China In Search of an Efficient Corporate Governance System

*International Comparisons and Lessons*

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Abstract

The main challenge facing Chinese economic reform in the coming years is that of how to set up an efficient corporate governance system able to effectively control state-owned enterprises (SOEs) and, on the one hand, encourage restructuring, while at the same time trying to ensure that the umbilical cord which links the State and the Party system to these enterprises is not severed.

The paper, based on the study of recent developments of the reform and the literature on non-standard corporate governance systems tries to assess how the Chinese government can cope with the huge task of modernizing the State sector which, for many years, will still play a major role in the development of the Chinese economy.

JEL classification: H1, H7, L, L1, L2, L5, M2, P1, P2, P5.

Keywords: China, economic reform, corporate governance.

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1. Introduction

Since the beginning of the economic reforms in 1978, China has been searching for an efficient corporate governance system for its state-owned enterprises (SOEs) through different waves of reforms. Although some progress has been made in this field, a large proportion of SOEs remain inefficient and unable to compete in a market environment. Recently, the XVth Party Congress has adopted further reforms and recognized the necessity of clarifying property rights, to separate ownership and management in the biggest SOEs and to privatize most of the small and medium sized enterprises (SMEs) (‘grab the big, release the small’). It is still unclear which form of control will emerge from these reforms but recent researches demonstrate that like in former European socialist countries, corporate governance in SOEs seems to evolve toward an ‘insider’ stockholder type control (mainly managers, and local State Holding Companies). Compared to the traditional standard model based on private property rights and control by financial markets, the type of control which is emerging in China does not represent the best solution given the current need of SOEs for external capital, expertise, and monitoring.

Nevertheless, international comparisons with other economies in transition and an historical analysis of the corporate governance system in Japan and in some European countries could provide China with some useful lessons. The so-called ‘neo-classical’ model on which the American economy is based is certainly a benchmark, or a useful reference but other models of corporate governance systems have also contributed to rapid economic development. It is also not certain that in transition economies, at least in the first stages of their transformation, where financial and legal institutions are lacking or take time to develop, this model represents the more adequate solution. Corporate governance systems do not simply fall from the sky; they are the result of institutional design, social and political experimentation and developments. If property rights matters and if the need to control companies is obvious in any system in order to avoid economic waste, alternative or hybrid models of corporate governance systems have helped, to some extent, to discipline the behaviour of firms. The banking system, the competition policy, the level of competence of the human resources can also contribute to the development of a more efficient control over firms. In fact, all these elements relate to each other in a systemic way, and shape the corporate governance system in a specific manner among countries and sometimes among industries. Finally, corporate governance systems are not static: they evolve and respond to domestic and international pressures. Even if globalisation in financial markets tends to reduce the diversity of corporate governance systems, lessons drawn from this international comparison demonstrate that China still has some room to implement an eclectic approach to improve its corporate governance system. But China will have to work on several fronts simultaneously to improve the monitoring of SOEs: urgent and drastic reforms are needed especially in the banking system, in the field of competition policies and to ensure that shareholders rights are protected within a legal framework.
Section 2 will assess the performance of the corporate governance system and the new stages of the reform in this field after the XVth Congress Party; Section 3 will review alternative models of corporate governance systems that can be found in developed market economies and in other transition economies; Section 4, tries to draw some lessons from international comparisons for further reforms of the corporate governance system in China.

2. The limits of corporate governance system reform in China

2.1 The relative failure of the ‘Contract Responsibility System’ policy

The transfer of decision-making power from the bureaucracy to the management of enterprises has been the main tool that Chinese policy-makers have used to reform the corporate governance system in the state sector. Fifteen years after the ‘contract responsibility system’ has been generalized in Chinese SOEs, management autonomy has increased significantly (Byrd, 1992; Lu and Child, 1996; Warner, 1995). Although the bureaucracy still exerts its decision-making authority in some very important matters (no. 10 to no.14), Table 1 shows that management enjoys, by now, a great deal of autonomy in decision-making. Furthermore, by the mid-80’s, the Central Government had relinquished nearly all its administrative powers to local level authorities where the management of small and medium sized SOEs was concerned. Before the beginning of the reforms in 1978, SMEs in China already enjoyed much more autonomy than in the planned economy of the former USSR, but their adoption of the ‘contract responsibility system’ simplified the decision-making process for this category of enterprises even more.

Compared with the old centralized and planned system before the reforms, the transfer of autonomy has created a lot of new incentives for the SOEs to invest in new production and to respond to the needs of markets. But these reforms are far from having created an efficient corporate governance system. The state sector is still plagued with problems which reveal the inefficiency of the corporate governance system. Most of those problems have been extensively analysed in the literature, but we would like here to focus on three of them which will probably become the most important bottlenecks that the Chinese leadership will have to solve in the near future:

(1) Unbalanced Industrial Structures: although a process of concentration has taken place since the beginning of the 90’s, most of the industrial sector is plagued with an irrational structure. According to official figures, there are 124 producers of TV sets, 122 automotive producers: nearly every province has an automobile or a truck producer; the situation is similar in the textile industry and for consumer products. It is difficult to believe that 118 000 industrial SOEs will survive in the future, especially if China joins the WTO. Excess production capacities are the norm in the light industries sector: at the end of 1996,
the utilization rate of production capacities among producers of TV sets, refrigerators, washing machines, air conditioners, radio cassette, tape, truck, camera, bicycle, video recorders, was in the vast majority of cases, below 50%.\(^1\)

China’s state sector is in a paradoxical situation. A minority of enterprises have been able to adapt their technologies and their products to markets and to the competition coming from imports, sino-foreign joint-ventures and from the collective sector. They have been able to overcome administrative regional barriers, to develop a ‘virtuous circle’ for investment where economies of scale and growing market shares generate sufficient cash-flow to finance further expansion and new products. But for the vast majority of SOEs, adaptation to markets and to competition has been very slow. Since the end of the 80’s they have entered a ‘vicious circle’: absence of economies of scale, small market shares, obsolete technology, low cash-flow, high dependence on bank credit to survive. Most of them are small enterprises created during the Great Leap Forward and the Cultural Revolution when the Chinese leadership promoted regional and local self-sufficiency. They represent 80% of the total of SOEs and nearly half of the total employees in the state sector.

Now, it remains to be seen if the XVth Party Congress decisions will be followed by a large movement of mergers and bankruptcies. If this happens, it will be more the result of \textit{ex post} adjustment of firms boosted by competition forces than the implementation of a relatively efficient corporate governance system aiming at reducing costs of exit of firms by anticipating problems at the micro-level (Jensen, 1997).

\begin{table}[h]
\centering
\caption{Degree of management autonomy in SOEs}
\begin{tabular}{|c|c|}
\hline
\textbf{Decision} & \textbf{\% of enterprises declaring complete autonomy on decision-making in the listed area} \\
\hline
1 Selling & 97 \\
2 Production & 96 \\
3 Purchasing & 94 \\
4 Use of retained earnings & 78 \\
5 Right to decide on organizational structure & 78 \\
6 Pricing & 73 \\
7 Wages and bonuses & 65 \\
8 Right to hire workers & 58 \\
9 Right to manage personnel & 55 \\
10 Investment & 47 \\
11 Establishment of JV or mergers & 40 \\
12 Import and export & 39 \\
13 Right to dispose of assets & 37 \\
14 Right to refuse non-regulated government charges & 21 \\
\hline
\end{tabular}


\(^1\) \textit{Zhongguo tongji nianjian} 1997, (\textit{China Statistical Yearbook}, p. 455)
(2) Lack of Corporate Group internal control: As in other reformed socialist economies, increasing autonomy without a clear definition of property rights has led bureaucrats and managers to develop opportunistic behaviour and insider strategies. Some have tried, and succeeded in diverting SOEs assets away from the state sector towards collective and private sectors where investment returns are higher and the business environment less bureaucratic. It is difficult to have accurate data on this phenomenon. No statistics at the national level are available; bureaucrats and managers do not talk openly about this matter as such activities are considered illegal. Nevertheless, some case studies suggest that this phenomenon is very common: in 1995, a study in Shanghai revealed that, on a small sample of SOEs, some managers admitted to have created nearly 5 enterprises in the collective and the private sectors (Kejijiaochazu, 1995). Another case study in Shenyang city has also shown that this practice is used by a majority of state enterprises (Kernen, 1997). It is also possible to find evidence in macroeconomic data despite the fact that the state sector now represents only 35% of national industrial production, it remains the main consumer of capital in the economy with 70% of bank credits and 60% of capital investments. The difference is huge and cannot be explained in the traditional manner by reference to such costs as the social burden supported by SOEs or the inefficiency of their investment decisions. Part of this difference could be explained by the fact that some of the capital obtained by the state sector is actually used to finance its activities outside the state sector.

Concerning corporate governance, this phenomenon has led to the creation of very opaque corporate groups: except for the very few companies listed on the Shanghai and Shenzhen stock exchange as ‘B’ shares or as Hong Kong ‘H’ shares which are obliged to disclose information on their activities, most of the time there is no consolidated accountancy system, no real long-term investment strategy, and no external control on their operations. This phenomenon can probably explain part of China exponential growth rate, but on the other hand, it is also responsible for the proliferation of speculative investment in, for example, the property market, the creation of excess capacities on consumer products made by small productive units, and probably the growth of bad debt supported by the banking system.

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Output</th>
<th>Employment</th>
<th>Net value of fixed assets</th>
<th>Profits &amp; taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>large</td>
<td>4.7%</td>
<td>56.7%</td>
<td>43.2%</td>
<td>62.2%</td>
<td>66.7%</td>
</tr>
<tr>
<td>medium</td>
<td>12.9%</td>
<td>23.6%</td>
<td>25.6%</td>
<td>18.6%</td>
<td>19.4%</td>
</tr>
<tr>
<td>small</td>
<td>82.3%</td>
<td>19.7%</td>
<td>31.1%</td>
<td>19.5%</td>
<td>13.9%</td>
</tr>
</tbody>
</table>


(3) Low cash flow and development based on a high level of leverage: Chinese SOEs registered a rapid slowdown in their after-tax profit at the end of the 80’s. Since 1995, the
total losses has exceeded even the total profit after taxes (see Chart 1). Productivity has
grown much more slowly than wages and social security payments, and enterprises have
had to face important rises in raw material prices. Even if the situation is different among
industries and enterprises as we have seen above, generally speaking, this situation has led
to a deterioration of cash flow (which is already traditionally low in socialist economies)
and to a higher dependency on the banking system.

This is particularly evident in respect of working capital requirements. In a survey
published in 1994, covering 124 000 state industrial and commercial enterprises, working
capital requirements represented 91.5% of debt (Zhongguo shehuikexuyuan gongye jingji
yanjiasuo, 1996). But working capital in China serves also to pay the burden of retirement
pay and all other social security benefits. Working capital is also very important in foreign
technology imports. It is needed to pay a lot of complementary expenses which are not
usually included in the budget of the purchase such as minor transformations and
adaptations of the imported technology or expenses induced by the new technology in the
production organisation. The lack of working capital in this case is often one of the main
reasons explaining the poor assimilation of foreign technology in SOEs.

*Chart 1: Trends in profits and losses in state-owned enterprises (billion yuan at 1978
prices)*

*Source: Various issues of the China Statistical Yearbook*
For fixed investment, government subsidies represented 60% of the funds for SOEs in 1979 but only 4.6% at the end of 1996. On the other hand, bank credit has grown from 4% in 1979 to 24% at the end of 1996. Nevertheless, a huge part of the bank credit given to SOEs is in the form of policy loans and can be considered as government subsidies (the difference lies in the fact that these loans are no longer within the state budget).

This evolution in enterprise financing structure has led to an impressive growth in the debt/asset ratio. According to Lardy (1998), the debt/asset ratio has grown from a low level of 11% to 85% by the end of 1995, with an acceleration since the beginning of the 90’s (Lardy, 1998). Furthermore, Lardy insists on the fact that this ratio is probably understated due to the unfounded pension liabilities of the SOEs, the overstatement of their assets and the fact that they do not take into account net debts to non-state firms. Even if we do not consider this, a ratio of 85% of debt/asset corresponds to a ratio of debt/equity (which is normally used in market economies) well over 500% according to Lardy, that is to say an incredibly high level of leverage. In comparison, the South-Korean Chaebols which are usually blamed for their high level of leverage, had an average of 300 to 400% of debt/equity ratio before the financial crisis.

Reasons for this poor efficiency of the corporate system are relatively well-known. They can be found in the literature dealing with former socialist economies in transition and are normally directly related to three main factors which are in reality very much interrelated: the absence of hard budget constraints for SOEs; the lack of a sound legal environment which regulates the business in the state sector and finally the lack of autonomous financial institutions able to exert an external control over the investment decisions of the firm. But four different factors are particularly striking in the case of the Chinese state sector:

(i) **The low efficiency of the banking system.** Despite some efforts to implement some structural reforms, the banking system is still not capable of playing the role it would have to play in a developing country. The banking system is still heavily influenced and controlled by the political system both at the central and the local level. To a certain extent, it has replaced the state subsidies which used to finance working capital and investments of SOEs: budget constraints are still very ‘soft’ for enterprises and policy loans to keep heavily indebted enterprises afloat are widespread. The banking system also lacks well-trained human resources capable of implementing a real credit risk policy towards enterprises. In general, no external financial institution has been able to exert any real pressure on the management of the SOEs. Only recently has the de facto central bank, the People’s Bank of China, been able to ‘harden’ the budget constraints and curb the redundant investment of the SOEs through a tighter monetary policy. The Central Bank subsidiaries at province level should be closed down to be replaced by regional units in order to escape the grip of local bureaucrats on their decision-making.

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2 *Zhongguo tongji nianjian* 1997, (China Statistical Yearbook)
(ii) **Fuzzy property rights**: despite the decentralization process, too many administrative entities can still claim ownership rights on SOEs. This phenomenon has led to a situation where nobody feels responsible for the SOEs’ losses but where everyone claims to have the right to use its assets. No institution or individual is bearing the risk which normally accompanies an investment decision but the most powerful actors of the state sector, mainly managers and bureaucrats, have become *de facto* owners of SOEs and have contributed to diverting SOEs assets outside the state sector. The monitoring of SOEs’ assets has become so difficult under the ‘contract responsibility system’, that it constitutes probably one of the main factors which has influenced the recent reform package endorsed at the XVth Communist Party Congress in October 1997.

(iii) **A low level of bankruptcy**: despite the existence of a bankruptcy law since 1986, the rate of bankruptcies has remained at a very low level considering that nearly one-third of all SOEs are probably insolvent and that their restructuring is doomed to fail. The level of bankruptcies was too small up until 1995 to constitute a real incentive to restructure SOEs. For all forms of ownership in China, the rate of bankruptcy remains particularly low at 0.06% compared to 1.1% in the United States. From 1990 to 1993, 1,287 cases of bankruptcy occurred in the state sector, 1,625 cases in 1994, 2,200 cases in 1995 (other sources are 2,348 cases for 1995) and 6,222 cases in 1996, but in 1997, the number of bankruptcies had declined to 4,498 cases. This slowdown is particularly apparent during 1997 and the first half of 1998 and raises again the difficult choice faced by the authorities between maintaining social stability and restructuring SOEs. Not only workers, but also managers and bureaucrats are reluctant to see corporations going bankrupt. Banks which are the main creditors of SOEs are also reluctant to let too many enterprises go bankrupt as they will have to write off their too many (bad and irrecoverable) loans.

### 2.2 The evolution of the corporate governance system after the XVth Congress and the limits of ‘insider’ control

Among all the major state sector reforms undertaken after 1978, there still remained one which the authorities left alone: the reform of public ownership. Until the latest Communist Party congress in October 1997, this remained a taboo subject. China is following a different pace than that chosen by former European socialist economies. Instead of launching massive privatization schemes, the Chinese leadership is tackling the idea of transforming the SOEs into share-holding companies (see Insert 1 for more details), with the share-holding being organized on a so-called co-operative basis (*gufen hezuo zhi*) for the

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3 South China Morning Post, 06.02.1998.
5 South China Morning Post, 06.02.1998.
6 *Ibidem*.
7 *Ibidem*.
small and medium sized companies; the progressive withdrawal of the state, whose extent will vary according to the size of the enterprise; establishing state holding companies (guoyou konggu gongsi) as subsidiaries of the central ministries; and finally, introducing State-Owned Asset Management Companies run by local municipal authorities (guoyou zichan jingying gongsi).

However symbolic the recent measures on ownership adopted by the XVth Congress may be, like most reforms since 1978, they represent the search for a compromise between what is politically tolerable and what is economically necessary. They are also the result of a compromise between the different influential participants within the power struggle over state sector reform. This context raises the question we will be asking, as to whether the course taken as a result of the compromise at the XVth Congress will be able to meet the challenge of restructuring of the state sector on a sound basis. There remain many unanswered questions over the future direction of reforms and their many possible local variants. The response to this compromise by the different participants and institutions will therefore be crucial if the ambitious goals set for the reform are to be reached.

2.2.1 The impact on large SOEs will be limited

The Chinese government has announced on several occasions that it will retain a majority shareholding in large enterprises. These enterprises will receive a special allocation of resources to speed up their restructuring. Within this category a distinction should be made between enterprises which will continue to be considered as public utilities and those which will face competition. For example, among the 57 industrial conglomerates set up by a decision of the State Council in 1991 (to which a further 63 were added at the beginning of 1997) six of them are operating in the production of electricity.

These companies will remain under the control of the Central government, reorganized as a single group or holding company (see insert, level 1). They will not develop their activities in a competitive environment and will have very little to say in setting prices, or in production or investment decisions. Despite being in urgent need of restructuring, they will not really feel the effects of property rights reforms, except perhaps in terms of an improvement in the central ministries’ decision-making process.

As for the large SOEs which will have to develop in a competitive environment (car manufacture, steel production, chemicals), it is also quite hard to envisage how the property reforms will have a direct influence on their restructuring. The state will remain by far their biggest shareholder, and channels for making decisions will also certainly remain under the control of the bureaucracy. Central ministries, operating through their new financial holding companies (see insert) will keep these enterprises as their private preserve (Xu, 1996). The best that the enterprises can expect may be some financial benefits from the state’s withdrawal from the control of small and medium SOEs. The state will be able to
concentrate its resources onto a smaller number of recipients. That could represent a positive aspect, if the signals coming from the state are reliable. But these new funds will have to be invested in restructuring, and should not be considered as renewable annual subsidies, as is the case at present.

2.1.2 What role is to be played by the local state asset management companies in the medium and small SOEs?
In enterprises, in which the state retains a controlling interest, a close look should be taken at local state-owned asset management companies which exert the real power at boards of directors. On paper, and according to interviews we have conducted with members of these companies in Wuhan and Hangzhou, they wish to have an important say in industrial restructuring. In Wuhan, for example, the first state asset management company created in 1994 (and the only one until late 1997, four new companies have been established since that date) has censured six managerial teams out of the 50 under its control. It has also facilitated the formation of conglomerates by withdrawing its financial stake in some firms and buying up others in order to reinforce its industrial strategy in the firms under its control.

However, it is still difficult to know whether they are going to become real agencies for industrial restructuring, in the same way as in East Germany with the Treuhandanstalt, which co-ordinated privatization and restructuring up until 1994 (Hirschhausen, 1996) or in Poland, where the Government has set up fifteen National Investment Funds in charge of conducting both restructuring and privatization of state assets in their portfolio. Chinese local state-owned asset management companies retain much more power in the enterprises than they care to admit, particularly in the regulation of local competition, and in decisions over financing and industrial strategy. They should not simply ‘change their door-plate’ (huan paizi) while just going on as before behind their new official identity. In this respect, in the experiment conducted in Shanghai, MacNally (1997) has listed the setting up of 33 state asset management companies in Shanghai, the majority of which were former industrial bureaux. Their state asset controlling function is limited to a single specific industrial sector. This is very similar to the definition of functions by sector, which was the norm before they were converted into state asset management companies. So Shanghai was certainly very quick to set up such companies, but the retention of the old sectoral organization, and the kind of control they exercise, gives grounds for a certain doubt about the degree of institutional innovation that they really represent.
Insert 1

Contents of reforms endorsed by XVth Party Congress

Level One: Changes in the economic bureaucracy

The ministries in charge of various industries (electronics, machine tools, light industry, etc.) have been stripped down: one part will continue to be concerned with administration and should deal with long-term planning in the state sector and be amalgamated into one large ministry of industry or other State Commission. The other part will discard its administrative functions, to become a State holding company (guoyou konggu gongsi). Also at the level of the central administration, the Ministry of Finance’s bureau for the management of state assets (guojia guoyou zichan guanli ju) is emerging from the shadows to take on real power in the management of state property. It is set above the ministries, and will become, in theory, the highest state institution in charge of state assets.

At provincial and local levels, local industrial bureaux will disappear more quickly than at the central level, but will take the same general form, with minor variations. Municipalities will set up a local state assets management commission (guojia guoyou guanli weiyuanhui) which will be subordinate to both the municipality and the central state assets management commission in Peking. In each industrial bureau, a large section of employees will relinquish their administrative status to become organized into industrial groupings or state asset management companies for any given sector, and acting on behalf of the local commission. And lastly, the remaining part, smaller in number, is to be amalgamated with one of the municipal economic commissions.

Level Two: The development of state asset management companies

These state asset management companies (guoyou zichan jingying gongsi) act on behalf of the local state asset management commission mentioned above. They are the municipal governments’ fund providers. But they also enjoy a considerable degree of autonomy. Their function is to manage assets belonging to the State in the SOEs which have been converted into share-holding companies. So they must above all protect the current value of state assets. But they can also sell off a part or all of assets of SOEs under their control. Whenever the sale of assets would result in a change in majority share holding, they must seek authorization from the municipal state assets management commission. But that is not all. They are supposed to play a role in the restructuring of the enterprises. In their capacity as shareholders, and mostly majority shareholders at that, they are in control of the enterprise board of directors. The president of the board of directors is a representative of the state assets management company, and is usually its director. So they have the power to nominate managers of the enterprise, and as majority shareholders, they oversee the general management. Its members are mostly former members of the local industrial bureau or economic commission, but they have relinquished their state functionary status (McNally, 1997).
The main development affecting enterprises themselves is their conversion into share-holding companies. This development is regulated by the company law passed in 1994. According to the evidence of experiments conducted in the different localities since 1994, and certain references made in Jiang Zemin’s speech at the XVth Congress, it would seem that, leaving aside companies listed on the stock exchange, a ‘co-operative type of share holding’ (gufen hezuozhi) is being encouraged. There would be three kinds of shareholders controlling the capital of the SOEs: firstly, the state itself, represented by state asset management companies; secondly, collective bodies which are usually subsidiaries or affiliated companies belonging to local administrations; and thirdly, employees and managers of the enterprise. Following the principle of ‘grabbing large enterprises and leaving the smaller’ (zhuada fangxiao), the state will retain a majority stake in the country’s large and medium SOEs, numbering around 15,000. As for small industrial SOEs, numbering around 100,000, the leadership, on several occasions, has let it be understood that the State could withdraw from them quite rapidly. But listing on the Shanghai, Shenzhen, and Hong Kong stock exchanges (let alone New York, Singapore, and Tokyo) will only affect a very small number of enterprises, even though the authorities have often stated that they will speedily increase their numbers (800 Chinese companies are listed on the stock market at the end of 1997). Accordingly, all SOEs should, in due course, set up managerial and supervisory structures necessary for a share-holding company: such as a board of directors, a supervisory committee, regular audits etc. The other major task facing the SOEs is the progressive dismantling of their provision of social services, like clinics, schools, transport, and so on.

It is crucial for the future of structural reforms to take into account how the sums raised from the sale of small and medium SOEs will be used. It is a question of deciding whether the state asset management companies are going to favour an industrial or a financial strategy. If the sell-off of state assets serves to provide new capital and a new structure to enterprises, then its effect may be considered positive. These state asset management companies would then disappear of their own accord, as the ceding of assets and the restructuring takes place, as happened in the case of East Germany’s Treuhandanstalt. This was dissolved at the end of 1994, when all SOEs had been fully capitalized. But if Chinese companies favour a financial strategy, their role in industrial restructuring is open to question. What is meant here by a financial strategy? The companies might make use of the transfer of assets to set up an investment portfolio. The Wuhan state asset management company has already created a subsidiary with the same powers as the parent company: Of course, industrial and financial strategies are not necessarily opposed to each other. It is possible to imagine the state asset management companies slowly turning into institutions like the investment funds in certain East European countries. That is to say, that in a further stage in the privatization process, SOEs employees might sell their shares to these companies which, in the interest of maximizing the value of their share portfolios, would encourage the restructuring of enterprises under their control. However, there is also the threat that the rapid development of opportunist financial behaviour on the part of state
assets management companies could be made at the expense of industrial restructuring. There are already disquieting elements in the present development of State asset management companies. In particular, judicial systems of control over their activities are very poorly defined. They enjoy a large measure of de facto autonomy, and at the national level, the central bureau of state asset management finds it difficult to exercise any control, given the increasing number of municipalities setting up such companies. There is a risk that local interests will become paramount. The cadres in charge are all from the former industrial bureau or local economic bureaux. Furthermore, there is only a very slim chance of developing co-ordination between these state asset management companies at the national level, which is worrying in view of Chinese industry’s need for concentration, and for the transfer of capital raised from the sale of assets towards those regions which are severely affected by the crisis in the state sector.

**Share holding arrangements which do not encourage restructuring**

With regard to the small and medium enterprises from which the state is going to withdraw, these seem to be heading towards shareholding by local insiders: consisting principally of managers and employees of the enterprise, followed by the local governments represented by the state asset management companies, and finally collective bodies with links to either local collective enterprises or other local bureaucratic entities. This shareholding arrangement gives the controlling power to the enterprise management, even when employees hold most of the capital. It gives rise to a situation which is unfavourable to change, as can be seen from the experience of privatization in Russia since 1992 (Pohl *et al.*, 1997). Naturally, some directors are very capable, and can take advantage of their new independence from the administration in order to embark on a bold series of reforms in their enterprise. But the majority of small and medium SOEs, which are those the most affected by the crisis, are in need of external expertise, which usually comes about through the active participation of shareholders from outside, whether in a majority or in a minority capacity. It can be foreign investors, but external shareholders can just as well be home-based investors, like a bank, an investment fund, another firm operating in the same sector, or a financial holding company. The important point is that such shareholders should have a certain expertise at their disposal, and that they should be determined to inject some dynamism into the enterprise. But enterprise managers, who have the most to lose, are able to develop alternative strategies to block such initiatives by outside investors. They can pressurize the workforce not to sell their shares to outside investors. They can obstruct the raising of new capital, or if that is unavoidable, they can make sure that they can buy back the majority of the new share issue.

The Chinese press provides many examples of enterprise management’s eagerness to take full control. Furthermore, with the exception of firms listed on the stock exchanges, matters are made worse by the fact that the workers are forbidden to sell their shares to
outsiders. Unofficial unions are banned, and the employees are in a far weaker position to defend their rights than in Eastern European countries. The 1994 company law does indeed represent a step towards setting up a more transparent legal framework with respect to shareholders’ rights, but as with all laws passed in China, the problem lies in their day to day application. Research into SOEs converted into shareholding companies prior to the XVth Congress shows up their many weaknesses: there is a failure by enterprises to report on their financial situation, a lack of respect for minority shareholders’ rights, and a decision-making process without consultation with shareholders. In general, management councils are in fact councils for ratifying decisions taken by the managers in consultation with local bureaucrats (Freund, 1997). In such a situation, transaction costs for a potential investor in a small or medium Chinese SOEs are still very high. This is particularly true for foreign investors. Apart from investors from Hong Kong or Taiwan who enjoy strong links with the local bureaucracies, they feel that their participation gives them no control whatsoever over the enterprise.

In conclusion, despite continuous reforms since 1978, the evolution of the corporate governance system is rather similar to the case of a blind man who, used to relying on his guide dog for his every move, suddenly regains limited vision which allows him to see shapes and colors but nothing else. This, of course, is much better than being totally blind, he can do away with his dog and take the initiatives to do what he wants, but he still makes a lot of mistakes and needs someone to advise him. It seems unlikely that China can rest content with the kind of property rights reforms that have emerged from the XVth Congress. These are a first step and a significant ideological break with the past. It is understandable that, for reasons to do with the political agenda and compromises between powerful actors in the state sector, the government wishes to handle the unavoidable privatizations at its own pace and in its own way. But eventually China will have to continue to improve its corporate governance system. If the necessity of introducing a new corporate governance is widely accepted, the difficult point is to choose a model which would give firms an efficient way of minimising the social cost of restructuring, and at the same time leave the government with control of strategic industries. Although the model which will be implemented in China is more likely to result from some kind of compromise arising from the need to meet the above mentioned objectives, there is no doubt that review of recent experiences in transforming SOEs in market and transition economies can help to highlight some of the main issues relating to corporate governance and the restructuring of the SOEs.

4. Experiences of corporate governance of firms in market economies and in transforming economies

4.1. The standard approach to the corporate governance system

Generally, the model of corporate governance to which specialists refer to is the standard model which is at work in big market economies and more particularly in the US and the UK. In decentralized and competitive markets, firms are controlled by external owners who take their decisions on the basis of the information provided by capital markets. On these markets, property is fragmented and distributed among owners (individuals, banks, investment and pension funds). At first view, the large spreading of ownership among economic agents should lead a de facto control of firms by their managers (managerial control). Taking advantage of the asymmetric information bias, managers are in a position to develop their own strategy in terms of security, rewards, expectations; they can allocate some profits to match these objectives instead of channelling it to shareholders.

In an open economy, with a well-functioning capital market, this kind of behaviour can be easily counterbalanced even if shareholders are kept at arm’s length of the daily routine. The information available on the stock market is sufficient to control firms and to take decisions if necessary. The valuation of assets on competitive markets can be a reward or a threat to managers even if they don’t take advantage in the same proportion of the reward of the risks than shareholders do (risk adversity vs risk neutrality).

In reality, firms, even in developed market economies, don’t behave as the theory explains it. The cost of information is generally high and there may be strong asymmetries in terms of access to it for different agents. Shareholders are generally neutral as they don’t invest enough to get the information about a specific business at a reasonable price and that they follow a portfolio strategy allowing them to spread the risk over different investments. So, corporate governance is a network of contracts between different agents, shareholders, directors, but also between the directors and the employees in order to respect the interests of shareholders. These contracts integrate, of course, the transaction costs of internal and external co-ordination of companies.

The correct functioning of financial markets which creates a strong pressure on firms is also a powerful device to discipline corporation: exit (Hirschman, 1970) might threaten companies and managers not doing well. Besides external and managerial control, stakeholders may influence the choice of the firm by exerting their own power on the organization (unions, interest groups inside the company, suppliers and customers, municipalities).
4.2. Anglo-Saxon vs. Rhenan and Japanese Capitalisms

In the literature on the control of firm, both the German and Japanese (and south Korean, to some extent) models of corporate governance have been popular for at least two reasons. First, because it was understood that it might be easier to set up this kind of model than to create *ex nihilo* a sophisticated financial market and market institutions to monitor firms. The other reason, maybe the most important one, was that having a friendly bank in the center of an industrial complex might have some interesting advantages: direct access to more or less soft finance, escape from the hard budget constraints coming from the implementation of macro-policies; allowing a longer period of time to restructure inside the group.

In terms of corporate governance in market economies, the US (and UK) model is generally opposed to the German and Japanese ones where the distribution of shares among shareholders is more concentrated among a few banks or financial investors. Those are in a position to more effectively control the behaviour of companies by being appointed to the company board. Instead of exit, as is the case in volatile capital markets, representatives of banks at the board of companies can have their voice heard (Hirschman, 1970). As a comparison, first institutional investors in General Motors, Mercedes-Benz and Mitsubishi control respectively 2.5, 25 and 54% of assets. There are, nevertheless, two main differences between the German and the Japanese model: in the first one, banks exert real control on firms’ decisions concerning investment projects; banks are in competition on capital markets. If the German model has helped to build up and develop big *Konzerns*, efficiency has always mattered both in terms of market strategy and financial control. The peculiar relationship between banks and companies may reduce transaction costs on financial markets in providing capital at a lower cost by reducing intermediaries but it limits room for insiders’ strategies. On the other hand, the efficiency of the German model, as in the case of the US, is that big companies follow industrial strategies both in terms of specialization and organization. Big enterprises rely heavily on strong externalized organizations, mostly powerful medium sized companies.

In Japan, the corporate governance is slightly different both in terms of control and strategy (Richet, 1998). There is a specific relation between banks and corporations (Aoki and Dinc, 1977). One bank acts as the main lender to a corporation; the same bank can also be its main shareholder. The bank provides the necessary financing to the company on the basis that the company can assure the expected level of return on investment to the lender. As a side effect, the bank, as a lender, is generally neutral and there is no trade-off between the bank as a shareholder and the bank as a lender. Another important point in the relation between the bank and companies it controls is the existence of a subtle co-operative game with pre-threat between both sides. For instance, the corporation knows that it can draw cash from the bank up to its capability to produce the expected level of return without supporting a direct control from the bank. Otherwise, the bank sends a representative to the
board to supervise the behaviour of the company; the bank can also, if the situation is worsening, replace the CEO of the company. This is an ultimate measure which has bad consequences for both parties. In Japanese companies, the leadership is exerted by prominent people finishing their career after having occupied different positions within the company. Removal from the position is considered as a humiliation for the members of the companies and is also a poor option for banks, since replacing the leadership by somebody from the bank could have a negative effect on employment. For the bank, contrary to what would be the case in Western companies, turning a company around after sacking the leadership can have a negative effect on the image of the bank in the future. It is generally the reason why both parties intervene before attaining these limits. In the meantime, if the financial constraint is not too high, and the prospects concerning future returns are good, Japanese firms are *de facto* leverage companies controlled by their managers able to generate a sufficient amount of cash.

Both German and Japanese models of corporate governance (with, to some extent, the Korean model) have attracted some interest in transforming economies mostly because reformers see one aspect of the model: how to protect enterprises from real financial pressures and from bankruptcy in gaining the support of banks associated to industrial groups. Once again, even if this model can give some independence to firms, market and financial competition in Germany and in Japan still exist and it is only possible to repel financial pressures up to a certain level. Another point that should be mentioned is that in both Germany and Japan, the deregulation of financial markets is beginning to impact on the behaviour of firms by entailing the specific nature of the relationship between banks and corporations.

**4.3 French state-owned companies and privatization strategy**

Generally, in the literature on transforming economies, little attention has been paid by scholars and specialists on the French experience of privatization and corporate governance although it contains some interesting features. France, for many decades and until recently, had a significant state-owned sector, mostly in infrastructures, basic industries, military equipment, chemicals, telecommunications and banking. The existence of a huge state-owned sector (with up to 30% of GDP in the 80s) can been explained by different factors: the role of the state in the development of a modern economy starting from the *Ancien Régime*, and consequently, the existence of a very competent class of civil administrators (bureaucracy) able to expend its skills among different sectors of the economy, the market failure in some sectors (that might be caused by state interventionism: for instance, the over-development of telecommunications comes from the former lack of interest in this sector by state bureaucracy up to the beginning of the 70s), the political choice of anti-capitalist parties which wanted the development of the state sector beyond the influence of markets; the political will to implement strong industrial policies in the 60s to catch up advanced technologies or to build up strong industrial bases for the sake of national
independence. State intervention, as a whole, has had a very positive impact in terms of growth, welfare, employment, innovation.

This model, which emphasizes on the separation of ownership and management, has, in the last period, *de facto* ‘privatized the management’: it has given autonomy to the manager for almost all decisions except giving away assets. Even the *abusus fructus*, the French government representatives on the board of companies, have always followed propositions made by the management (for instance, acquisition of French foreign subsidiaries, or mergers) sometimes backing some critical choices (see the Crédit Lyonnais).

Globalisation, the European integration and declining returns of big SOEs have pushed governments to change the nature of their relations towards state-owned enterprises in several ways. After the partial failure at restructuring state-owned companies which has followed the last nationalization of private assets in 1982–83, the government has changed the rules by pushing SOEs to find their own financing on capital markets, by issuing investment certificates (similar to equities without voting rights), to develop strategic alliances with private companies, to acquire private companies abroad, to open up capital to private companies and banks to a certain level. The next step has been the implementation of a privatization programme in the second half of the 80s. The aim of the government was threefold:

- first, it was looking for cash by selling state assets in order to raise money to reduce the public debt;
- it wished to increase the so-called ‘popular capitalism’ in spreading almost 50% of shares among the population,
- it aimed at stabilizing ownership by selling assets to strategic investors, that is investors that were committed to retain this new acquisition in their portfolio for at least some years. The majority of ownership had to be French associated to minority European investors. The government would not sell assets to foreign investors. As the French capital market is quite narrow (compared to the UK market, for instance), the Government looked for core investors, that is investors with an interest in the business and that could unite and bring in the necessary capital. The government had its stock of assets evaluated by different audit companies which came out with different price values. Interestingly, a company at Saint-Gobin (glass maker) had a difference of almost 17% between the higher and the lower evaluation, although that company had been nationalized for only four years. This demonstrates the difficulty encountered in objectively estimating the future value of assets, even in a market economy with almost complete information available. Systematically, the government has selected the lower price to sell shares in order to attract potential investors (the population) and to force them to keep their share after the first trading on the stock exchange as the price of shares would increase at least in the short run.
As a consequence, this method of giving away public assets has had a positive effect on the distribution of assets among the population and strategic owners. But, different criticisms have been made as the selling out of assets to selected strategic owners has, in fact, locked up the control of firms among few strategic investors (the new ‘50 familles’), preventing the entry of competing investors. A kind of cross-control of shares has resulted from this policy. The need of capital and merger strategies followed by European companies has recently contributed, to some extent, to the unlocking of control of assets by the original post-privatization owners by bringing in foreign investors.

5. Transforming economies: restructuring and privatizing state assets and the building up of new corporate structures

If mass privatizations are not yet on the agenda and if the political and economic environment might differ from the present situation in China today (EBRD, 1997; Estrin, 1994; Pohl et al., 1997; Woo, Parker and Sachs, 1997), there are some interesting lessons that can be drawn from the experience accumulated during the last eight years in Eastern Europe concerning the impact of redistributing assets on the behaviour of firms. First, privatization in this area took place amidst deep institutional changes and, notably, the building up of new market institutions (enterprise law, bankruptcy law, law on competition, anti-trust, law on foreign investment) and sometimes very severe macro-stabilization policies.

Fundamentally, there have been two ways of privatizing state assets, with different outcomes in the short run both in terms of concentration of property, speed of restructuring, and corporate governance. The first method followed by some countries has consisted of giving away state assets to the population using voucher schemes. The state, through this procedure, has transferred the biggest part of the property to the population, either to all citizens (external privatization), or to workers of companies being privatized (internal privatizations). Although there is an important ethic content in this policy (restitution to the population of the wealth that has been accumulated by the Party-State for decades), this policy has had two shortcomings at least in the short run (even up to now). First, it brings no money back to the State that could have been used for alternative purposes (reducing foreign and domestic debt) or to capitalize remaining enterprises that were not to be privatized now. Secondly, the large spreading of ownership among the population, for the sake of creating a so-called ‘popular capitalism’ has had a counter-effect in terms of control: de facto, newly privatized firms, through this system, became managerial enterprises, under the control of managers often with no real understanding of the new financial and market environment. On the other hand, it took time for new owners to become familiar with the new financial market and more precisely with the market for corporate control. This has opened the way to opportunistic behaviour of managers and intermediaries who have tried to take advantage of this situation. The recent collapse of the
Czech model is, in a way, a good example of the shortcoming of this strategy. In Russia, the distribution of assets to managers and workers has also created a *de facto* managerial capitalism favouring insider strategies by top managers who have succeeded in getting most of the shares for themselves. As an outcome, this mode of privatization has delayed the process of adjustment; firms have tried to escape to the external control and to take sharp measures when it was necessary. Where investment funds have been created as in the Czech Republic, their lack of capital has led to the concentration of these Funds and has facilitated their control by state-owned banks which, on the other hand had a very limited knowledge of controlling enterprises. Banks have been faced with the trade off between: getting back the money lent on the one hand, in order to provide new credits to their clients and to wait for the maturation of investments after supporting a high cost of restructuring on the other. It is also important to notice that the bad debts accumulated by companies and supported by banks have limited their ability to put strong financial pressure on them and, at the same time, have limited their capability to bring them new loans. Finally, this mode of privatizing has brought in no fresh capital.

The second method followed by some transforming economies has consisted of selling out state assets at market prices (either at book value or after evaluation by foreign audit companies) through bids or through direct sales. For governments which have embarked on this path, they were following at least three aims:

- bring in fresh capital that was missing to restructure firms,
- speed up the restructuring of firms with a new management and a new corporate structure
- have access to Western markets through exports.

The control of firms by new owners, mostly foreign investors, has had a direct impact on restructuring. Companies that have been the most efficient in the area have been greenfield companies controlled in majority or even totally by foreign investors; then brownfield – a mix of acquisition and greenfield, then joint-ventures and , finally, enterprises acquired by domestic owners. Another important impact of foreign direct investment has been the setting up of new start up companies through the spin off created by new foreign firms. As restructuring means unbundling and externalization of some assets of big enterprises, it has expended the number of small and medium sized enterprises.

In the long run, after a trial and error process, after the exit of bad enterprises or the shutting down of businesses without markets and after banks have solved their bad debt problems and have also restructured, a stronger external control is growing in the region along with the development of more efficient financial markets at least in the most advanced transforming economies (The Czech Republic, Hungary, Poland)
6. Lessons from international comparison for further reforms in China

What lessons can be drawn for China from this international review of different corporate governance systems? We should be very cautious when we try to answer this question. China cannot expect to pick up one corporate governance model and implement it on the spot in its state sector. This could be dangerous and could bring more damages than benefits. There are various reasons for that:

**Corporate governance systems are not like devices that can easily be transported from one country and adopted by another.** Corporate governance systems involve institutions like banks, financial organizations, enterprises but also state supervision; rules like the legal framework governing equity purchase, shareholders’ rights, financial institutions or bankruptcies; expertise and know-how which enable people and institutions to exert their rights. Furthermore, institutions, rules, know-how are interrelated in a specific manner which form the idiosyncrasies of each system we have described above (Anglo-Saxon, German, Japanese, French). It is difficult, most of the time impossible, to copy and create one of the most apparent part (let’s say stock exchange) without the other parts (in that case the fact that shareholder rights are well protected, or the existence of an efficient bankruptcy law) which create the efficiency of the entire system (the Anglo-Saxon corporate governance system). For this reason Aoki insists on the fact that the institutions and rules on which the Anglo-Saxon model is based are not present in former socialist countries or need to go through a process of modernization before being able to perform their role effectively (Aoki, 1995).

**The logic of each corporate governance system is also a result of history.** For example, the establishment of the so-called ‘main bank’ system in Japan is deeply rooted in some WW2 and post-war events in Japan like the nationalization of banks during the war, the breakdown of the family capitalism system by the American occupying forces and limits put by the State on equity-control (Aoki and Dore, 1994; Aoki and Patrick, 1994; Fruin, 1994; Kim et al., 1995). Implementing the core feature of the Japanese main-bank system in China without any analysis concerning the current state of the public sector could worsen its situation: on the one hand Chinese banks are not in a good financial shape, policy loans are widespread, and they do not enjoy a lot of autonomy from the central and local political forces; on the other hand, SOEs are not entirely market driven organizations and the legal system ruling the business environment is far from being perfect. In this context, the implementation in China of the core feature of the Japanese main bank system would not produce the same result as in Japan and would probably perpetuate a soft budget constraint for the SOEs and aggravate the level of bad loans in the balance sheet of the main bank.
Some core features of corporate governance systems can also evaluate, or simply disappear under external pressure or after some evolution in the political structure. Again, if we refer to the Japanese main bank system, it has been criticized recently for its poor efficiency in governing Japanese enterprises since the beginning of the 80’s. When enterprises are highly leveraged as was the case at the end of the 70’s, the main bank got a lot of incentives to monitor investment choices, profitability and the management of the firm. But, when firms became ‘rich’ at the beginning of the 80’s and started to rely on their own cash-flow to finance investments, the main bank didn’t play its usual monitoring role on firms. According to some tenants of the agency theory, this ‘free cash-flow’ without external control created an important agency cost simply by the fact that the return on investment requirements was no longer sufficiently market oriented. Managers who had a complete control on this ‘free cash flow’ were not able to recognize sectors plagued by overcapacity in time and return on investments has been declining progressively since the mid-80’s for Japanese firms (Jensen, 1986; Kaplan, 1997; Watanabe, 1998). For these reasons, some important features of the Japanese corporate governance system will have to change drastically in the near future. The South Korean corporate governance system that the Chinese leaders are so keen to follow, will probably encounter the same fate. In that case, the state is more involved in designing strategies, in helping corporations to develop new products and to enter new markets. It seems that this will not happen in China as the central government has not the power to design and to implement such strategic industrial policies. Nevertheless, given these limits and precautions, we think that some interesting lessons can be drawn from former socialist countries and industrialized capitalist economies:

There is no restructuring policy viable without the development of a strong financial constraint on firms: This could come from a non-inflationary policy carried out by the central bank but this should also be complemented by a sound banking system. Even if the banking system in China is in poor shape, there is room for improvement with relative small reforms. Corporatization and listing of banks on the stock market or a progressive opening of the financial market to some foreign institutions could provide a sound competitive pressure on commercial banks to reform their activities (Lardy, 1998; Qian, 1995). Nevertheless, in the mid-term, it raises the question of whether the Chinese government will tolerate a much greater autonomy of banks from the political power and the possibility to have some really independent financial institutions (domestic and foreign) operating in China.

There is a necessity to promote active investors in the capital of the new corporatized SOEs: active investors could be domestic or foreign financial institutions, enterprises, individuals who are committed to monitor and to be involved actively in the restructuring of newly corporatized SOEs through a minority stake in the capital of these enterprises. This is to counter-balance the effects of an ‘insider’ control which like in other former socialist
countries, is probably going to emerge in China. This is particularly important for big SOEs which will be corporatized but will probably remain under State control. It would be helpful if the government could inform these enterprises that it would be prepared to privatize them at a later stage in the reform process, in order to reinforce the new signals it is sending out to them. These enterprises should progressively familiarize themselves with a control carried out by financial markets. In this context there is a need to continue to implement new reforms concerning the legal system especially to protect the rights of minority shareholders (but who could be active), to allow a good functioning of the board of directors, to put pressure on these enterprises to have a better disclosure of their financial situation and a better transparency on their operation. In this respect, there are two interesting points in the French strategy which might be interesting to consider in the light of the experience followed in China: the first one is the fact that a compromise between massive or partial privatization and the emergence of active investors is possible. It is possible to distribute part of the assets, through sales, to the population willing to hold shares and secondly to design a model to sell the other part of assets to domestic companies which remain tied up for a while with the obligation to fulfill some engagements such as not to sell assets before a certain time, to show up a business plan concerning the coming years following the purchase to gather sound investors committed with the business. The second one is the fact that the state could also keep some ‘golden shares’ in the capital of big SOEs operating in some strategic sectors (infrastructure, military) which give him the possibility to put its veto in an operation like the transfer of control to a foreign company.

The large privatization of assets of medium and small size enterprises, along with the development of an efficient banking system should play a major role in disciplining the financial market. The success of the Chinese economy in the two last decades has strongly relied on the competition on product markets and less on capital markets. Now, at the new stage of the reform, competition on financial markets should play a major role and exert the necessary pressure on big SOEs as the experiences accumulated abroad show.

**There is a necessity to improve the way boards of directors are working in order to improve internal control** (Jensen, 1997): the current law should be upgraded and fully implemented. But along with the necessity to have strategic external investors taking part in the board of directors as we mentioned above, there should be a diversification of the membership of the board; members should come from outside the firm but well informed on the company and the sector in which the company is involved. It is preferable that the CEO does not cumulate the position of president of the board and the agenda of the meeting should be kept by the president of the board. Rights for shareholders to bring an action against the CEO of the firm should be also granted.

Even if this would come only as an indirect support to reform the corporate governance system in China, there is the necessity to upgrade competition policy and to reduce the
**cost of exit in industries.** Although competition on product markets has grown very quickly since 1978, there is no formal competition policy in China. Chinese leadership will probably have to think about this aspect especially if they want to promote big industrial groups. The cost of exit in the industry is still relatively high in China. Many things remain to be done to overcome provincial administrative barriers, to promote mergers, to facilitate geographical mobility for workers leaving in depressed industrial areas, to established a sound social security system, but also to recapitalize banks in order to write off bad loans and to raise their assets. All these factors will facilitates the exit of thousands of SOEs which have literally no future in a market economy.

Last but not least, there will be in the near future the necessity to guarantee better representation of workers and to set up institutional channels for collective bargaining: restructuring SOEs will lead to drastic changes in the value added sharing and in the establishment of a very hierarchical management organization in the firm as many example of already corporatized SOEs are suggesting. Many case studies show a shift from one extreme (workers reading newspapers, stealing raw materials (Kernen, 1997)) to another (high degree of hierarchy and discipline, harsh working conditions (Zhao and Nichols, 1996). At the same time, as Chinese leadership wants to enter high technology industries, it will be difficult in this context to escape from the new form of institutionalized social dialogue in the Chinese society. South Korean and Taiwanese or even the Japanese situation (all of them are much more relevant examples for China than Singapore) are powerful examples of this evolution. Corporate governance will be greatly improved with the establishment of flexible and negotiable contracts (in Williamson sense) between management and workers in the organization (Jensen, 1997). The earlier it is done, the better are the chances of escaping a conflictual situation which normally leads, after a few years, to the establishment of very rigid explicit contracts in the favour of workers, which become difficult to renegotiate when a firm and a country need to adapt their structure to a new economic environment. The past 30 years of South Korean industrial development are again a good example of this negative impact of authoritarian political regime (Clifford, 1994).

In conclusion, we think that in this context, flexibility and variety are the best options for China. No single foreign model seems able to answer to all types of problem faced by SOEs. Chinese policy-makers should resist the temptation to follow one model only because they think it would be the most suitable to preserve a political status quo. The economic crises in Asia especially in South Korea and Japan provide powerful incentives for Chinese leadership to speed up their reform in SOEs, in the financial system but also to draw some lessons on the negative parts of the model of corporate governance of these two countries. They should also bear in mind that even non-Anglo-Saxon corporate governance systems like in Germany, Japan or in France are now (or will soon be, especially in Asia) adopting rules and practices that they have long refused to implement. These corporate
governance systems are probably becoming more hybrid and have a tendency to adopt features from the Anglo-Saxon model, especially concerning the importance of the financial market to monitor firms. So, there is a necessity for China to work on several fronts at the same time (stock exchange, banking system, legal system), which makes the task difficult to carry out. But given that it is probably the soundness of future economic growth which is at stake, we think that the different actors involved in this reform will push forward to speed up the reform in the right direction even if it has some implications on the current articulation between politics and economics.

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