

Corporate governance in China: a changing model?

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Workshop “The Chinese economy”
Venice – 25-27 November 2010

What defines a good corporate governance system

- a. Incentives for controlling agent to “invest” in company specific assets
- b. Some degree of separation between ownership and control to ensure growth
- c. Efficient allocation of control (to agent most “productive for the company”)

What ensures these objectives

Adequate institutional framework, composed of

- company law
- securities law
- bankruptcy law
- enforcement structure (public and private)

.. which...

- a. ensures some degree of protection of specific investment in the company → stability of control
 - b. offers enough protection to investors and creditors
 - c. facilitates reallocation of control when necessary
- ➔ Even if most attention for objective b., other objectives relevant as well
- ➔ No ownership and control model has proven to be superior under all respects → co-existence of different models

Structure of presentation

- Evolution of China ownership structure
- Current ownership structure (only largest listed companies)
- Institutional framework underlying this structure
- Evaluations based on conceptual framework
- ➔ **China c.g. a rapidly changing (and improving) model even with still strong role for State ownership**

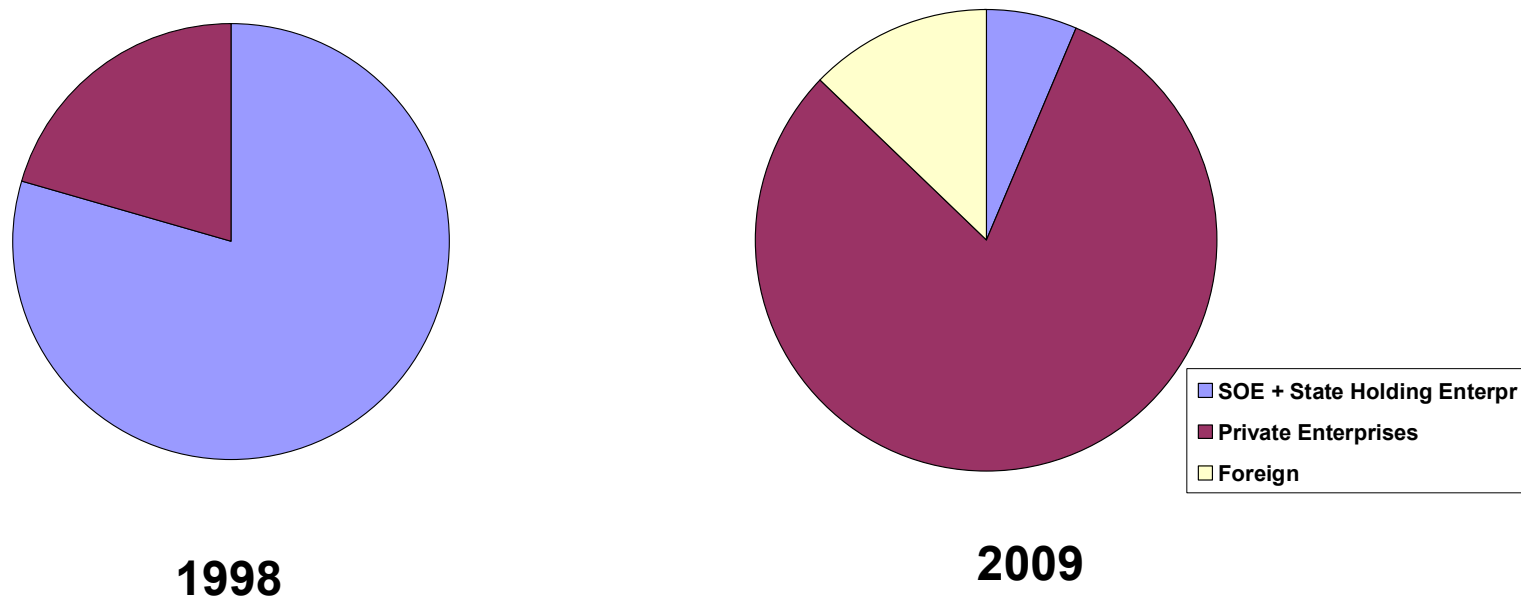
Evolution of ownership structure

Since 1978..

- From state owned companies (SOEs) only, mainly large companies, to development of small, locally promoted, collectively owned enterprises
- ..to “corporatization” of SOEs..
- .. to larger weight of private companies and foreign presence..

State owned vs private companies

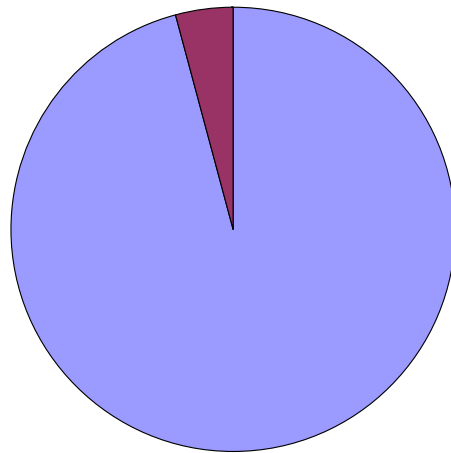
number of enterprises



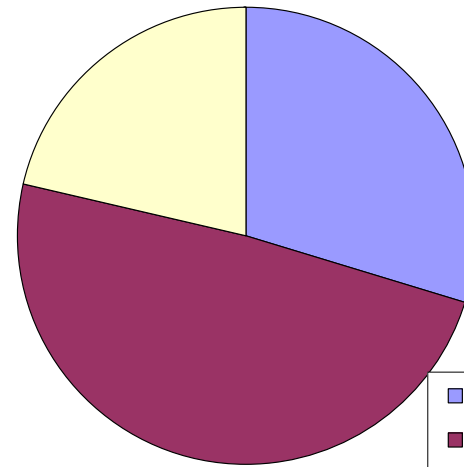
Source: China Statistical Yearbook, 2010.

State owned vs private companies

number of employees



1998



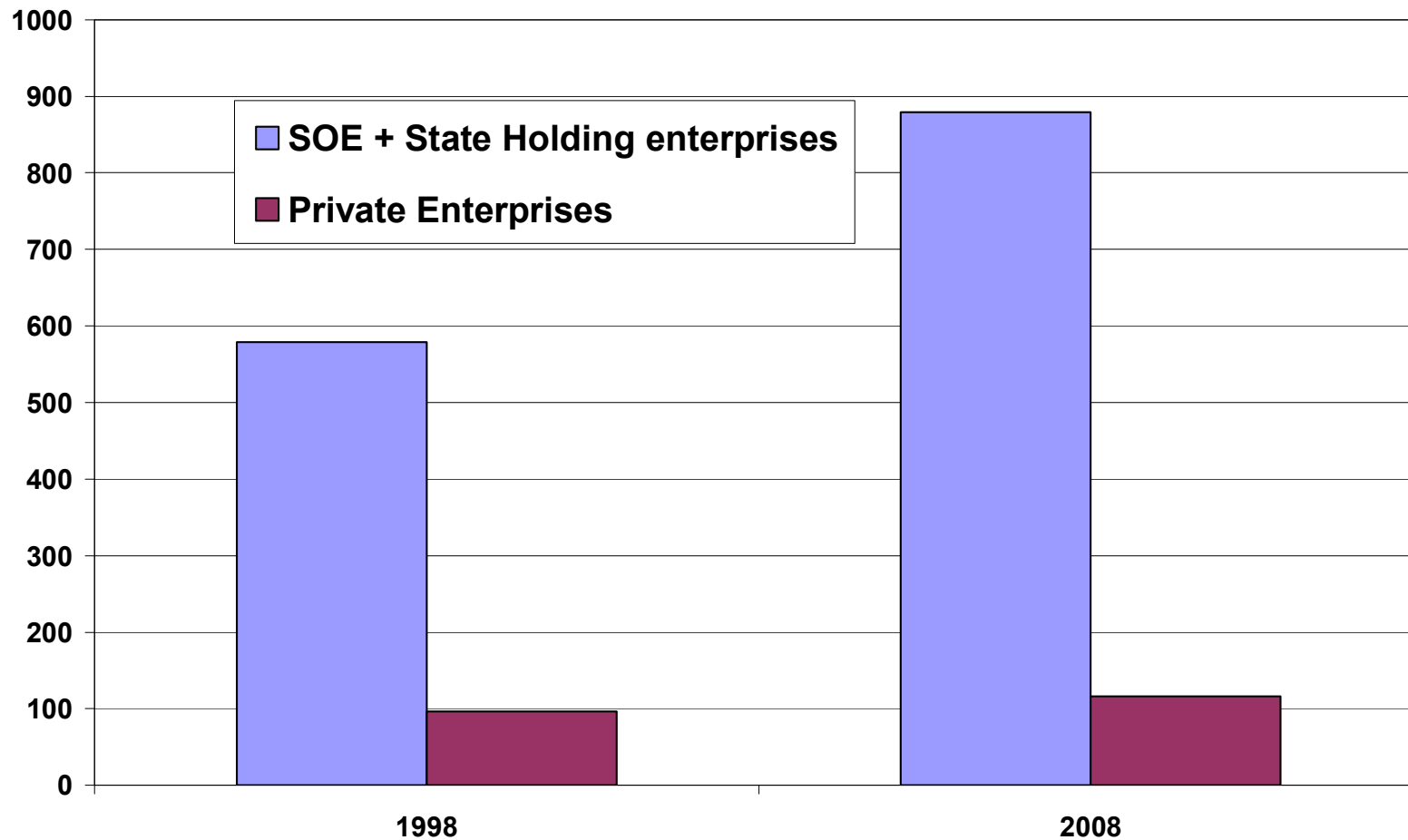
2009



Source: China Statistical Yearbook, 2010.

State owned vs private companies

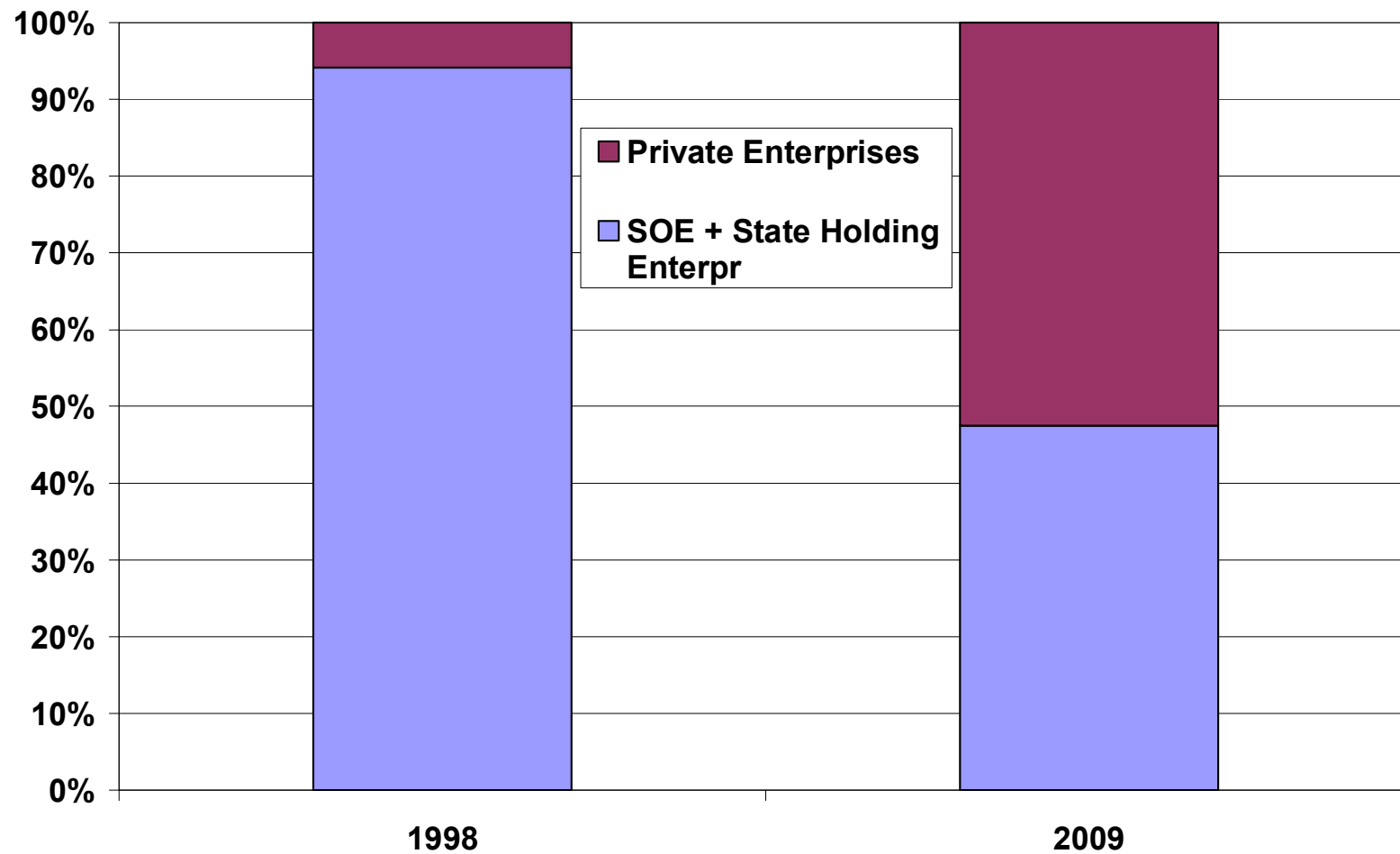
average size



Source: China Statistical Yearbook, 2010.

State owned vs private companies

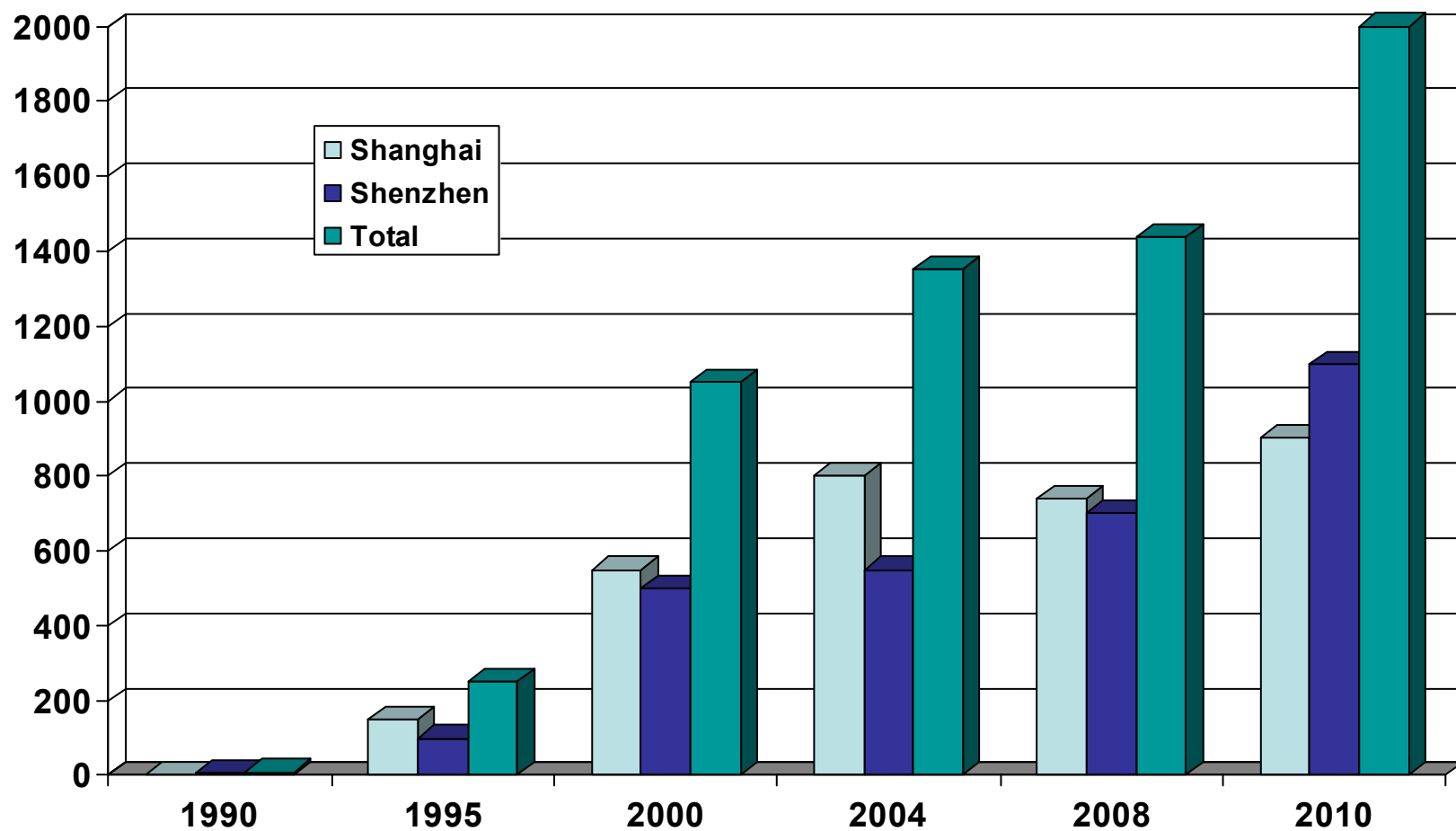
gross industrial output



Source: China Statistical Yearbook, 2010.

Current structure

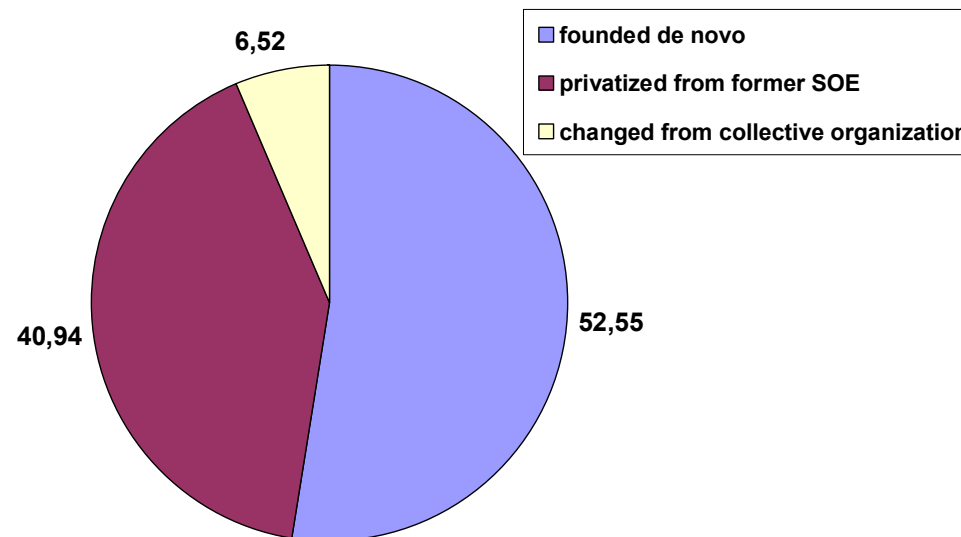
Increasing role of stock exchanges



Source: Shanghai, Shenzhen Stock Exchanges

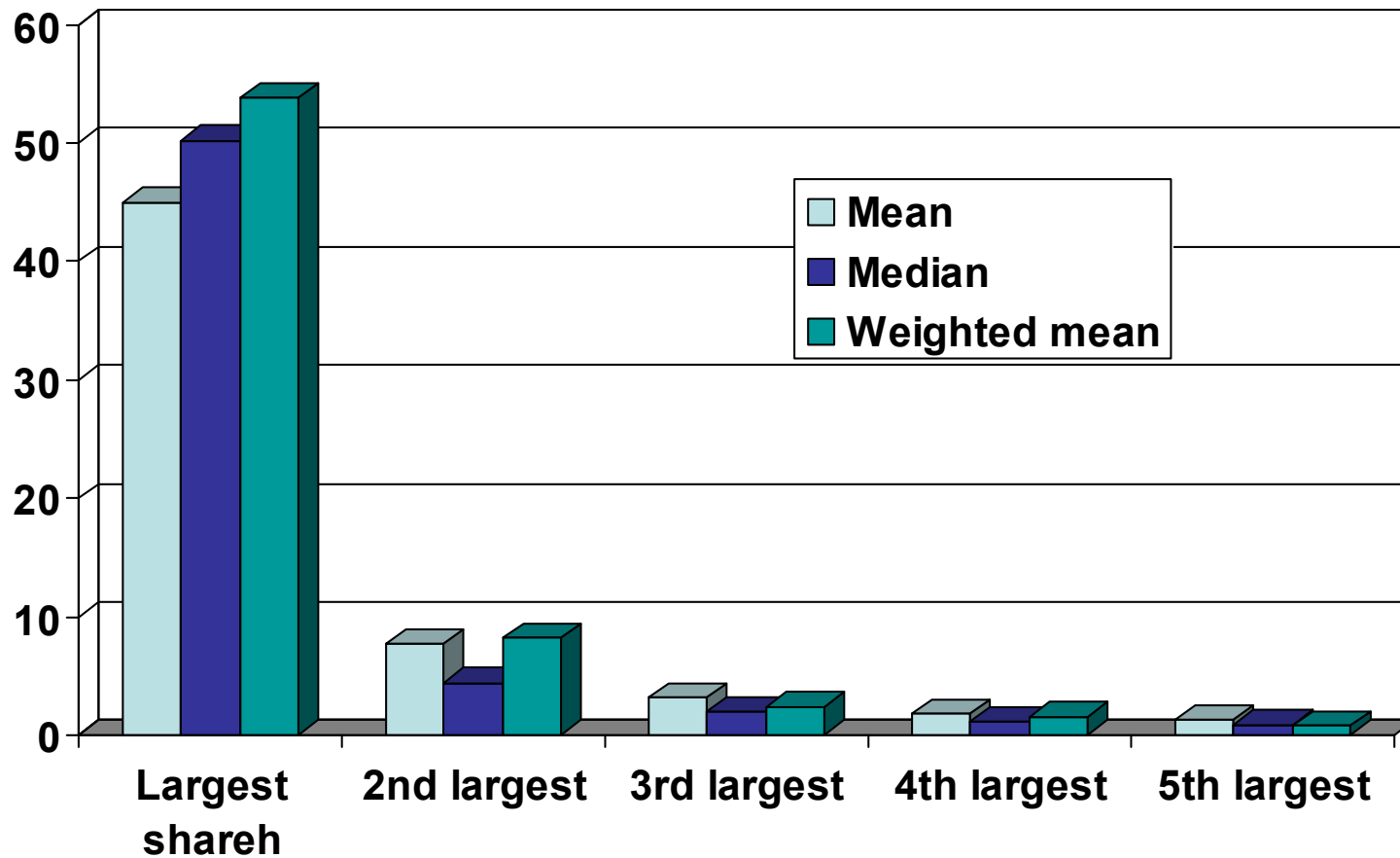
Current ownership structure

- difficult to have data on ownership structure
- only feasible for listed companies
- for large sample of listed ones (more than 1400 in 2007), Amit et al (2010) show that 62% were State controlled but 34% were family firms



Current ownership structure

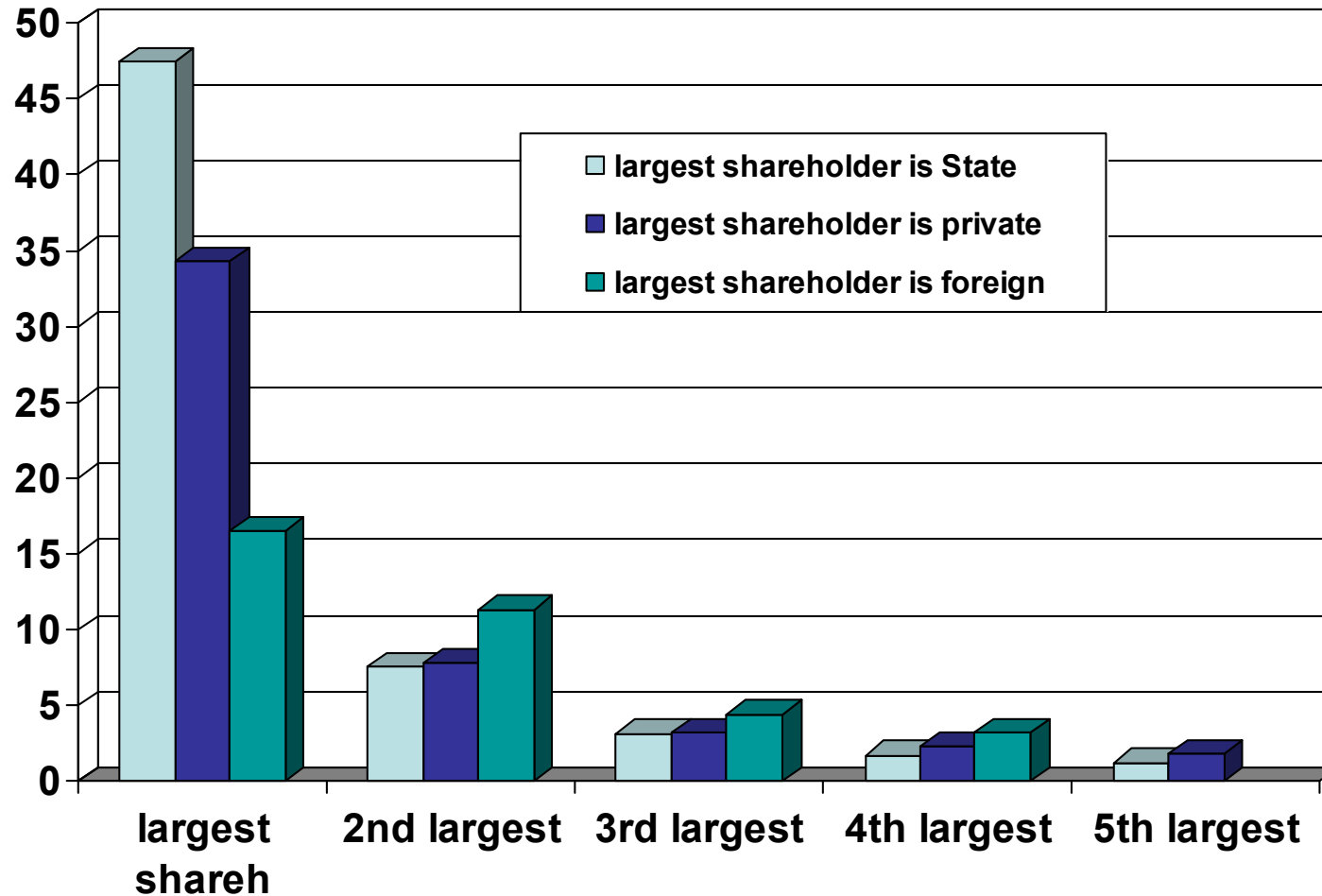
(100 largest listed companies, concentration)



Weighted (by market capitalization) mean computed on a subset of companies.

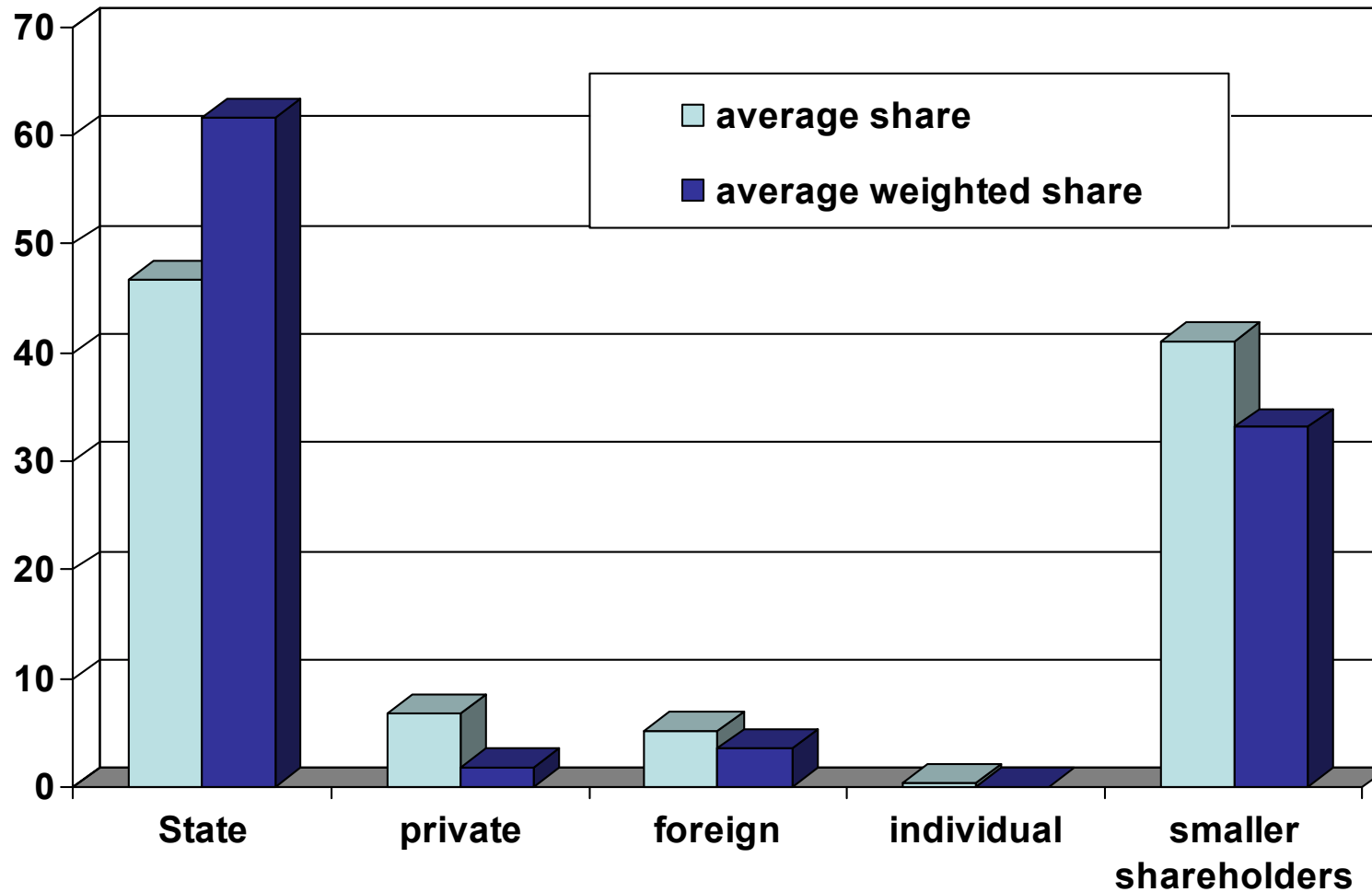
Current ownership structure

(100 largest listed companies, concentration)



Current ownership structure

(100 largest listed companies, largest owners)



Underlying institutional framework

Institutional evolution

Major steps in limited period of time...

- company law
- securities law
- bankruptcy legislation
- enforcement
- + labor law, contract law...

Company law

- 1993 - First company law → maximization of owners' interests; basis for “corporatization” and privatization of SOEs
- 2002 – Code of corporate governance → issued by CSRC (not comply or explain)
- 2006 – Major company law reform with most “best practices” from international standards

Securities law

1992 – creation of China Securities
Regulatory Commission

1998 – First securities law → powers to
investors and strengthening of CSRC

2002 – QFII program → allowed foreign
investors

2005 – convert non tradable shares

2006 – major Securities law reform; new
accounting standards (in line with IFRS)

Investor protection

(Doing business indicators, WB)

	2008	2009	2010	2011
Disclosure (0-10)	8	10	10	10
Director liability (0-10)	1	1	1	1
Shareholders' suits (0-10)	4	4	4	4
Strength investor protection (0-10)	5.0	5.0	5.0	5.0
Ranking	83	83	89	79

Bankruptcy law

1986 – Law of PRC on Enterprise
Bankruptcy (only for SOEs)

2007 - new legislation closer to international
standards, applicable in principle to both
public and private enterprises (bankruptcy,
reorganization, out of court agreements)

Closing a business

(Doing business indicators, WB)

	2008	2009	2010	2011
Time	3.0	1.7	1.7	1.7
Costs (% of estate)	22	22	22	22
Recovery rates	35.9	35.3	35.3	36.4
Ranking	57	62	65	68

Getting credit

(Doing business indicators, WB)

	2008	2009	2010	2011
Strength legal rights (0-10)	3	6	6	6
Depth of credit information (0-6)	4	4	4	4
Public registry coverage %	49.2	58.8	62.1	63.9
Private bureau coverage %	0	0	0	0
Ranking	84	59	61	65

Law enforcement

- Still a major problem even if
 - ...procedural reforms introduced
 - ...increased quality of judiciary
- Corruption still an issue, especially in rural areas

Enforcing contracts

(Doing business indicators, WB)

	2008	2009	2010	2011
Procedures (n.)	35	34	34	34
Time (days)	406	406	406	406
Costs (% of claim)	8.8	11.1	11.1	11.1
Ranking	20	18	18	18

**Evaluations (...based on
conceptual framework..)**

Some evaluation?

a. Incentives for controlling agents

...in SOEs possibly still a problem but changing

b. Investor protection

...strongly improved →

c. Efficient allocation of control

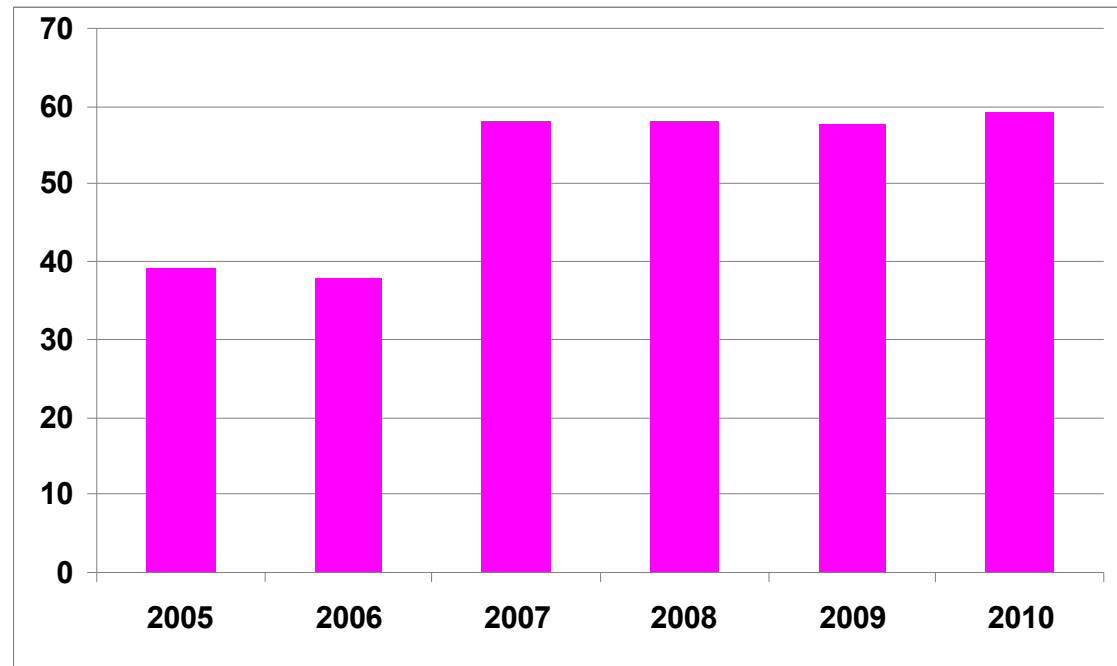
.. Still major issue (→ board of directors in SOEs..)

Investor protection

- Shareholders' rights
- Disclosure and transparency
- Boards of directors and supervisors
- Discipline of conflict of interests
- Role of institutional investors
- Market for corporate control

Shareholders' rights

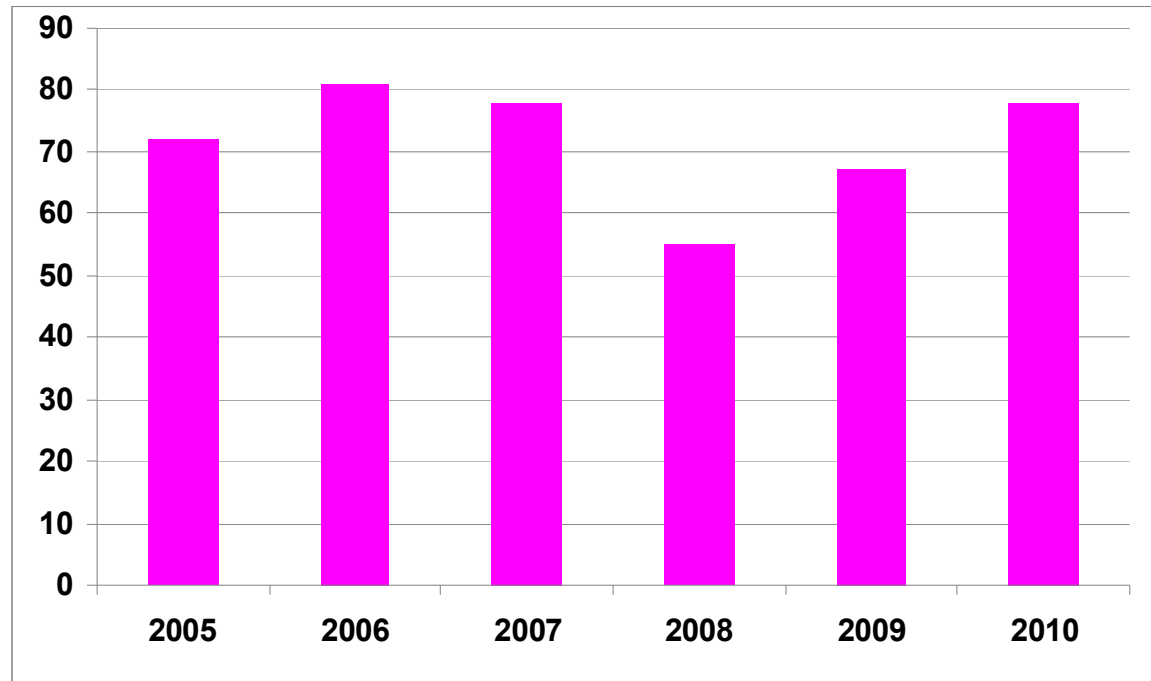
Synthetic 0-100 score
on shareholders' rights
(information + rights)



→ High scores mainly due to information provided to shareholders, less to rights to participate in decision - making

Disclosure and transparency

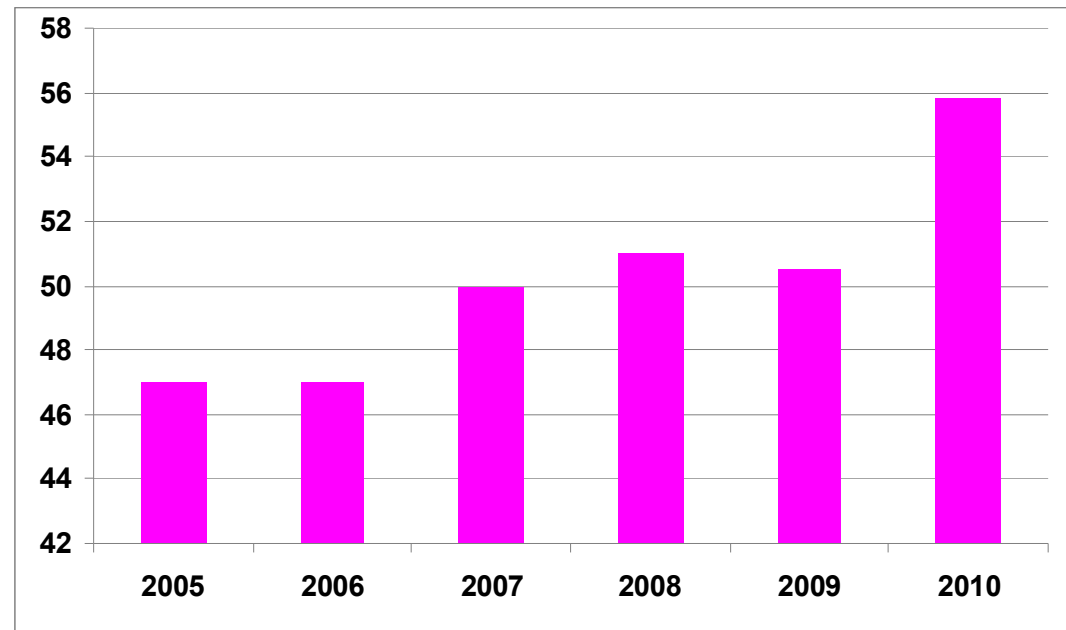
Synthetic score (0-100) on financial and non financial info disclosed in annual report and company website



→ Highest scores of all indicators: improvements in last few years

Boards of directors

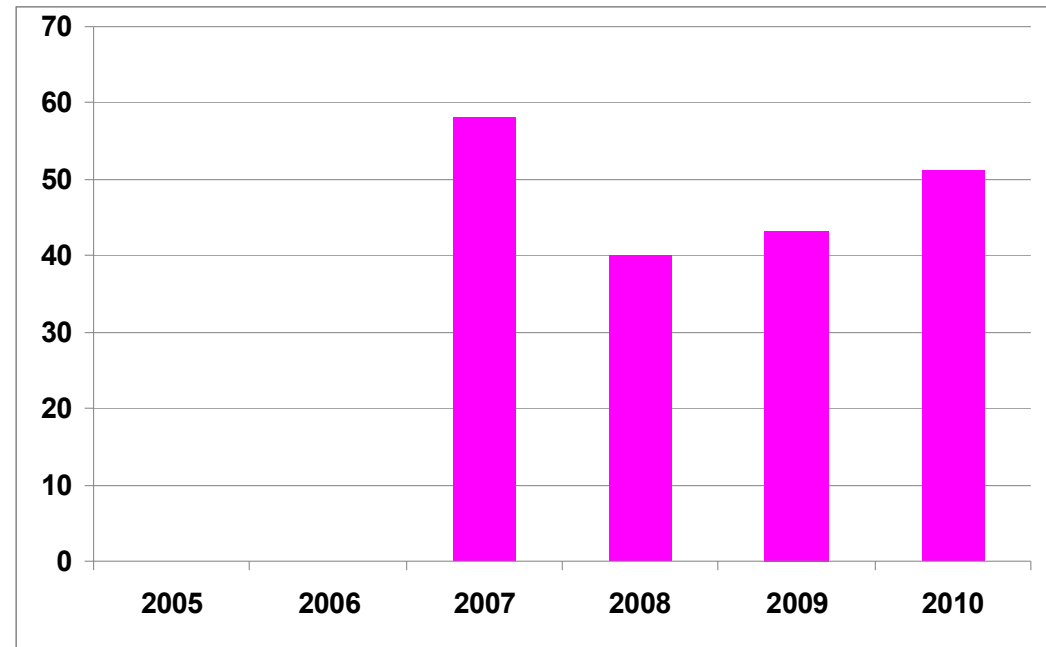
Synthetic score on role of board of directors



→ Improvements over last few years in: size (slightly increased due to greater % of independent); increased number of meetings; increased attendance; functioning of committees. But still relevant weaknesses

Boards of supervisors

Synthetic score on role of board of supervisors (dual board system)

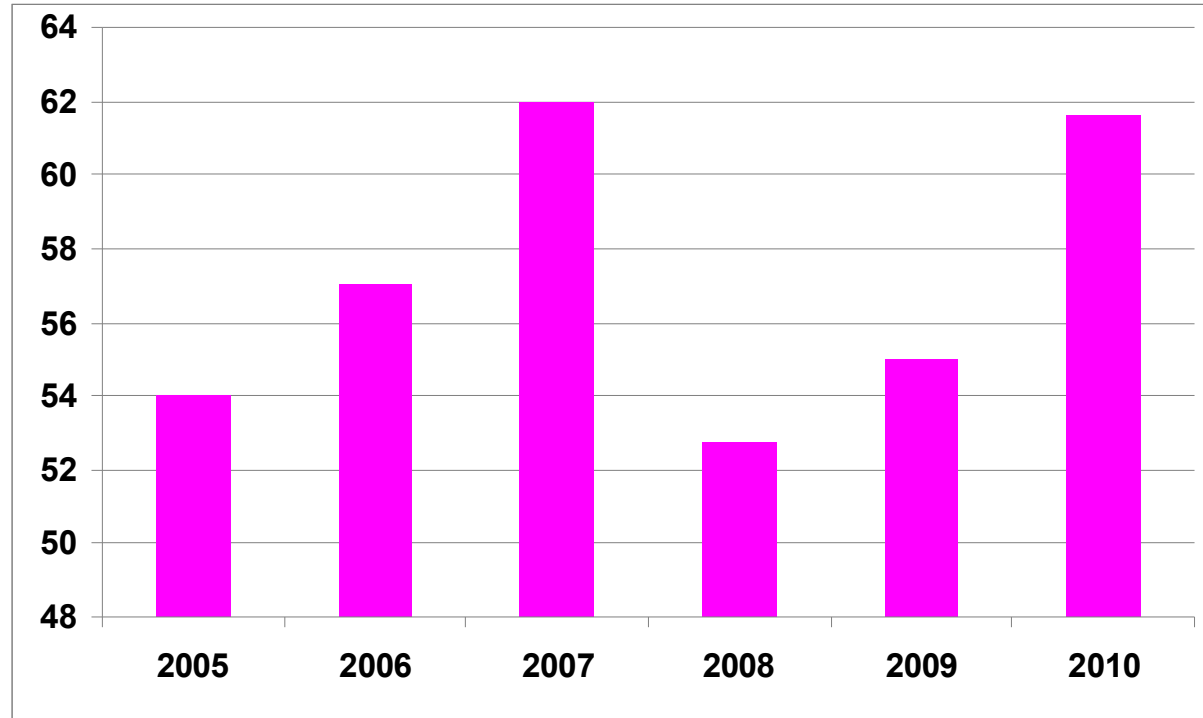


→ Still very weak: increased number of meetings but limited attendance and very low competence (also compared to board of directors) → role of state

.. other

- Discipline of conflict of interest → related party transactions discipline adequate but how well enforced?
- Role of institutional investors → still limited presence and rather passive role
- Market for corporate control → compulsory tender offer when reaching 30%; market becoming more active but still limited...

A synthetic indicator



Based on OECD Principles of Corporate Governance

- ➔ **After reduction in 2008 (due to new requirements of CSRC) strong increase**
- ➔ **Higher for financial companies and for non state owned industries**

Some conclusions

- Major changes in structure
- Institutional framework rapidly adapting to these changes
- Even with substantial State ownership, corporate governance improving (especially in terms of disclosure and investor protection), first just “formally”, now more substantially
- Strong commitment of institutions (CSRC, Stock Exchanges..)

Still an issue:

- Dynamic allocation of control
- Enforcement of rights