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Abstract
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Keywords
corporate governance, People's Republic of China, PRC Code of Corporate Governance For Listed Companies, OECD Principles of Corporate Governance

CORPORATE GOVERNANCE IN PEOPLE'S REPUBLIC OF CHINA
A NEW CODE FOR LISTED COMPANIES

*Violet Xing**

Introduction

There is no single model of good corporate governance.[1] Every nation has its own historical, cultural, political, legal and economic circumstances by which their corporate governance model is largely determined.

The People's Republic of China ("PRC" or "China") has its own unique features. In many aspects, the study of corporate governance in China increasingly attracts attention despite the fact that the concept of corporate governance was introduced into China relatively late.

The securities regulators issued its first *Code of Corporate Governance For Listed Companies* (the Code or PRC Code) in January 2002. It is relatively recent action that Chinese regulators made it a crucial task to improve corporate governance. The current focus is on the corporate governance of listed companies. First of all, the present governance of China's listed companies is inefficient. PRC began to have listed companies since the early 1990s as an experimental program during the economic reform (1978 onwards). The majority of them are restructured from traditional state owned enterprises ("SOE") where the fundamentals of corporate governance did not exist. The Chinese government's objective in allowing SOEs to be transformed into joint stock companies, some of which are also permitted to float part of their stocks, is to install a better modus operandi (*jingying jizhi*) to break away from the dysfunctional constraints and problems inherent in a centrally planned economy.[2] However, as analysed later, the present listed companies have not met that objective yet.

Secondly, China's enterprise reform has been toward the separation of ownership and managerial control, which is especially visible in listed companies. As a result, this has created a new agency relationship with the potential for conflicts of

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1 See OECD *Principles of Corporate Governance*, Preamble.

2 On Kit Tam, 'Corporate Governance in China's Listed Companies', (1995) 3 Corporate Governance, p.24.

interest among stakeholders.[3] However, in the early stage of the reform, regulators failed to install an appropriate governance structure. This consequently caused inefficient enterprises and market disorder.

Thirdly, it is believed that good corporate governance helps to increase efficiency and ensures order. Efficiency and good order is exactly what China's listed companies and stock markets urgently need.

Therefore, Chinese regulators have made various efforts in the recent years to improve the corporate governance of listed companies, such as to impose internal governance requirements, to strengthen monitoring of corporate management, to introduce a system of independent directors and board committees, etc. The most impressive development is the new *Code of Corporate Governance For Listed Companies* issued in January 2002 by the State Economic and Trade Commission ("SETC") and the major regulator of the securities industry, China Securities Regulatory Commission ("CSRC"). The Code has strictly followed the *OECD Principles of Corporate Governance*, which indicates that China is making efforts to raise its corporate governance standards toward an internationally accepted standard.

My purpose in writing this paper is to introduce the PRC *Code of Corporate Governance For Listed Companies* and compare it with the *OECD Principles of Corporate Governance*. In the following parts, I will: (1) briefly look at the corporate governance in China's listed companies; (2) introduce the new *Code of Corporate Governance For Listed Companies*; and (3) identify the similarities and differences of the PRC Code and the OECD Principles.

Corporate Governance in China's Listed Companies

Corporate Governance

Corporate governance is the system by which companies are directed and controlled.[4] Although widely accepted, this Cadbury definition of corporate governance is too narrow. Modern corporate governance is believed to be a blend of legal, regulatory, board and management practices which interact to ensure long term economic corporate value for shareholders while representing the interests of other stake holders and the broader community.[5] The structure of corporate governance in wider spectrum according to Farrar, consists, in a ascending order

3 Simon Ho, 'Corporate Ownership and the Governance of Listed Firms in China', (2002) Corporate Governance International.
4 Cadbury Report (2.5).
5 John Hall, 'Corporate Governance Should Be Dynamic', Company Director, November 2001.

from the core: legal regulation, stock exchange listing rules and statements of accounting practice, institutional codes of self-regulation, codes of individual companies, and business ethics.[6]

China does not lack the elements described in that structure. However, this Anglo American model of corporate governance does not necessarily fit China[7] due to the following factors:

1) China is in a stage of transition and retains a feature of government dominance in many areas.
2) It is often difficult to distinguish law from non-law.[8]
3) Regulation of the new sectors, such as the stock market and financial services, is largely achieved by administrative measures.
4) Business sectors such as listed companies, auditors and institutional investors lack the self-discipline.
5) It is a question whether the systems of self-regulation truly exist in China.

In addition, in the past the concept of corporate governance has not been well developed or understood in China. This may be partly due to the transitional stage from a planned economy to a market economy, and partly due to the entanglement of ownership rights with management responsibilities.[9] However the study of corporate governance receives increasing attention in China. There are several aims in building a corporate governance system in China: "(1) State ownership can be separated from business management; (2) Ownership and controls can be clearly delineated; (3) The interests of resource providers can be protected and conflicts among their interests can be resolved; (4) The interest of owners, directors, managers, and other stakeholders can be resolved; (5) Scientific and efficient management decisions can be made independently; and (6) Managers and the board can be effectively monitored and motivated to maximize firm's values." [10]

6 See "Figure1.1 Structure of Corporate Governance", John Farrar, *Corporate Governance in Australia and New Zealand,* (2001) 4.
7 See J H Farrar, 'Developing Corporate Governance in Greater China' (2002) 25 *University of New South Wales Law Journal,* 6.
8 Ibid.
9 Laura Cha (CSRC Deputy Chairman), *The Future of China's Capital Markets and the Role of Corporate Governance*, speech at China Business Summit, 18 April 2001.
10 Simon Ho, 'Corporate Ownership and the Governance of Listed Firms in China', (2002) *Corporate Governance International*, 2002, 21.

Corporate Governance in Listed Companies

China established two stock exchanges in Shanghai and Shenzhen to start building a market-based enterprise system in early 1990s. Since then, a large number of SOEs have been transformed to joint stock companies or shareholding companies. Currently, there are approximately 1200 listed companies on the two stock exchanges in China.[11]

A listed company refers to "a joint stock limited corporation which has its issued shares listed and traded at stock exchanges with the approval of the State Council or the department of securities administration authorized by the State Council".[12] The Chinese listed companies are equivalent to public companies in western countries. Activities of these listed companies are subject to the Company Law, Securities Law as well as relevant administrative regulations and the stock exchange listing rules.

Internal Governance of Listed Companies

Chinese Company Law provides a two-tier board structure. However, the internal governance arrangements between the shareholders, directors, managers and supervisors are unbalanced and insufficient to provide effective internal governance.

The shareholders' meeting is considered as the "supreme organ of power" in a company.[13] Some scholars think such corporate governance philosophy resembles the political governance philosophy expressed in the Chinese Constitution that "National People's Congress is the supreme state power organ".[14] Thus, it was natural for Chinese legislature to translate the rationale of the political governance regime into corporate life.[15] The Company Law empowers the shareholders' meeting to exercise wide decision making powers, including some powers that are normally exercised by the board of directors, such as approval of business operation and investment plan and annual financial budget and final accounts.[16] In practice, such arrangement is inefficient in decision-making and often results in slow response to the rapid changing market situation.

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11 CSRC Statistics 1-1 Major Index, available at <http://www.csrc.gov.cn/CSRCSite/tongjiku/199911/default.html>.
12 Company Law, Article 151.
13 Company Law, Article 102.
14 C.A Schipani & Liu Junhai, *Corporate Governance in China: Then and Now* (November 2001), William Davidson Working Paper Number 407, November 2001.
15 Ibid
16 Company Law, Article 103.

Directors are appointed by shareholders and are accountable to shareholders. Similar to the shareholders' meeting, the powers of the board of directors are also provided in the Law.[17] As the shareholders' meeting has a wider range of decision making-powers, consequently the powers of the board are narrower. The main function of the board is to implement resolutions of shareholders' meeting. However the law does recognize that the board is a decision-making organ and the executive powers are given to company managers, who are subject to the appointment and dismissal by the board. In this way, the board of directors and managers jointly formulate the management in a listed company. However in practice, the board of directors are often in the dilemma in confronting a powerful shareholders' meeting and a strong CEO.

The supervisory board has been empowered to supervise corporate activities. However its function in practice is weak, which is a result of the following factors:

1) An overweight power of the controlling shareholder due to the concentration of state ownership[18], which interferes with the operation and appointment of supervisors of listed companies;
2) The Company Law gives the supervisory board a monitoring function but fails to specify how it should be exercised;
3) The supervisory board is composed of shareholder representatives and employee representatives: the former is likely to have connections with the controlling shareholder; the latter faces more challenges in acting against their superiors; and
4) A lack of an effective evaluation and incentive system of the supervisory board.

External Governance Framework

As mentioned in previous sections, the corporate governance structure may consist of legal regulation, stock exchange listing rules, statements of accounting practice, codes of conduct and business ethics. The governance of China's listed companies is mainly subject to legal regulation, administrative measures by regulators, and stock exchange and listing rules. Other external institutions that may play a significant role in corporate governance, such as, auditors, institutional investors, and other intermediaries, have not been effective.

It is because of the immaturity of the market mechanism that the enforced laws and regulations play a more important role in China[19] while market based

17 Company Law, Article 112.
18 About two-thirds of the value of total issued share capital on stock exchanges of China are state owned shares or legal person shares, which are directly or indirectly held by SOEs.
19 Tang Xin, *Corporate Governance and Takeovers of Listed Companies* (2001), 91.

monitoring functions are weak in comparison. Not surprisingly, the external governance largely depends on administrative regulations and administrative measures by the CSRC as well as the listing requirements of the stock exchanges. The CSRC, which was formed in 1992 and was given the unified power over the national securities sector in 1998, now plays an active role in imposing unifying corporate governance requirements on listed companies as well as in protection of investors and fighting against corporate fraud or corruption. In addition, many provisions of the Company Law have become outdated as new circumstances arise in the economic development. Therefore, regulation of the securities market and listed companies largely depends on administrative regulations by the CSRC.

Stock exchanges are also quite active in seeking to improve corporate governance of listed companies. Their function in corporate governance can be realized in different ways. Firstly, stock exchanges can impose requirements on issuers on the matters such as capitalization, number of shares, disclosure requirements, internal governance and reporting procedures through listing rules. Secondly, stock exchanges have the authority to investigate any unusual movement of share prices or trading volume of listed companies to ensure a fair and orderly market. Thirdly, stock exchanges can impose other corporate governance requirements on listed companies such as through guidelines on corporate governance matters and the code of best practice.

Some Factors Affecting Corporate Governance

Factors affecting corporate governance in China are many. The followings are the most significant ones.

Unclearly Defined Ownership and Property Rights

The Company Law provides that shareholders have the right of ownership, a company has the property rights as a legal person over the capital contributed by shareholders, and the state assets of a company belong to the State.[20] However, the law is extremely imprecise in defining the “right of ownership”, “property rights” and “legal person property rights”. This has resulted in confusion and inefficiency in practice and debate and disagreement in theory on these issues.

Concentration of State Ownership

The concentration of state ownership has resulted in various problems such as insider control and ineffective monitoring mechanisms. Under such structure, the interests of the state are not well represented. The state owner suffers from an inefficient bureaucratic agency. However, on the other hand, the controlling

20 See Company Law, Article 4.

shareholder is a threatening power capable of interfering with company's operation activities, which often conflicts with minority shareholders' interests. Furthermore, minority shareholders' ability to influence corporate governance is limited by their small shareholding and the inadequate legal protection of shareholder's rights.

Agency Problem

The agency problem is considered as one of the major problems affecting the efficiency of Chinese SOEs.[21] Failure to install a rational accountability and monitoring mechanism during the enterprise reform has worsened the problems, which now include: (1) agent's over-consumption at company's expense; (2) insufficient information disclosure or deceptive accounts; (3) short-term dealing merely for the good of agent's "achievements", position or other benefits without considering the company's perspective; (4) increasing marginal cost due to over-investment and over-consumption of state owned assets; (5) over-rapid increase of the agent's remuneration or misappropriation of interests; (6) loss of state owned assets by illegal transfers; (7) agent's lack of consideration of minority shareholders' interests; (8) no or low profit distribution; etc.[22]

Inefficient Stock Markets

China's stock markets have several distinctive characteristics which contributed to an inefficient market: (1) most of the listed companies are developed from SOEs or underlying organizations of SOEs; (2) two-thirds of the value of total issued share capital on stock exchanges of China are held in the form of state owned shares or legal person shares, which are directly or indirectly held by SOEs;[23] (3) State shares and legal person shares are theoretically non-tradable in the market.[24] The separation of the stock markets is undoubtedly a barrier of efficient and rational allocation of resources.

The Code of Corporate Governance for Listed Companies

The Recent Development of Corporate Governance

The CSRC has promoted several programs to improve corporate governance in listed companies. One of such programs is to introduce the independent director

21 Ni Jianlin, *Corporate Governance: Laws and Practice*, (2001), p 34.
22 Ibid, p.34-35.
23 CSRC statistics December 2001, available at: <http://www.csrc.gov.cn/CSRCSite/tongjiku/199911/default.html>.
24 Equity structure of Chinese listed companies is divided into: shares owned by state, shares owned by legal persons and shares owned by individuals.

system in August 2001. Listed companies are required to have at least two independent directors in their boards by June 2002 and independent directors shall represent no less than one third of the board members by June 2003. Another program is to establish a modern enterprise mechanism. Listed companies are encouraged to take the lead in the program. Whether an enterprise has a modern enterprise mechanism is assessed by the standard of "clear ownership, defined rights and obligations, separation of enterprise from government, scientific management".[25]

Among the recent developments, the milestone is the *Code of Corporate Governance for Listed Companies* issued by SETC and CSRC in January 2002. Earlier in September 2001 CSRC released a draft code for feedback from experts, listed companies, intermediaries and the public. Having followed the accepted standards in international corporate governance, the Code is aimed at enhancing the modern enterprise system for listed companies, standardizing the operation of listed companies and bringing forward the healthy development of the securities market.[26]

The Code consists of 95 articles in 8 chapters. It provides the basic principles of corporate governance for China's listed companies, focusing on the issues such as protection of investors' rights or interests, the code of conduct for management such as directors, supervisors, and managers of listed companies. The chapters of the Code are under the following headings:

1) Shareholders and Shareholders Meeting
2) Listed Company and Its Controlling Shareholders
3) Directors and Board of Directors
4) The Supervisory and the Supervisory Board
5) Performance Assessments and Incentive and Disciplinary System
6) Stakeholders
7) Information Disclosure and Transparency
8) Supplementary Articles

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25 *Decision on Issues of Establishing Socialist Market Economy Mechanism*, approved at The Third Meeting of the 14th CCP Congress, 14 November 1993.

26 CSRC, The Code of Corporate Governance For Listed Companies, Preamble

An Outline of the Code

Application

The Code is applicable to "all listed companies within the boundary of the People's Republic of China".[27] Listed companies shall act in the spirit of the Code to improve corporate governance. The preface states clearly that the Code represents a standard to evaluate whether a listed company has a good corporate governance structure. Where major governance problems are found in a listed company, the securities supervisory and regulatory authorities may instruct the company to correct them in accordance with the Code.

Shareholders and Shareholders' Meeting

The Code provides recommendations and requirements on shareholders and shareholders meeting in three sections: (1) rights of shareholders; (2) rules for shareholders' meetings; (3) related party transactions.

In relation to the rights of shareholders, the Code requires that corporate governance structure of listed companies should ensure full exercise of shareholders' rights. Shareholders, "as the owner of a company", have "the legal rights stipulated by laws, administrative regulations and the company's articles of association", and "right to participate in corporate affairs set forth in laws, administrative regulations and the articles of associations of the company".[28] Shareholders are encouraged to protect their interests and rights through civil litigation.[29]

The Code provides a set of rules for the convention and procedures of shareholders' meeting. Listed companies are required to set out in articles of association in detail the procedures of a shareholders' meeting, the principles and content of authorization granted by the shareholders meeting to the board of directors (Articles 5, 7). Listed companies should make every effort to increase shareholders' attendance at the shareholders meetings (Article 8). Shareholders may attend meetings either in person or by appointing proxy (Article 9). During a shareholders' meeting, a reasonable time should be given for discussion on each matter set in the agenda (Article 6). In addition, institutional investors are encouraged to "play a role in appointment of company directors, compensation and supervision of management and major decision-making process".[30]

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27 Ibid
28 Ibid 3
29 Ibid 4
30 Ibid 11.

On related party transactions, a listed company and its related parties are required to:[31]

- have a specific and detailed agreement;
- disclose significant matters;
- follow commercial principles and pricing;
- prevent misappropriation of listed company' assets and other resources;
- prohibit financial guarantees to company's shareholders or their affiliates.

Listed Company and Its Controlling Shareholders

This part provides requirements of: (1) behaviour rules for controlling shareholders, and (2) independence of listed company.

Section one emphasises two basic matters: to establish a balanced shareholding structure and regulate controlling shareholders' behaviour. Articles 15 through 18 set out the basic principles on company's prelisting reorganization, such as to establish a reasonably balanced shareholding structure, to strip out the non-operational assets and to rationalise the personnel and distribution systems. Controlling shareholders have the duty of good faith toward the listed company (Article 19).

Section two requires that listed company's management, assets, accounts, and business shall be independent from controlling shareholders. A listed company shall independently operate its business, practice accounting and bear the risks and obligations (Article 22). The Code restricts controlling shareholders' interference in listed companies. As a subordinate relationship between a listed company and its controlling shareholder has become a common phenomenon in practice, it has caused problems in the operations of listed companies. To tackle this problem, it was made clear in Article 26 that "there shall be no subordinating relationship between…a listed company…and the company's controlling shareholders".

Directors and Board of Directors

This section represents the most important part of the code, dealing with: (1) election procedures for directors; (2) the duties and responsibilities of directors; (3) duties and composition of the board of directors; (4) rules and procedures of the board of directors; (5) independent directors; and (6) specialized committees of the board of directors.

31 Ibid 12-15.

Articles 28 through 32 set out the procedures for the election of directors. Listed companies shall "establish a standardized and transparent procedure for director election in its articles of association so as to ensure the openness, fairness, impartiality and independence of election" (Article 28). Disclosure of detailed and true information on candidates is required (Articles 29, 30). The Code recommends "cumulative voting" in election of directors in order to effectively reflect minority shareholders' opinion (Article 31). A listed company and its directors should have "appointment agreements" to clarify the issues such as rights and obligations, the term of the directorship, etc. (Article 32)

"Directors shall faithfully, honestly and diligently perform their duties for the best interest of the company and all the shareholders" (Article 33). Other recommendations on directors' duties and responsibilities include:[32]

- adequate time and energy to perform duties;
- attending board meetings and expressing opinions;
- abiding laws, regulations, rules and articles of association;
- directors' training;
- liability for board resolutions made and agreed upon; and
- liability insurance for directors.

In relation to the composition of the board of directors, the Code recommends a structure "in compliance with laws and regulations", ensuring the "effective discussion and efficient, timely and prudent decision-making process" (Articles 40, 42). Further, "the board of directors shall possess proper professional background" to perform their duties (Article 41). The Code deals with the responsibility of the board quite simply by stating "the board of directors shall be made accountable to shareholders" and "perform its duties as stipulated by laws, regulations and the company's articles of association" (Articles 42, 43).

Articles 44-48 specify the rules and procedures of the board of directors in the following areas:

- The general requirement is to ensure efficiency and rational decision-making;
- To meet periodically and timely when necessary;
- To conduct the meeting in strict compliance with prescribed procedures;
- Make complete and accurate minutes of board meeting; and
- Give clear and specific authorization to the chairman to exercise the board's function during the recess of the board meetings.

32 Ibid 34-39.

Articles 49 through 51 are about independent directors. It is stated that, "independent directors shall be independent from the listed company that employs them and the company's major shareholders"; "An independent director may not hold any other position apart from independent director in the company". Independent directors have the duties of good faith and due diligence toward the listed company and its shareholders.

Articles 52 to 58 deal with board committees. The Code recommends that the board of a listed company establish a corporate strategy committee, an audit committee, a nomination committee, a remuneration and an appraisal committee and other special committees subject to the resolutions of shareholders' meetings. Board committees shall be accountable to the board of directors (Article 58). Members of these committees "shall be solely composed of directors". "The audit committee, the nomination committee and the remuneration and appraisal committee shall be chaired by independent directors, and independent directors shall constitute the majority of the committees" (Article 52). Each specialized committee may engage intermediary institutions to provide professional opinions at the expense of the company (Article 57).

The Supervisors and the Supervisory Board

The chapter on supervisors specifies: (1) duties and responsibilities of the supervisory board, and (2) the composition and steering of the supervisory board.

Accountable to all shareholders, the supervisory board's responsibility is to "supervise the corporate finance, the legitimacy of directors, managers and other senior management personnel's performance of duties and protect the company's and the shareholders' legal rights and interests" (Article 59). Supervisors have the right to get information on a company's operating status and can hire intermediaries to provide professional opinions (article 60). They may report directly to securities regulatory authorities or other authorities when discovering violation (Article 63). On the composition of supervisory board, the Code recommends supervisors to have a professional background in law and accounting, in addition, "the members and the structure of the supervisory board shall ensure its capability to independently and efficiently conduct its supervision of directors, managers and other senior management personnel and to supervise and examine the company's financial matters"(Article 64).

Performance Assessments and Incentive and Disciplinary Systems

The chapter includes: (1) performance assessment for directors, supervisors and management personnel; (2) selection of management personnel; and (3) incentive and disciplinary systems for management.

The Code recommends, "a listed company shall establish fair and transparent standards and procedures for the assessment of directors, supervisors and management personnel" (Article 69). The evaluation of directors and management personnel shall be conducted by the board of directors or by the remuneration and appraisal committee (Article 70).

The Code restricts any interference with normal recruitment of management personnel of a listed company (Article 73). The recruiting of management personnel of a listed company shall, to the extent possible, be carried out in a fair and transparent manner (Article 74).

Stakeholders

A listed company shall respect the legal rights of banks and other creditors, employees, consumers, suppliers, the community and other stakeholders. Detailed requirements are set out as below, a listed company shall:[33]

- actively cooperate with its stakeholders;
- provide the necessary means to ensure the legal rights of stakeholders;
- provide necessary information;
- encourage employees' feedback; and
- be concerned with the company's social responsibilities.

Information Disclosure and Transparency

This chapter contains three sections: (1) listed companies ongoing information disclosure; (2) disclosure of information regarding corporate governance; and (3) disclosure of controlling shareholder's interests.

The Code emphasizes that "information disclosure is an ongoing responsibility of listed companies", and "a listed company shall truthfully, accurately, completely and timely disclose information as required by laws, regulations and the company's articles of association" (Article 87). Listed companies are encouraged to disclose "information that may have a material effect" in addition to mandatory disclosure, and ensure "equal access to information for all shareholders" (Article 88).

Disclosure of information in relation to corporate governance shall include but is not limited to:[34]

- the members and structure of the board of directors and supervisory board;

33 Ibid 81-86.
34 Ibid 91.

- the performance and evaluation of the board of directors and supervisory board;
- the performance and evaluation of the independent directors;
- the composition and work of the specialized committees of the board of directors;
- the actual state of corporate governance of the company, the gap between the company's corporate governance and the code and reasons for the gap;
- specific plans and measures to improve corporate governance.

Articles 92 to 94 set out the disclosure requirements on controlling shareholder's interests. Controlling shareholder refers to "shareholder who owns a comparatively large percentage of shares of the company, or the shareholders who actually control the company" (Article 92). A listed company shall disclose timely and accurately on change of shareholders, movement of their shareholding, transfer of actual control and other important events (Articles 93, 94).

Conforming to the International Benchmark? Similarities and differences of the PRC Code and OECD Principles

The International Benchmark: The OECD Principles of Corporate Governance

The OECD plays a prominent role in fostering good governance in public service and corporate activity. It helps governments to ensure the responsiveness of key economic areas with sectoral monitoring.

In May 1999, the OECD published the OECD Principles of Corporate Governance, built upon experiences from national initiatives in member countries, previous work carried out within the OECD and input from non-OECD countries, the World Bank, the International Monetary Fund, the business sector and other interested parties. The OECD Principles contains five chapters on the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board. The principles are non-binding and modestly aim to serve as a reference point which "can be used by policy makers, as they examine and develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices".[35]

The OECD principles have proved to be influential for corporate governance in a global context. The international organizations such as IMF and World Bank look

35 OECD Principles, Preamble.

to the OECD to provide the standards to their assessment criteria. Many OECD countries have adopted the OECD Principles and developed their corporate governance programs. The OECD Principles are also followed in non-member countries, for example, China now.

Similarities

The PRC Code embodied the spirit of the OECD Principles. Comparisons are made under the following four areas.

Shareholders

Equity investors have certain property rights.[36] Such as, an equity share can be bought, sold, or transferred. An equity share also entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting.[37]

The OECD Principles addressed in section I, "the corporate governance framework should protect shareholders' rights". Similarly, the PRC Code expressed in Article 1 that, "a listed company shall establish a corporate governance structure sufficient for ensuring the full exercise of shareholders' rights". Both OECD Principles and PRC Code recognize the significance of shareholders' rights to influence the corporation centre on the fundamental issues of corporations based on the fact that the corporation cannot be managed by shareholder referendum. These rights include the right to participate in and to be informed on the major matters of the company, the opportunity to participate effectively and vote in general shareholders' meetings, etc.[38]

Both the OECD Principles and the PRC Code recognize that the corporate governance framework should ensure equitable treatment of all shareholders, in particular minority shareholders.[39] In addition, shareholders should have the right to protect their interests and rights and opportunity to obtain redress for violation of their rights.[40] Insider trading and abusive self-dealing are prohibited in the OECD Principles. Although the PRC Code does not use exactly the same term, it does impose restrictions and disclosure requirements on related party transactions in Articles 12 to 14 and insider dealing is prohibited by the Securities Law (1998).

36 Annotation of OECD Principles, Section I.
37 Ibid.
38 OECD Principles, I. B-C; PRC Code, Articles 3, 5-10.
39 OECD Principles, Section II; PRC Code, Article 2.
40 OECD Principles, Section II; PRC Code, Article 4.

Board of Directors

The OECD Principles provide that the corporate governance framework shall ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. Similarly the PRC Code requires the same in Article 42 and such spirit has been embodied in Chapter Three on the matters such as election of directors, duties and responsibilities of directors and the board, composition of the board, etc.

In relation to the responsibility of directors and the board, both the OECD Principles and the PRC Code addressed the significance of the following points:

- to act in good faith, with due diligence and care, in the best interest of the company and all shareholders;[41]
- to ensure compliance with applicable laws;[42]
- to treat all shareholder equally and take into account the interest of stakeholders;[43]
- to devote sufficient time to their responsibilities;[44] and
- to exercise objective judgment independently.[45]

Both the OECD Principles and the PRC Code recognize the significance of introducing a sufficient number of non-executive board members or "independent directors" capable of exercising independent judgment to tasks where there is a potential for conflict of interests, in particular, in the areas of financial reporting, nomination and executive and board remuneration.[46]

Stakeholders

The OECD Principles addressed the corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. In detail: "the corporate governance framework should assure that the rights of stakeholders that are protected by law are respected" (Section III-A); "where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights"(Section III-B); "the corporate governance framework should permit performance-enhancing mechanisms for stakeholder

41 OECD Principles V-A; PRC Code, Article 33.
42 OECD Principles V-C; PRC Code, Articles 36, 43.
43 OECD Principles V-B, C; PRC Code Article 43.
44 OECD Principles V-E.2; PRC Code Article 34.
45 OECD Principles V-E; PRC Code, Articles 49-51.
46 OECD Principles V-E; PRC Code, Articles 49-51.

participation"(Section III-C); "where stakeholders participate in the corporate governance process, they should have access to relevant information"(Section III-D).

Similarly the PRC Code contains a chapter on stakeholders and addresses that a listed company shall:

- respect the legal rights stakeholders(Article 81);
- actively cooperate with stakeholders (Article 82);
- provide necessary means to ensure the legal rights of stakeholders(Article 83);
- provide necessary information to stakeholders (Article 84).

Disclosure and Transparency

Information disclosure and transparency are fundamental in corporate governance. A strong disclosure regime is pivotal to market-based monitoring of companies and is central to shareholders' ability to exercise their voting rights.[47] It also helps to attract capital and maintain confidence in capital markets as disclosure is regarded as a powerful tool for influencing the behaviour of companies for protecting investors. In addition, disclosure helps to improve public understanding of the structure and activities of enterprises.[48]

The OECD Principles state that, "the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including financial situation, performance, ownership, and governance of the company". Similar sentiments are embodied in the PRC Code: information disclosure should be an ongoing responsibility of listed companies and a listed company shall truthfully, accurately, completely and timely disclose mandatory information.[49] Besides mandatory disclosure, the PRC Code encourages voluntary disclosure of information that may bring material effects.[50] In addition, both addressed the importance of fair and timely disclosure, and cost efficient access to information by users.[51]

Differences

The OECD Principles recognize that there is no single model of corporate governance.[52] Every nation has its own historical, cultural, political, legal and

47 Annotation of OECD Principles, IV.
48 Ibid.
49 PRC Code, 87.
50 Ibid 88.
51 OECD Principles IV-D; PRC Code, Article 89.
52 OECD Principles of Corporate Governance, Preamble.

economic circumstances by which corporate governance is determined. China's listed companies have many unique features in corporate governance as seen previously. Accordingly there are differences between the OECD Principles and the PRC Code.

Application

The OECD Principles are non-binding and the purpose is to serve as a reference point for policy makers and market participants as they develop their own practice. The PRC Code states clearly in the Preface that, "the Code is applicable to all listed companies within the boundary of People's Republic of China", "listed companies shall act in the spirit of the Code in their efforts to improve corporate governance", and "the Code is the major measuring standard for evaluating whether a listed company has a good corporate governance structure". This is because, as mentioned previously, in a stage of transition, laws and regulations play a more important role in China. In addition, the regulators are sceptical about the self-disciplinary ability of the listed companies. Therefore, not surprisingly, the PRC Code, issued by the major regulators CSRC and SETC, is more like an administrative regulation rather than a self-regulatory code.

Scope

The OECD Principles include five chapters under the headings of "the rights of shareholders", "the equitable treatment of shareholders", "the role of stakeholders in corporate governance", "disclosure and transparency", and "the responsibilities of the board". The PRC Code covers all of these areas. But equitable treatment of shareholders is not a separate chapter in the PRC Code. Another difference is that the PRC Code consists of three parts - "listed company and its controlling shareholder", "supervisors and supervisory board" and "performance assessments and incentive and disciplinary systems".

The different chapter arrangements in the PRC Code result from some institutional differences, for example, a two-tier board system and the current problematic areas of corporate governance such as the independence of listed companies from their controlling shareholder, performance assessment and incentive scheme for management.

Differences in Identical Chapters

(1) The Rights of Shareholders

Unlike the OECD Principles, the PRC Code did not specify the basic rights of shareholders. Rather, it simply provides that "shareholders shall have the legal rights stipulated by laws, administrative regulations and the company's articles of association".

(2) Markets for Corporate Control

The OECD Principles I-E emphasized that, "Markets for corporate control should be allowed to function in an efficient and transparent manner". However the PRC Code ignored the concept of "markets for corporate control" in corporate governance. Nor did it mention acquisition, mergers and takeovers.

(3) Key Functions of the Board

Unlike the OECD Principles, the PRC Code does not specify the key functions of the board.

(4) Disclosure and Transparency

OECD Principles specify the types of material information to be disclosed[53]. Instead of providing specific basic disclosure requirements, the PRC Code simply states "a listed company shall…disclose information as required by laws, regulations and the company's articles of association". However, it does require disclosure of corporate governance matters and controlling shareholders' interests.

In addition, the PRC Code does not mention what the OECD Principles addressed in IV-B and C, such as "information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit"; "an annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented".

Some Special Requirements in the PRC Code

Shareholders' Action

The PRC Code encourages shareholders "to protect their rights and interests through civil litigation or other legal means in accordance with laws and regulations".

It is a shareholders' right to seek protection by legal remedies such as to take action against wrongdoers in case their rights or interests are infringed. Although Article 111 of the Company Law supports shareholders' action under certain circumstances,[54] in practice, shareholders litigation did not really start until the

53 OECD Principles, IV-A.

54 Company Law, Articles 111: "In case of the resolutions of a shareholders' meeting or the board of directors' meeting have violated the law, administrative decrees or encroached upon the legitimate rights of shareholders, the shareholders concerned have the rights to sue at the people's court, to demand that such acts of violation or infringement be stopped."

Supreme Court issued a notice in January 2002.[55] Before this, many shareholders actions ended up with the court's decision to refuse to accept them. The PRC Code, along with the new measure taken by the Supreme Court, will help the legal protection and enforcement of shareholders' rights. It also provides a reminder for company directors, supervisors and managers to be aware of their liability for violation of laws and regulations.[56]

Listed Company and Controlling Shareholder

The PRC Code includs a separate chapter to regulate the behaviour of controlling shareholders to ensure independence of listed companies.

It is common that most of the listed companies have a controlling shareholder, which often results in interference with the operations of listed companies and the problem of insider control. In such situation, the interests of shareholder are neither well represented nor treated equally. Also, there is sometimes unclear segregation of assets, management and businesses between the listed companies and their parent companies.[57] Thus, related party transactions happen frequently, which sometimes severely affects the interests of minority shareholders. Recent scandals of egregious behaviour by the controlling shareholders of some of listed companies highlighted the insufficient understanding of the responsibilities of the board and management to their shareholders, and the lack of internal control and accountability by the management.[58] Therefore, it is crucial for the Code to regulate controlling shareholders' behaviour, related party transactions and to ensure the independence of listed companies.

Supervisors and Supervisory Board

The PRC Code includes a separate chapter for "supervisors and supervisory board", aiming to clarify the duties and responsibilities, composition and conduct of the supervisory board.

In reality the supervisory board plays a weak monitoring role in listed companies. It is often argued that more authority should be given to the supervisory boards. However, the regulators take the point of view that:[59] (1) the system of supervisory board is not effective as it is often unclear whose interest that the supervisory board represents; (2) the supervisory board duplicates the authority of

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55 The Supreme People's Court, *Notice on Some Issues of Accepting Civil Litigation Caused by False Statement in Securities Market*, January 15, 2002.

56 Code of Corporate Governance for Listed Companies, Article 4.

57 Laura Cha, *The Future of China's Capital Markets and the Role of Corporate Governance*, Speech at China Business Summit, 18 April, 2001.

58 Ibid.

59 Ibid.

the board itself but without corresponding responsibilities; (3) the presence of the supervisory board may give the illusion of certain checks and balance in the listed company when none exists. Therefore, another monitoring system in the form of independent directors is introduced to the board of directors. At present, the supervisory board still exists legally and the Code recognizes its monitoring function and provides some requirements and recommendations to strengthen the supervisory board.

Performance Assessments and Incentive and Disciplinary Systems

Problems of incentive and disciplinary on management have been quite obvious in the corporate governance issues of listed companies. On the one hand, the incentive mechanism for managers is not adequate; on the other hand, which is more serious, the disciplinary mechanism is not functional.[60] In order to hold company directors, supervisors and managers accountable to their positions, to improve the efficiency and to reduce irregularities in operations, it is necessary to install an effective system of performance assessment, incentive and disciplinary system in listed companies.

Conclusion

Looking at the corporate governance in China's listed companies, we understand that it is not efficient at present. However, from the recent developments, it is positive to see that Chinese regulators have targeted many crucial and problematic areas as addressed in the PRC Code. The Code emphasized the regulation of controlling shareholders' behaviour, related party transactions, the independence of listed companies, directors' duties, etc. It is especially noticeable that the new *Code of Corporate Governance For Listed Companies* has closely followed the OECD Principles.

Self-regulation has also started to grow in China's listed companies. Soon after the draft of the Code was published, the annual general meeting of Shengli Gufen Company Limited, a listed company on the Stock Exchange of Shanghai, approved its company's voluntary corporate governance code "*Shengli Gufen Guidelines of Corporate Governance*" on 26 September 2001. Regulators should foster self-regulation "because laws and regulations are not sufficient to provide guidance to enterprise activities in the rapidly changing situation." "It is rational to activate the internal balancing and monitoring mechanism, and replace part of the legal regulation and administrative regulation with reliable self-regulation"[61].

60 Ni Jianlin, *Corporate Governance: Laws and Practice* (2001), 177.
61 Tang Xin *Corporate Governance and Takeovers of Listed Companies* (2001), 155.

Another point that policy makers cannot ignore is that corporate governance systems are not like devices that can easily be transported from other country and adopted by another[62]. The standard of corporate governance cannot be raised overnight. How to make the new Code effective and how to increase the overall corporate governance standard are real challenges for the Chinese regulators and enterprises. They require continuous efforts. China is certainly getting on the right track now.

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62 Jean-Francois Huchet and Xaver Richet, *China in Search of An Efficient Corporate Governance System, International Comparisons and Lessons*, discussion paper No.99/01, February 1999, Centre of Economic Reform and Transformation, Department of Economics, Heriot-Watt University.