), the World Bank and ratings agency, Standards and Poor: See for example, T Lu and S Cheung, *Corporate Governance Assessment: Report on Top 100 Chinese Listed Companies in 2004*, Beijing, Chinese Centre for Corporate Governance, Chinese Academy of Social Sciences; 2005; S Tenev et al, *Corporate Governance and Enterprise Reform in China*, World Bank and IFC, Washington DC 2002; and also see International Finance Corporation, “Step by Step: Corporate Governance Models in China: The Experience of the International Finance Corporation”; In this report, IFC noted (at p 17) that: “The legacy of a state dominated economy has provided few rules or guidelines to support businesses that are accountable and transparent to private shareholders.” This paper is available at [http://www.ifc.org/ifcext/home.nsf/AttachmentsByTitle/Governance_Pub/\\$FILE/Step+by+Step+FINA_L.pdf](http://www.ifc.org/ifcext/home.nsf/AttachmentsByTitle/Governance_Pub/$FILE/Step+by+Step+FINA_L.pdf). A Standards & Poor corporate governance country study of China is also illuminating: see K Tai, “China”, (pp 439-458) in G Dallas (Ed), *Governance and Risk*, New York, McGraw Hill, 2004. Also see, CA Schipani and J Liu, “Corporate Governance in China: Then and Now”, (2002) *Columbia Business Law Review* 1; S Shi and D Weisert, “Corporate Governance with Chinese Characteristics”, *The China Business Review* 2002, available at <http://www.chinabusinessreview.com/public/0209/shi.ktml>.

In regard to the dangers of abuse of power by dominant shareholders in China's listed companies, the CSRC Code goes on to provide that:

“19.The controlling shareholders owe a duty of good faith toward the listed company and other shareholders. The controlling shareholders of a listed company shall strictly comply with laws and regulations while exercising their rights as investors, and shall be prevented from damaging the listed company's or other shareholders' legal rights and interests, through means such as assets restructuring, or from taking advantage of their privileged position to gain additional benefit.”

Implicit in this effort to protect minority shareholders is a clear response to the kinds of problems that are widespread within the Chinese securities market. Concern with problems of this kind has been echoed in the many guidelines issued by the Commission, as well as by Chinese Stock Exchange Listing Rules. In addition, in a 2003 report on China's corporate governance problems, the Shanghai Stock Exchange concluded that:

“[The]..shareholding structure of Chinese companies is problematic. First, the institution for implementing state shareholder's rights is unsatisfactory. Either the government exerts too much influence on listed companies and the company's objective is affected by political considerations, or there is a lack of monitoring on the shareholders, resulting in insider control in the form of misuse of company assets and [pursuit] of private objectives.”

This research report went on to criticise the prevalence of related party transactions and the excessive concentration of management, which affected the capacity to effectively monitor managers. It also pointed out that minority shareholders or “public shareholders have no direct role in corporate governance.”⁸ It is not surprising therefore that public or minority shareholders in PRC listed companies adopted investment strategies that are widely seen as being essentially short term and speculative in nature; this is probably the only rational strategy available to them given their lack of capacity to affect decision making within listed companies.

Some formal legal rules on minority shareholder protection: Turning from regulatory rules and guidelines, China's more formal corporate and securities laws have also increasingly referred to the importance of protecting shareholders, including minority shareholders. For example, Article 1 of the PRC Company Law (as amended in October 2005) provides that this Law was enacted in order to “protect the legitimate rights and interests of companies, shareholders and creditors...” Further, Art 4 of the Company Law provides that the “shareholders of a company shall, according to law, enjoy such rights of owners as benefiting from assets of the company, making major decisions and selecting managerial personnel.”

The PRC Company Law goes on to provide various legal remedies that are available to shareholders who may have suffered at the hands of management, such as the new Art 153 which allows shareholders to bring group actions before the people's court

⁸ Shanghai Stock Exchange, *China Corporate Governance Report 2003 – Executive Summary*, p 8, available at <http://72.14.203.104/search?q=cache:ZzgLI8VlvOJ:rru.worldbank.org/Discussions/O> .

where damage has been caused “to the interests of any shareholders of the company” by any illegal action by a director or senior officer of the company.⁹ This provision follows Art 150, which states: “If the directors, supervisors and senior executives violate the laws, administrative regulations or the articles of association of the company in performance of their functions and thus cause loss to the company, they shall be liable for compensation.”

How these new provisions will work to protect the interests of minority shareholders is far from clear, given the short term horizons of such shareholders and the low levels of expertise of Chinese courts in dealing with such cases, let alone the problems of proof that need to be dealt with in bringing such civil cases. The limited scope for effective civil litigation against directors and controlling shareholders in securities fraud cases in China has been well documented. For example, writing in 2004, Naomi Li and Stephen Green found that over 1000 civil actions have been filed against some 14 companies in China, but they noted “most remain in legal limbo with courts refusing to make judgement, and none having been settled by a court judgement in favour of the investors.”

They went on to argue that reasons for this failure in the legal process included the very narrow legal requirements for establishing a causal link between losses suffered by an investor and the false statements made by a company that led to the losses; they also attribute failures to the unwillingness of local courts to hear cases of this kind because the companies involved in them often enjoyed the protection of local government.¹⁰ The PRC Supreme People’s Court also imposed some restrictive procedures on plaintiff’s seeking to bring civil actions against directors or the listed company, which made actions without the approval of the CSRC very difficult.¹¹ Improved company law provisions will not necessarily easily change the social and political dimensions of civil litigation in the Chinese court system.¹²

The PRC Company Law also provides various opportunities to shareholders to participate in the corporate governance of the company, such as through the shareholders meeting (Arts 37 ff); the limited rights of shareholders to inspect company books (Art 34); and, through independent directors who have recently been given legal status (by Art 123) and particular responsibilities to protect the interests of

⁹ This has not worked well in the past and we have yet to see if these new provisions are any more effective; See further, PRC Supreme People’s Court, “Some Provisions of Supreme People’s Court on Trying Cases Involving False Statements Related to Securities Market”, (Effective 1st February 2003); B Hu, “On Civil Compensation in Securities Law Violations – in the perspective of the company law and the securities law”, available at <http://www.cipe.org/printerfriendly/printpage.php>.

¹⁰ N Li and S Green, “Civil Litigation against China’s listed firms: Much ado about nothing?”, Asia Program Working Paper No 13, The Royal Institute of International Affairs, London, 2004 at p 2.

¹¹ See Baihai Hu, “On Civil Compensation in Securities Law Violations – in the perspective of the company law and the securities law”, Centre for International Private Enterprise, available at <http://www.cipe.org/china/civil.htm>; Announcement of the Supreme People’s Court of People’s Republic of China, “Some Provisions of Supreme People’s Court on Trying Cases Involving False Statements Related to Securities Market”, available on web site of Lehman, Lee & Lu, http://www.lehmanlaw.com/lib/library/Laws_regulations/civil/some_market2002.htm.

¹² See generally, DC Clarke, “Power and Politics in the Chinese Court System: The Execution of Civil Judgments”, (1996) 10 *Columbia Journal of Asian Law* 6-15. For a general discussion of the problem of local corruption and its impact on the market economy see further: Yan Sun, *Corruption and Market in Contemporary China*, Ithaca, Cornell University Press, 2004.

minority shareholders.¹³ However, independent directors tend to be appointed by majority shareholders and are beholden to them; and, despite new regulations strengthening their position, they may be readily dismissed and therefore are a weak mechanism for protecting minority shareholders.¹⁴

It should be noted that the 1998 PRC Securities Law was also amended in October 2005. It also contains some very general principles that seek to protect the interests of all investors in listed companies. For example, Art 4 of the Securities Law speaks of the parties involved in the issuing and trading in securities having “equal status” and having to adhere to “the principles of voluntariness, compensation and good faith.” Art 15 also provides that unless otherwise approved by the general meeting of shareholders, funds raised by the company through the issue of shares must be used for the purposes set out in the prospectus; this provision responds to a common practice of listed companies raising funds for a particular stated purpose and then using these shareholder funds for quite different purposes.

Art 20 of the Securities Law requires that any documents prepared for the issue of securities must be “truthful, accurate and complete.” One of the most common problems in the listing of Chinese companies has been the use of inaccurate or fabricated information to support the listing or share issue, such as the use of false company accounts. Public shareholders obviously suffer from practices such as these. The Securities Law also contains a number of provisions (Arts 73-76) regarding insider trading by such persons as directors and senior executives of the company; insider trading is obviously more likely to benefit corporate controllers and insiders and outsiders, such as public shareholders. The Law deals with other securities market offences; these include the manipulation of the securities market (Art 77), and the fabrication or dissemination of false information (Art 78).

Securities Law penalties for manipulating the securities market include the disposal of the illegally gained securities and the confiscation of illegal gains as well as the giving of a disciplinary warning to the person directly in charge and the person responsible for the manipulation (art 203). No provision is made for the payment of damages to those who have suffered as a result of the securities manipulation (although, as we have seen, the Company Law does contain some compensation related provisions). A number of other provisions of the Securities Law refer to failures by controlling shareholders (eg Art 71, Art 150(6) and Art 214), but these may not be of much assistance to minority shareholders.

¹³ For example, in the event of the provision of guarantees by the company to its major shareholders or controllers, these guarantees must be approved by the remaining (minority) shareholders in a general meeting (Article 16). See however, S Sibao and J Jia, “Will the Independent Director Institution Work in China ?”, (2005) 27 *Loyola LA International & Comparative Law Review* 223. Also see CSRC’s earlier Guidelines requiring listed companies to appoint independent directors: CSRC, *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, Issued 16 August 2001 and available at <http://www.csrc.gov.cn/CSRCSite/eng/edeplt/frz10242902.htm>. And CSRC, *Several Provisions on Strengthening Protection of Rights and Interests of Public Shareholders*, Issued 7 December 2004 (Isinolaw Reference ID 231: 2008427).

¹⁴ The CSRC has issued various guidelines and policy papers dealing with independent directors: CSRC, *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies* issued 16 August 2001 See further T Lu, “Defects in China’s Independent Director System: A Case Study of Leshan Power Company”, available at: http://www.iwep.org.cn/pdf/2005/Defects_in_China's_Independent_Director_System_TongLu.pdf.

However, based on fieldwork with regulators and officers from China's top 100 listed public companies, the actual position of minority shareholders is much weaker than either government rhetoric or legal rules would suggest. This article will illustrate this by reference to data derived from face to face interviews conducted by the authors. Before going on to discuss the findings from this fieldwork, a brief mention of our methodology should be made.

2. A brief note on methodology

With funding from the Australian Research Council, face-to-face interviews were conducted with 108 informants in nine cities across China during 2003 and 2004; the interviewees included senior officers from China's top 100 listed companies, independent directors, accountants and lawyers, as well as regulatory officials from the CSRC and the various Chinese stock exchanges.

Roman Tomasic and Neil Andrews were directly involved in most of the interviews that were conducted for the project and were accompanied by one or other of the Chinese-speaking colleagues associated with the project; this included Jane Fu, Jenny Jian Rong Fu, Xinting Jia and Wusheng Zhang.

Table 1 sets out details of the locations of interviewees visited and the types of persons who participated in the interviews conducted for this study. The research utilised a composite listing of the top 100 PRC listed companies as reported in the Fortune magazine since 2002. Companies located in cities in relatively remote areas or in cities in which only one top 100 listed company was based, were excluded from the interview sample for logistical reasons

In addition to this fieldwork data, we also looked at other published material relevant to the relationship between corporate governance and the subject of this article. This included an array of legal rules and regulations, company annual reports, academic and official studies and media discussions of corporate transparency and disclosure in China and more widely. About 20 questions from our interviews dealt with various minority shareholder issues.

Table 1: PRC Top 100 Listed Companies - Project Interviews				
<i>City</i>	<i>Listed Companies</i>	<i>Professionals, Academics and Independent Directors</i>	<i>Regulators</i>	<i>Subtotal</i>
Beijing	17	12	3	32
Shanghai	19	8	5	32
Hong Kong	7	7	6	20
Shenzhen	7		3	10

Qingdao	4			4
Jinan	3			3
Chongqing	2			2
Nanjing	2			2
Guangzhou	2		1	3
Subtotal	63	27	18	108

3 Who are the Major Stakeholders in China's Listed Companies ?

During the course of our interviews we asked our informants to seek to rank the most important stakeholders in Chinese listed companies, especially where the companies were largely owned by the State.¹⁵ It was rare for the minority or public shareholders to be seen as the most important stakeholders, although one academic company lawyer in Beijing who expressed this progressive view also acknowledged that they were in “a difficult position” in China. A picture of a range of dominant stakeholders was provided by a senior company officer in Guangzhou when he noted that:

“Depending on the nature of the majority shareholder, companies have different stakeholders. For the State-owned companies, the State will be the primary stakeholder. Sometimes, the government may want a State-owned company to take up certain projects...The stakeholders in non-State owned companies are more complicated...But I think that the majority of directors in non-State owned companies will not be engaged in activities that damage the company's interests.”

An even starker picture of the range of stakeholders in PRC listed companies was provided by a very senior former regulator who saw dominant stakeholders as being:

“The Party, the government, their employees and their shareholders (in that order).”¹⁶

A more common and simpler response to the dominant stakeholder question emphasised the dominance of major shareholders (usually State-owned) and included the following expressions of this view:

- “In theory, the interests of all shareholders should be put first, but in practice, of course the majority shareholders get priority”(Senior banking executive, Beijing);

¹⁵ Question 8: "In regard to PRC listed companies, what would you see as being their most important stakeholders (from most important to least)?"

¹⁶ The emphasis on the import role of the Chinese Communist Party was stressed in answers to other questions. The Party's role is central within most listed Chinese companies and Art 19 of the Company Law (as amended in 2005) provides that “In accordance with the Constitution of the Communist Party of China, the organization of the Communist Party of China shall be established in a company so as to carry out the activities of the Communist Party. The company shall provide its communist organization with conditions necessary for carrying out its activities.” It is often the case that the Chairman of the company is also the Party Secretary of the local Communist Party branch within the company, effectively fusing managerial and political control in one office. This at least creates some stability, but it concentrates power without the kinds of checks and balances that may be of assistance to minority shareholders.

- “The majority shareholder should be the most important” (steel company executive, Shandong);
 - “First, the majority shareholder. Then it will vary by reference to the particular situation of each company as to who is next” (accounting academic, Beijing);
 - “Of course, it is the controlling shareholders and then institutional investors. Individual shareholders have a very low interest...” (Company secretary, Beijing);
 - “The priority is given to the majority shareholder or the government...After that, the strategic investors, if any, and then minority shareholders” (accounting partner in international accounting firm, Beijing);
- “For the management, it is important for them to know what the big shareholders want...” (company secretary, technology company, Shenzhen).

Another response to our dominant stakeholder question was to see the government itself as the principal player. This was often merely a rearticulation of the priority given to the dominant State-owned shareholder, but sometimes there were other aspects of government that were important. Commonly expressed statements, which stressed the importance of government as the dominant stakeholder included:

- “For listed companies, the government is the most important stakeholder...The government, as the majority shareholder still holds 50% – 70% of shares in large listed companies and will not decrease its stake in companies operating in areas of nationally strategic significance, such as energy” (Senior oil company executive, Shanghai);
- “The most important stakeholder is the government represented by the parent company” (international accounting firm partner, Beijing);
- “The dominant shareholder is the government in most listed companies...The Chinese government does not want to loose its grip of the companies” (financial journalist, Shanghai);
- “In...a State-owned company, the most important thing is the government. For a company, the lobbying of government is very important...I think that public relations with government are the top priority. It is the common practice for all oil giants. The second most important stakeholder is the shareholder. Government will give you approval to exist and shareholders will approve your development. Originally, employees were the most important [stakeholders]” (Senior oil company executive, Beijing);
- “The most important is the government and then the investors” (senior company officer, Guangzhou);
- “For the public listed companies with large operations in China, firstly it is the government. The senior managers of these companies are still regarded as public servants. Therefore they won’t turn a blind eye to the concerns or wishes of the government department.” (Hong Kong listed mainland company, senior officer).

Some respondents tended to see the above two approaches to the stakeholder question as being closely related. A former senior CSRC official nicely summarised this when he observed that:

“In all former SOEs, [the most important stakeholder] is either the parent company or the parent government (there are various levels of government) who

decide their salary, position and their existence. Otherwise, they are in awe of the regulators. But, they need to give more attention to small shareholders.”

Although employees were once seen as the most important stakeholder in China’s State Owned Enterprises, their interests have not been forgotten in today’s major listed companies. In listed companies their role was often emphasised by interviewees and from a long term perspective was probably seen to be more important than that of minority shareholders. For example, a famous Beijing company law professor summarised a common opinion when he told us that: “the most important stakeholders are the shareholders; the second most important stakeholders may be the employees.” A Shanghai Stock Exchange officer took a similar view when he said: “for State owned companies, it is the government [that is the major stakeholder]; it is hard to generalise as to which is next, probably the employees.”

A traditional view that is still alive and well in some internationally active Chinese listed companies was expressed by the company secretary of one of China’s major automobile companies when he replied: “it is difficult to answer [the question as to who is the most important stakeholder].” He added, “employees love the company.” A Shenzhen Stock Exchange official also echoed this view when he told us “in China, the employees are still seen as the most important stakeholders.” Other important stakeholders that were often mentioned included banks, suppliers, customers and creditors.

4. The State as major shareholder in China’s listed companies

The basic feature of Chinese corporate governance which affects almost all other aspects of governance in China’s top 100 companies is the dominance of the State as the major shareholder. This can be reflected in the ownership of shares that are controlled by the national government through the State-owned Assets Supervision and Administration Commission (SASAC) or through China’s provincial governments. These shares are generally not tradeable, although efforts are beginning to be made on a trial basis by the CSRC and the State Council’s SASAC to seek to split these state owned shares to achieve some degree of transferability of these shares and to address the imbalance that currently exists between the interests of listed company shareholders.¹⁷ However, this reform effort is likely to be a slow process.

It was not unusual for between 60% and 80% of the shares of Chinese listed companies to be state owned, especially in strategic areas. Often such control is

¹⁷ See further, *Guidance Opinions on the Split Share Structure Reform of Listed Companies*, issued by CSRC, SASAC, Ministry of Finance, People’s Bank of China and the Ministry of Commerce on 23 August 2005; and CSRC, *Administrative Measures on the Split Share Structure Reform of Listed Companies*, available at <http://www.csrc.gov.cn/en/jsp/detail.jsp?infoid=1129278662100&type=CMS.STD>. Also see, CSRC “Drafting Notes on the Administrative Measures on the Split Share Structure Reform of Listed Companies (Exposure Draft)” available at <http://www.csrc.gov.cn/en/jsp/detail.jsp?infoid=1129277806100&type=CMS.STD>.

exercised through a wholly state owned enterprise (SOE) out of which the listed company had been spun off. The Shanghai Stock Exchange in 2003 noted that:

“A prominent characteristic of Chinese listed companies is an overwhelmingly large percentage of non-tradeable shares, which represent about 2/3 of all the listed company’s combined equity. The tradeable shares represent the remaining 1/3. A majority of listed company’s non-tradeable shares are 60%-80% of their total number of shares. A few companies have more than 90% shares not tradeable. About 6% of all the listed companies have more than 40% of their total equity in tradeable shares. Only 0.4% of all listed companies have only tradeable shares. On average, the larger the size of the company, the higher the percentage of state shares, which demonstrates that large listed companies are essentially state-owned.”¹⁸

A Shanghai based law professor and legal practitioner expressed a similar point to us when he also noted “most listed companies are dominated by SOEs as their largest shareholder.” He went on to observe that this had deleterious consequences for the quality of accountability in such companies when he said: “In these companies, there is no corporate governance at all and it is meaningless to talk of voting in the boardroom.” This message was to be echoed time and again in our interviews. A Chinese financial journalist provided a broader explanation of this process when she explained that:

“It is important to understand the structure of Chinese companies. They were former SOEs (i.e. enterprises owned by the whole people), but it is hard to run a company by allowing every shareholder to decide what to do. So you need someone to represent the State. But the State is an abstract entity, not a real person. China has been trying to materialise the State shareholder, which is the premise of corporate governance. That is, to put the structure in place and then put people in place to do the job. So far the structure has not been in place. So the question remains, who owns the company; we are talking about corporate governance, but have not tackled the basic problem...”

The consequences of State domination of the share registers of listed companies were explained by a senior officer of a Shanghai based electronics company when he observed that although many listed companies have the State as their major shareholder, “...this structure may only look after the interests of the big shareholders and does not protect minority shareholder interests.” A Chinese commercial lawyer in Shanghai drew similar conclusions when he noted that where a single shareholder controls more than half of the company’s shares, “they pass resolutions at AGMs without the presence of other shareholders and small shareholders have no chance to be involved in corporate governance.”

In a similar vein, a senior executive from a major Chinese oil company also pointed out that whilst his company “was unique” it is a “restructured SOE” with a parent entity. He added “we are much influenced by the parent as a state-owned company,

¹⁸ Shanghai Stock Exchange, *China Corporate Governance Report 2003 – Executive Summary*, p 8, available at <http://72.14.203.104/search?q=cache:ZzgLI8VlvOJ:rru.worldbank.org/Discussions/O>.

so the balance of all interests is very complicated. The drive here is from the largest shareholder/owner of the company.”¹⁹

The governance problem that exists here stems from the basic duality in the role of the State as major shareholder; as a Shenzhen officer of an electronic goods company pointed out when he noted that such dominant state shareholders “wear two hats: firstly, making profits and secondly, protecting state assets.” This echoed views expressed by the Shanghai Stock Exchange when it observed in a 2003 report that the State was both the referee (as the lawmaker and regulator) as well as a player (as the dominant shareholder in listed companies).

The Stock Exchange added that this created problems within companies as “the state as owner of the state-owned enterprises influences business decisions through several departments of the government. Inevitably the government will use administrative measures to directly affect business decisions and burden these enterprises with public functions.”²⁰ This is obviously not in the best interests of minority shareholders.

Another dualism that was seen to affect Chinese listed companies led to a degree of timidity upon the part of management. A former CSRC official explained this corporate governance problem as follows:

“The main concerns are two-fold: They do not want to get into trouble with government and do not want to get into trouble with shareholders. They get fired if they get into trouble with either. This is the bottom-line for all of them.”

A Beijing based academic commercial lawyer pointed to another subtle aspect of the dualism inherent in having a dominant state owned shareholding in a listed company when he said of such companies that as owners they were both “very strong as well as being very weak.” This was because as representatives of the state the dominant shareholder was a government official; however, this created a clash between their roles as government official and their role as corporate officers. A Shanghai based business lawyer made a similar point when he observed that in China “state owned enterprises have traditionally had a deep sense of responsibility and accountability to the government; their difficulty is with accountability to public shareholders.”

Not surprisingly, some even thought that listed companies that were dominated by the State as shareholder were not far removed from their controllers. As one Shanghai company secretary noted of such companies, “these companies can be seen as part of government departments and not companies in a real sense. They do not have the internal force to apply corporate governance principles [in contrast to privately controlled companies].”

In regard to the shareholders, the interests of the dominant shareholder were invariably seen as taking priority in such situations.²¹ A Shanghai based listed

¹⁹ Some similar comments made by other interviewees included the following: “There is a lot of tension between the majority shareholders and minority shareholders and the interests of the controlling shareholder may outweigh the interests of others” (Hong Kong based regulator).

²⁰ Shanghai Stock Exchange, *China Corporate Governance Report 2003 – Executive Summary*, p 9, available at <http://72.14.203.104/search?q=cache:ZzgLI8VlvOJ:rru.worldbank.org/Discussions/O>

²¹ Chinese commentators have long pointed to the difficulties that Chinese listed companies have with dealing with related party transactions, despite the existence of “bright line rules” in regard to these

company officer bluntly described this situation when he said: “big shareholders still decide everything.” As a government official in Shenzhen also told us:

“About 75% of listed companies have one dominant shareholder. This results in the dominant shareholder appointing directors to look after its interests. In terms of shareholder return, if there is a conflict of interest between the dominant shareholder and the minority shareholders, the interests of the dominant shareholder will be looked after first.”

This inevitably leads to some damage being caused to the interests of minority shareholders. As one company secretary in Shanghai told us, “in practice, the majority shareholders still engage in conduct that may damage the interests of minority shareholders.” Such damage is commonly caused by way of the large number of (often unfair) related party transactions that occur between listed companies and their related or controlling entities.

A Shanghai based audit partner in an international accounting firm noted that related party transactions were “a serious problem” in China’s listed companies. Similarly, a Shanghai based regulator observed that whilst directors were aware of the rules in relation to such transactions, he added: “we often see related party transactions that are obviously unfair to minority shareholders.” He explained that this could occur in a number of ways:

“Sometimes, the parent company offers a low price to the listed company for its purchase of assets from the parent company. On the other hand, the parent company may abuse its power to siphon funds from the listed company.”

This official added that it was often hard to identify these transactions as the listed company had “gone through the relevant procedures” of seeking internal approval for the suspect transaction. A senior CSRC official in Southern China noted that “connected transactions are a big problem for listed companies” in China. A Shanghai Stock Exchange official also noted that whilst directors probably knew whether a related party transaction was fair and in the interests of the shareholders, he added, “it is another issue whether they will object to related party transactions due to the influence of the parent company. Directors are not truly independent.” This was especially so when the listed company was dealing with a transaction involving a parent rather than a subsidiary company; as a Shandong based company officer told us in this regard:

“There is big pressure from the majority shareholder, as the Chairman is nominated by the majority shareholder. It is easier for the listed company to deal with its subsidiary company than its parent [when related party transactions were involved].”

kinds of transactions. For example, Professor Tong Lu, Director of the Centre for Corporate Governance at the China Academy of Social Sciences, has noted that control of Chinese listed companies by “insiders” has meant that “[t]his governance structure enable holding shareholders to cause large numbers of connected deals to take place between a listed company and themselves by manipulating the shareholders general meeting and the board, at the expense of the interests of the company and medium-sized and small-shareholders.” See further, T Lu, “Corporate Governance in China”, at p 1, available at <http://www.iwep.org.cn/cccg/en/publications.htm>. (accessed 10 June 2005).

It is easy to excuse the imbalance of power between the State as dominant shareholder and the relatively powerless minority or public shareholders by pointing to the “transitional” state of the Chinese economy. This explanation only takes us so far as there are some basic structural features that inhibit a progress toward giving minority shareholder more power. Thus, the Shanghai Stock Exchange has noted in a 2003 research report that: “in a transition economy, the government’s dual role of being both a regulator and a shareholder of state enterprises is inevitable. The misplaced government position in corporate governance is having an adverse impact on its development...”

The Stock Exchange went on to suggest various reforms, including the following:

First, the scale of state assets should be downsized...If the government is a controlling shareholder, the board meeting is likely dominated by a single shareholder...

Secondly, regulator and shareholder must be separate entities. Otherwise, the role of shareholder will inevitably be scattered among many government organizations. Everyone can intervene in the business operations and none is willing to take responsibilities...

Thirdly, the market mechanism should be fully utilized and the administrative interventions [of the State] should be minimized...When the government stops being both player and referee, the market mechanism will begin to take a role in corporate governance at a larger scale and with profound impact.

Fourthly, the new [State] asset management organization should confine its role to ownership. As representative of state assets, it must exercise shareholder rights according to corporate law and not by direct intervention in the business..."²²

Beyond official bodies like the Stock Exchange, there is a widespread recognition of a need for change, as was admitted by a senior Chinese steel company executive when she told us that "shareholders now want to play a more important role in the appointment of board members, etc."

Another major constraint on the movement to achieve a better balance between the shareholders of Chinese listed companies is attitudinal or cultural in nature. This goes beyond the adoption of modern legal rules and corporate governance structures. As one leading corporate lawyer in charge of a Chinese law firm explained: "the controlling shareholder or the CEO has the power; they can always find a chance to use their powers for themselves."

So, while the system, laws and regulations are important, the most important thing is their spirit." In companies with dominant state-owned shareholders, the State representatives were reluctant to see their position diminished; as a Hong Kong based officer of a mainland company observed: "it is hard for the State to become the 2nd or 3rd largest shareholder, although this might improve the situation of other shareholders." Other company executives confirmed that this might be so where the size of state-owned shareholding in a listed company was lower than usual.

5. Some governance effects of the State as dominant shareholder

We sought to tease out some of the implications for corporate governance in Chinese listed companies of having the State as the dominant shareholder.²³ Some of these effects have already been referred to above. In listed companies whose share register is dominated by a majority State shareholder, the State will have a considerable

²² Shanghai Stock Exchange, *China Corporate Governance Report 2003 – Executive Summary*, p 15, available at <http://72.14.203.104/search?q=cache:ZzgLI8VlvOJ:rru.worldbank.org/Discussions/O>

²³ Question 17 asked "It is well known that the State is a dominant shareholder in PRC listed companies. How, if at all, do you see this as affecting corporate governance practices in these companies?"

influence upon the composition of the Board and the appointment of the Chairman. This is usually undertaken through the personnel management role of the Communist Party Committee within each company.²⁴

The dominance of the Chinese Communist Party: The Central Committee of the Communist Party has declared that “[t]o meet the needs of a modern enterprise system and to survive and grow amidst fierce competition, SOEs must build a contingent of highly qualified managers and nurture a large number of skilled entrepreneurs. The Party must manage and supervise its SOE cadres.”²⁵ The Central Committee also highlighted the central role of the party in China’s socialist market economy:

“Strengthening and improving the Party leadership is the fundamental guarantee for speeding up the reform and development of SOEs. To manage well SOEs in general, efforts must be made to establish a leadership system and organisational and managerial system in them that conforms to the law of the market economy and China’s actual situation, to strengthen the building of their leadership, and to adhere to the principle of relying on the working class wholeheartedly.”²⁶

The central role of the Party in Chinese listed companies has recently been strengthened in the 2005 amendments to the PRC Company Law.²⁷

Deferring to the majority shareholder before making major decisions: Another consequence of having the State as the dominant shareholder is that the Board of a listed company will be unlikely to make a major decision before this has been cleared with its majority shareholder. For example, a Beijing based company officer from a transport company therefore noted that the State as the majority shareholder in a listed company “will have a great influence on corporate governance of the company.” He added that:

“If the board wants to make a decision, it will first contact the parent company. This is normal in China as the parent company will have full control of the listed company.”

A company secretary in another Beijing based top 100 company expressed a similar view when he observed that:

²⁴ The Communist Party’s concern with increasing the quality of management personnel in state owned enterprises is well known and this concern clearly extends to majority state owned listed companies; see further, “*The Decision of the Central Committee of the Communist Party of China on Major Issues Concerning the Reform and Development of State-Owned Enterprises*”, Adopted at the Fourth Plenum of the 15th CPC Central Committee on September 22, 1999.

²⁵ Ibid at p 9.

²⁶ Ibid at p 9. However, it has been said that the Party has long had difficulties in dealing with corrupt practices involving its members: see further, X Lu, *Cadres and Corruption – The Organizational Involvement of the Chinese Communist Party*, Stanford, Stanford University Press, 2000. But see also, BJ Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change*, Cambridge, Cambridge University Press, 2003.

²⁷ Art 19 of the 2005 version of the Company Law (amended in October 2005) is much stronger than the equivalent provision (Art 17) of the 1993 version

“Directors of listed companies will first check with controlling shareholders. This is the biggest problem with State-owned listed companies. In most of these companies, the government appoints the Chairman and senior management, so they are very careful about issues relating to the government or controlling shareholders. This will badly affect corporate governance in China.”

These were commonly expressed views that were put to us by many company officers. A Beijing based Chinese partner in an international accounting firm similarly noted that:

“With major decisions the board will often say that they have to take the interests of their parent company into account as the next move in their career will depend on how they perform and the judgement made by the parent company of their performance. It is common to see a Chairman going on to become a senior official.”

It would be rare for minority shareholders to be treated in this way, although so-called “independent directors,” who theoretically are appointed to protect minority shareholder interests, must approve related party transactions with a parent company. A Beijing based senior oil company executive expressed a very even handed view when he said that:

“When the listed company makes a major decision, the parent company is of course interested, but the parent company and our company must not make decisions which damage the interests of minority shareholders.”

However, this is a somewhat theoretical view as the more common view negated the extent to which minority shareholder interests were in reality protected. This was because of the very close identification that often exists between company management and the parent company. As a Hong Kong based shareholder advocate observed “the senior management [of listed companies] and the controlling shareholder operate as one. They are usually located in the same premises and the listed company is seen as a way to attract funds for the group [within which the listed company is located].” The internal capital market that exists within Chinese corporate groups encourages such transfers from the listed companies in the group.²⁸

Different types of interference by the State as owner: It should be noted that the Chinese State is not monolithic and in fact operates differently at the national and at the local level; with much more direct interference in the company’s affairs occurring at the local level. For example, a Shanghai based secretary of a technology company characteristically noted “local governments may use their status as State shareholders to manipulate companies.” Another Beijing based legal observer noted whilst

“At the central level, the government has loose control of its holding companies as the holding companies are too big and no one can gain advantage from them. [But] at the local level, local government interferes more in holding companies.”

²⁸ See further, M Zhong and C Lin, “The ownership structure and internal capital market in Chinese business group affiliations of listed corporations.” (2004) 17 *Aust Jnl of Corp Law* 33-47.

Some local governments have a reputation for being less interventionist than others. For example, in Qingdao one company secretary noted that “the Qingdao government is very open and never interferes in the governance of our company; [adding however that] the chairman is appointed by the government.” Perhaps the Qingdao government is more progressive than many other local governments in such matters. Often it is a matter of the amount of money involved in a decision. As a Shanghai based company officer explained: “if a proposed investment exceeds US \$300 million, the board has to consult the Shanghai City government; if the investment exceeds US \$ 1 billion, the central government has to be consulted.”

Another such variation in the nature of outside interference was explained by a Nanjing based company officer who observed that:

“There are two types of state-owned listed companies in China. Among the first type, the company is controlled by a parent (holding) company, and in such cases, the control exercised by the parent is usually very tight. Among the second type, the majority shares of the listed company are held by a State assets management (operational) company. In this case, the asset management company may nominate members to the company board. However, as the government nominees do not quite understand the business of the listed company, they usually do not interfere much with the decisions of internal directors.”

A Beijing based officer of the CSRC and a staff member of the Shanghai Stock Exchange confirmed this hands off approach of state assets administrators. In their experience state assets administrators acted more like regulators than owners.

The “key-man” problem in Chinese corporate governance: Interference into the affairs of the company by a dominant shareholder will be less likely to occur where there is a strong company chairman, who will often also be the Party Secretary in the company. As a senior company officer in Guangzhou explained: “the key man in corporate governance of the company is the Chairman; if he plays his role, the State will not interfere.” This “key man” model was seen as “the traditional Chinese model” of management (by a Shanghai Stock Exchange official).

The power of the company chairman will be enhanced where he or she is also the chairman of the parent company. A company secretary in Shanghai, somewhat tongue in cheek, noted that there was such a situation in his company and that therefore “the parent company does not have to be consulted.” A Shenzhen regulator also noted “in many cases, the dominant shareholder still manages the listed company as an SOE, which is not good for corporate governance.” He added that, in such a situation, “at the general meeting, usually only the dominant shareholder will be voting.” As one corporate governance expert in Hong Kong noted, Chinese listed companies “don’t see it as a priority to get minority shareholders to attend the AGM.”

Probably the key area of on-going external control over the internal affairs of listed companies is in regard to key appointments in the company. As one Stock Exchange official explained:

“The state shareholder interferes too much in HR issues, like the appointment and removal of the CEO. It does not care about commercial operations and profits. In this situation, the CEO just tries to please the government to retain their appointment, rather than to please minority shareholders by achieving good profits.”

In such situations, the Chairman will simply follow the views of the majority shareholder unless they are required by law to consult more widely with other shareholders. However, the fact remains, as a leading Beijing based corporate law commentator remarked, “dominant shareholders are more privileged in accessing [company] information than the minority shareholders.” As another Shanghai based company officer also noted of China’s listed companies, “transparency decreases if the company is controlled by a large shareholder.”

The problems of non-transferable State shares: A serious problem with the dominance of the State as a shareholder in Chinese listed companies is the fact that State-owned shares are generally not transferable. As a former senior CSRC official pointed out, “non-tradeable shares create a type of interest that is different from that attaching to tradeable shares.” Another corporate law authority, a leading Beijing academic, noted that as a result, majority and minority shareholders had different interests. This academic went on to note that “although boards are required by law to look after the interests of all shareholders, but they would in fact look after the interests of majority shareholders more than those of the minority shareholders.”

It is for this reason that the block shareholder interest of the State has appeared so immutable. Another Beijing based commercial law expert noted “when State shares are non-transferable, management expects to be always in control and they see the making of good relations with government officers as being of first importance. Companies always think of how to make government officers happy ..[as].. good relationships mean a more stable position.”

As pointed out above, it should be noted that the Chinese Government has been very conscious of the problem that the non-transferability of State-owned shares has created for listed companies and has sought to slowly introduce a trial program to address this issue.²⁹

It is common for directors of companies in which the State is the dominant shareholder to equate the interests of the dominant shareholder with the long-term interests of the company.³⁰ This is especially so given the relatively short-term horizons of minority shareholders. Indeed, there is often a view that the interests of the majority and the minority shareholders are in conflict. Not surprisingly, with a dominant shareholder, such as occurs in most listed companies, it was frequently stated said, “the directors will look after the interests of that majority more than other shareholders”(as one Shanghai based senior company executive put it).

²⁹ See above note 16.

³⁰ Interviewees were asked the following question: Question 20: “In Australia, directors are required by law to be concerned primarily with the interests of the company as a whole (ie of all shareholders and other interests). Would you say that this occurs where a single shareholder owns 80% or 90% of a listed company’s shares ?”

A Shanghai Stock Exchange official added that directors in such a situation “will take a broader view only when laws are in place to uphold rights of all shareholders, where the State shareholding has been diversified and where the corporate governance culture is more mature.” Changes in legal rules alone will have little effect.

Unless the interests of majority and minority shareholders are aligned, regard will usually only be had by directors of listed companies to the interests of majority shareholders, as a Hong Kong based China corporate governance expert observed. Ultimately, because director in China’s listed companies are usually appointed by the majority shareholder, this will affect their ideas of accountability, as one Stock Exchange official warned when he observed:

“The situation in China is the opposite to that in other countries. In China, directors are nominated by the majority shareholder and represent the interests of the parent company. If there is a conflict between the interests of the listed company and the parent company, they will turn their back on the listed company in favour of the parent company.”

Ultimately, the position of the State as the dominant shareholder in Chinese listed companies has a corrosive effect on the balance that is struck between the differing interests of shareholders, with minority shareholders usually being disadvantaged. Even though the company’s share price is seen to be dependent on the price paid for shares held by public shareholders, and it is seen to be desirable to keep this share price at a favourable level, company directors and management still do not have sufficient incentives to depart from a practice of favouring the shareholder interests associated with the non-transferable State-owned shares. Based on responses to this study, this situation will take some time to change.

6. Minority shareholder protection as a corporate governance issue³¹

Are corporate governance principles important? As we have seen above, there is a widespread view that minority shareholders have little interest in seeking to improve the standards of corporate governance in Chinese listed companies and that they tend to adopt short-term horizons in relation to their shareholdings. As one Beijing corporate lawyer pointed out, “most shareholders make money through speculation in share prices and not from dividend distributions.”

Where minority shareholders are interested in corporate governance issues, they realise that they do not have much power to influence company corporate governance practices. The degree of interest in focussing upon corporate governance in listed companies that minority shareholders will have will be limited as they generally do

³¹ This section of the paper is based on answers to four questions: Question 9: "How much interest do you think shareholders in PRC listed companies have in corporate governance principles?"

Question 10: "Would you say that any particular class of shareholders has a disproportionately strong belief in the importance of good corporate governance"?

Question 11: "Some would say that the protection of minority shareholders is an important feature of good corporate governance. Would you agree with this"?

Question 12. "How have minority shareholder interests been protected in PRC listed companies, if at all?"

not have the time and resources to spend much time looking at these issues. As a CSRC official in Beijing observed: “the medium and small sized shareholders are not very interested in corporate governance as it is too costly for them to look into it; secondly, their shareholding is too small...[to justify such action]”

Even majority shareholders have a limited interest in corporate governance and are often seen as being more interested in simply retaining their control over the company. Perhaps institutional shareholders will be better equipped to pay more attention to corporate governance issues in Chinese listed companies. Given the close association of many listed companies with government, minority shareholders were reluctant to be too critical of their company's practices. As one Shanghai based financial journalist explained: “everyone in China understands the policy and knows that it does not do any good if you speak against the government.”

Probably the greatest interest in corporate governance issues relating to China's listed companies is held by regulators such as those in the CSRC and China's two Stock Exchanges. Company secretaries, the bridge between listed companies and the regulators, are trained to be aware of and express corporate governance rhetoric. However, improving the quality of corporate governance is not a dominant concern of most Chinese boards.

A Stock Exchange official summed up this situation when he observed that listed company shareholders have “very little” interest in corporate governance issues:

“I would say very little for two reasons: First, two thirds of the shares are non-tradeable and one third are in the hands of the public. So the public investors have no interest and no impact on corporate governance; Second, the stock market has been very speculative, public investors have invested for capital gain, not revenue. For big shareholders, I also doubt that they have an interest; they have set up the listed company to tunnel out the assets into their own pockets. Most shareholders are state owned companies and they do not care much about profits or the appreciation of value. The government is a big shareholder, but does not think like a shareholder. This is a big problem in Chinese corporate governance.”

To the extent that there is an interest in corporate governance issues upon the part of Chinese listed companies, it is because of legal requirements that may be imposed by regulators and the threats implicit in public statements such as the Commission's Code of Corporate Governance.

However, interest in such rules and guidelines is generally superficial and, despite glossy corporate governance statements in company annual reports, such an interest has not yet been firmly embedded with the corporate cultures of these listed companies. A sobering view of the different types of expectations regarding corporate governance issues was provided by a former senior corporate regulator who observed that:

There are different expectations [in regard to corporate governance principles]. The Party's expectation of companies is that the Party machinery is well oiled and that its edicts (eg regarding corruption and ethics) are followed; the

Government expects that the State assets are not frittered away. People worry about being retrospectively disciplined where expectations change...Parent companies seek to get enough money from the listed companies to keep them out of problems. As to public shareholders in the top 100, 40% of circulating shares are owned by mutual funds (it was 10% two years ago). This may change shareholder expectations from the old approach in which shareholders churned a lot.”

Is the protection of minority shareholders important ? We were interested in finding out whether those involved in China’s listed companies thought that the protection of minority shareholders was an important feature of good corporate governance. We received paradoxical answers to this and a subsequent question which looked at the degree to which minority shareholders had been protected.

Generally, we found that most people associated with listed companies thought that in theory the protection of minority shareholders was important to achieving good corporate governance. However, we also found that in practice the protection of the interests of minority shareholders was not seen as a high priority by listed companies. As one Shanghai based audit partner noted, “academics talk a lot about this, but in companies, it is not a top priority.”

Nevertheless, a great deal of regulatory effort has gone into seeking to protect the interests of minority shareholders, at least in so far as the production of guidelines and regulatory rules is concerned. As one senior CSRC official told us, “the central concern for the CSRC is the protection of minority shareholders. We call them public shareholders. Most of the CSRC policies focus on their protection.” A senior company offer in a Shenzhen based company also noted that that whilst ‘many talk about protecting minority shareholders, it is hard to see how effective this can be.”

What has been the record of success in protecting minority shareholders ? When we went on to ask how well minority shareholder interests had been protected within China’s top 100 listed companies, very few people were prepared to say that the record had been good. The following ten quotes are characteristic of the 108 responses that we received to this question regarding the protection of minority shareholder interests; they well illustrate the very poor record that regulators have had in this area:

- “They are not very well protected as the board of directors and the supervisory board are highly influenced by the majority shareholders”(International accounting firm partner, Beijing);
- “If they were well protected the CSRC would not have issued so many rules and regulations to enhance their protection” (CSRC official, Guangzhou);
- “If the current shareholding structure in Chinese companies remains unchanged, any discussion on protection of minority shareholders is meaningless” (Steel company executive, Nanjing);
- “The government and companies want to protect minority shareholder interests, but the fact is that their interests have not been effectively protected” (Independent director and law professor, Shanghai);

- “They have not been protected as such, because it is a by-product of the government protecting itself as the majority shareholder” (former senior corporate regulator);
- “There are no effective legal measures to protect minority shareholders” (Shanghai Stock Exchange official);
- “Not that well” (Banking official, Beijing);
- “It is not good” (Corporate law academic, Beijing)
- “Not as well as it should be in the listed companies” (company secretary, Beijing);
- Not well protected (company general counsel, Beijing).

The above extracts do not present a comforting picture of minority shareholder protection in China’s listed companies. However, one former regulator took a broader view and thought that whilst there had not been protection of minority shareholders as such, they still received some protection as a result of the efforts of the State Audit Commission. As he explained:

“[Minority shareholders] have not been protected as such, because this is a by-product of the Government protecting itself as the majority shareholder...The State Audit Commission audits everything. Their motive is not to try to protect minority interests, but minority shareholders get protected as a by-product. This is not the same system of empowering minority shareholders [as exists] in other jurisdictions.”

It is well known, as two Chinese accounting professors recently observed, that “the quality of enterprise financial information [in China] is a major concern.”³² Another accounting professor has argued that another “key problem of China’s corporate governance is the falsification and fabrication of financial data by listed companies” and cited a Chinese report which found that “98.7% of Chinese companies falsified their earnings in annual reports...”³³ The quality of Chinese audit practice is also obviously a very important issue. It is therefore interesting to note that the CSRC in 2002 required that A share listed companies should commission a supplementary audit by an international accounting firms, perhaps suggesting a lack of faith in the reliability of domestic auditing practice.³⁴ Nevertheless, the Company Law has been recently amended to seek to enhance the range of legal protections available to minority shareholders, but these are unlikely to have much effect given the broader structural features of the Chinese securities market (especially the problem of dominant State owned shareholders) that have been discussed above.

³² AX Zhang and X Wang, “Conceptual Changes for Enterprise Management in China: An Analysis the Quality of Corporate Assets, Profits and Cash Flows”, (pp 111-123) in R Tomasic et al (eds), *Corporate Governance – Challenges for China*, Beijing, Law Press, 2005 at p 115.

³³ TW Lin, “Corporate Governance in China, Recent Developments, Key Problems and Solutions”, (2004) 1 *Journal of Accounting and Corporate Governance* 1-23, reproduced in USC Marshall Research at http://www.marshall.usc.edu/media/pressroom/pdf_long/GLOB_LIN_CHINAXL.pdf at p 9; also see C Groom, S Du, W Qu and R Sims, “Accounting Regulation and Corporate Governance in China’s Listed Companies – an Examination of the Changing Environment and Current Issues”, (pp176-199) in R Tomasic et al (eds), *Corporate Governance – Challenges for China*, Beijing, Law Press, 2005.

³⁴ See further,

7. Some Tentative Conclusions

The development of corporate governance standards has been a top down process in China.³⁵ It has been led by regulatory bodies such as the China Securities Regulatory Commission and the Shanghai Stock Exchange and has borrowed liberally for foreign codes of practice, such as the 2004 OECD Principles of Corporate Governance. Although China's listed companies have made massive strides in recent years to adopt the superficial trappings of Western corporate governance structures, their underlying structures and cultures have not embraced these new ideas as foreigners might expect. This is especially so in regard to the protection of minority shareholders.

Where the State is a majority shareholder in a listed company, any concession of power to minority shareholders will diminish State power. Corporate directors and managers who owe their positions to the State and the Party will be reluctant to bite the hand that feeds it. Although the Chinese economy has grown at an enormous speed over the last fifteen years (since the establishment of China's first Stock Exchange), it is unrealistic to expect a wholesale departure from pre-existing ways and structures in what were until recently government controlled State Owned Enterprises.

However, the problems that China experiences with the control of listed companies by holding companies or state owned entities are not unique to China as the experience of these listed companies is comparable to that of wholly owned subsidiaries in Western group companies or to government owned companies in Australia, such as Telstra. What is however unique to China is the scale of the level of State control of listed companies, although the private economy is now growing very rapidly, especially as the government has moved to dispose of smaller State owned entities.³⁶

Although China's laws are slowly being modified to move China close to an American model of corporate governance which depends upon a ready transferability of company shares, this market for corporate control model will take some time yet before it is operating in China's top 100 listed companies. There are simply too many major structural obstacles to such changes occurring any more quickly.³⁷ Until these structural problems are solved, effective minority shareholder protection in China will have to wait. In the meantime, minority shareholders will need to look to other means of protecting their interests than seeking greater participation within China's listed companies or seeking more effective legal remedies to deal with misconduct by dominant shareholders.

³⁵ See generally, R Tomasic, "Comparing Corporate Governance Principles: China, Australia and the OECD" (pp 1-32) in R Tomasic et al (eds), *Corporate Governance – Challenges for China*, Beijing, Law Press, 2005.

³⁶ See generally, R Garnaut and L Song (Eds), *China's Third Economic Transformation: The rise of the private economy*, London, RoutledgeCurzon, 2004; and R Garnaut et al, *Private Enterprise in China*, Canberra, Asia Pacific Press, 2001.

³⁷ See generally, OK Tan, *The Development of Corporate Governance in China*, Cheltenham UK, Edward Elgar, 1999.

