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An Empirical Taxonomy of SOE Governance in Transitional China

JINYANG HUA[1,*], PAUL MIESING[2] and MINGFANG LI[3,4,5]
[1]*School of Public Economics and Administration, Shanghai University of Finance and Economics, 777 Guoding Road, Shanghai, 200433, China (*Author for correspondence, phone: +86-21-6542-6687; e-mail: hjy@mail.shufe.edu.cn);* [2]*School of Business, University at Albany, State University of New York, Albany, NY, 12222, USA;* [3]*Hohai University, Nanjing, China;* [4]*Xian Jiaotong University, Xian, China;* [5]*College of Business and Economics, California State University, Northridge, Northridge, CA, 91330-8376, USA*

Abstract. China's State-Owned Enterprises (SOEs) traditionally have been governed by the Communist Party. Privatization has brought greater numbers of investors who have a stake and demand a voice in how SOEs are managed. Three traditional governance perspectives are agency theory, resource dependence, and institutional theory, but China's transition introduces several additional governance approaches. Are "capitalism with Chinese characteristics" and "bureaucratic entrepreneurialism" paradoxes? Based on initial interviews of SOE executives, a survey of top managers and board chairs of listed companies, and subsequent interviews and observations in select case companies, this paper develop a taxonomy of SOE governance that now exists in China. Two of the approaches represent the extremes of the old state-centered regimes and the new shareholder-centered regimes. Considering China's historical and cultural contexts coupled with its current stage of economic transition, two additional approaches to corporate governance are to have a vacuum as neither the state nor shareholders dominate or – in unique contrast to other countries – a hybrid of both.

Key words: capitalism with Chinese characteristics, governance taxonomy, institutionalism, state-owned enterprises, transition economies

Abbreviations: ARBE, accounting regulations for business enterprises; ASBE, accounting standards for business enterprises; FIEs, foreign-invested enterprises; NTCs, new three committees; OTCs, old three committees; SMEs, small and midsize enterprises; SOEs, state-owned enterprises; TVEs, township and village enterprises

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1. Introduction

"Walk along the old road in new shoes." (Top manager during interview)

China's transition from a centrally-planned socialist economy to one with increasing market liberalization is a unique context in which to explore the benefits and limits of alternative corporate governance approaches to its State-Owned Enterprises (SOEs): Institutional and cultural contexts change slowly and with great difficulty, and economic transitions are fraught with market uncertainties (e.g., labor, capital, suppliers, customers, etc.), managerial inexperience, and intense competition. This combination makes corporate governance (*gongsi zhili*) complex, uncertain, and multi-layered. We especially know little about their structure and effectiveness in developing economies. Tai and Wong (2003) note that SOE corporate governance is now the Chinese government's top priority. This will require new laws, incentives, and achieving world-class codes, guidelines, and stock listing requirements. But how should these enterprises deal with the tension between the old and new corporate leadership systems? What are the unique characteristics of governance approaches in transitional China? As the reform proceeds, will different approaches appear as the enterprises deal with the relationship between old and new leadership systems in their own ways or will there be a convergence to universal standards?

These three questions provide an understanding, solution, and evolution. That is, *understanding* current SOE governance characteristics and learning ways to *resolve* tensions between the economic and political systems exemplified in these approaches will enable us to speculate about the *evolution* of SOE governance over time. To try to answer these questions, this paper first briefly reviews the background on SOEs then summarizes the traditional corporate governance literature. We then examine SOE governance in transitional China. The next section presents how this study empirically developed a taxonomy of alternative approaches and their characteristics as well as presents case examples. We conclude by speculating about the future of SOE governance in transitional China.

2. Background on state-owned enterprises

As a consequence of "The New World Order," many countries around the world are facing radical economic transformation and none more so than China. All Chinese enterprises – be they State-Owned Enterprises (SOEs), foreign-invested enterprises (FIEs), township and village enterprises (TVEs), small and midsize enterprises (SMEs), or family businesses – are undergoing a transition from operating in a centralized socialist economy to greater autonomy and openness in a mixed market economy as well as financial incentives to managers. Traditional SOEs were initially ideological organizations created as work units (*gongzuo danwei*) to serve social and political purposes more than attain economic objectives. The primary stakeholders of "China, Inc." were public officials, government bureaucrats, and top managers appointed (and dismissed) to run the SOEs but enjoying the same privileges as the state cadres (*guojia ganbu*). Secondary stakeholders were the SOE workers who expected an "iron rice bowl" (*tiefanwan*) with cradle-to-grave benefits.

When China opened its "bamboo curtain" to the West in 1978, SOEs provided about three-fourths of total industrial output; by 2003, their share had fallen to about one-quarter even while employing nearly two-thirds of urban workers (Morrison, 2003). Some of the SOEs (e.g., Bank of China, China Life Insurance, China Petroleum & Chemical, China Telecom, Citic Pacific, PetroChina, Shanghai Automotive Industry Corporation, Shanghai Bao Steel, Sinochem) have joined the *Fortune* 'Global 500' (2004) and *Business Week* 'Global 1000' (2004), often as a result of mergers and acquisitions. But many others are organizational relics mired with bloated assets, mediocre products, uninspired leadership beholden to party officials, obsolete technology, negotiable (or soft) budgets and subsidies, rewards based on meeting plans set by government agencies instead of economic performance, and huge losses requiring China's banks to inject capital to keep them afloat. Bankruptcy or restructuring these SOEs would exact a heavy toll by dislocating large numbers of workers. But "stakeholder capitalism" brings all claimants into corporate governance structures, and Chinese enterprises must now consider a broader array of independently organized as well as intricately linked interests including those of investors, customers, competitors, and suppliers.

Clearly, reforming economic institutions to better match this new business environment is deemed vital to China's sustained economic growth and social stability as well as one of its greatest economic challenges during this transition (Hua, 1998; Steinfeld, 1998). China has introduced market forces with accompanying financial incentives, with the Chinese stock market, financial reporting, and accounting rules driving much of the change (Slough and Miesing, 2003). SOEs first became shareholding enterprises in 1984 through a process called *gufenhua* or shareholding transformation. The Chinese equity market has enabled wealth-sharing with investors, managers, and employees, and adopting Western financial reporting requirements has forced greater transparency and accounting standards. Many SOEs also adopted a contracting system (*chengbao zhi*) in 1987 (which became national law in 1993). The state significantly diminished its interference in SOE operations, giving them more freedoms including competitively selecting its CEO to act as its legal representative and be responsible for operations, as well as permitting them to retain more of their profits. Regrettably, privatization also resulted in the disappearance of enormous amounts of state assets due to private profiteering and chaos.

China's Shanghai Stock Exchanged[1] and Shenzhen Stock Exchange were created in 1990 and 1991, respectively. Deng Xiaoping famously called for introducing a market economy in China in 1992, including SOE reforms, and economic growth took off. Shi and Weisert (2002) estimate the government directly owned from half to as much as 80% of a company's shares (“absolutely dominating” or *juedui konggu*); more significantly, it indirectly owns virtually all listed Chinese firms as subsidiaries of state-owned groups or owns more shares than any other shareholder (“relatively dominating” or *xiangdui konggu*). It seems as though Deng's “socialism with Chinese characteristics” has evolved into “capitalism with Chinese characteristics.” This dominance by the Chinese government of SOEs, whether absolute or relative, represents an important characteristic of these enterprises competing in the market place.

To establish an orderly market mechanism, hundreds of laws and regulations have been promulgated. The *Company Law of 1993*[2] (amended in 1999) specified governance structures “to meet the needs of establishing a modern enterprise system, to standardize the organization and activities of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, to maintain the socio-economic order and to promote the development of the socialist market economy” (*Zhonghua Renmin Gongheguo Gongsi Fa*, 1993). Listed companies are required to adopt a two-tier board structure similar to co-determination in France, Germany, the Netherlands, and emerging economies. The board of *directors* operates the company on a day-to-day basis and works closely with management; it is accountable directly to shareholders and consists of two-thirds top executives and one-third independent directors. The board of *supervisors* is supposed to provide independent views and monitor management and the board of directors; it consists of independent shareholders and employees and must exclude directors and top management. Oftentimes, however, it is nominal and ineffectual. Both boards are supposedly appointed by and accountable to the shareholders.

Also in 1993, the Ministry of Finance issued the Accounting Standards for Business Enterprises (ASBE) embodying generally accepted accounting principles. In 1998, the government eliminated direct control and ownership by the communist party (but it continues to make appointments and dismissals), and issued Accounting Regulations for Business Enterprises (ARBE) in 2001. In 2003 – a decade after the first public listings – over 71 million new stock market accounts opened (1,300 firms listed in Chinese stock markets, 2004). Incredibly, 940 of the 1,287 enterprises listed on China's two exchanges at the end of 2003 (nearly three-quarters) were SOEs (Investment Climate Statement – China, 2005).

As the backbone of China's national economy, SOEs are attracting the attention of the highest Chinese authorities, scholarly opinion, and press coverage, all of whom envision a greater role for private corporations and demand more responsible and responsive SOE governance (Xu and Wang, 1999). SOEs remain burdened by their traditional "old three committees" (OTCs), the main governance bodies in traditional SOEs: The Communist Party Committee, the labor union, and employees' representatives meetings. We refer to this approach as a "State-Centered" regime. The mandated transitional "new three committees" (NTCs) governance system challenges SOEs to remain compatible with a socialist market economy (Hua, 1998): Shareholders' general meetings, the board of directors, and a supervisory board. We refer to this approach as a "Shareholders-Centered" regime. While the old corporate bodies continue to play a role, it remains to be seen if one approach will prevail, if both will weaken, if there will be a confluence of the two, or if these enterprises can emulate international standards.

Institutional shifts are never simple, and the final results of China's transition remain unknown. As firms progress in their governance, some results are unpredictable while others cannot even be fathomed; and some results are superficial rather than substantive (Mar and Young, 2001). The traditional state-centered regimes dominate planned economies, while the modern shareholders-centered regimes are believed to be the ideal for market economies. The institutional environment of China's transitional economy, however, may place conflicting demands on firms by simultaneously exerting political and market pressures on them. Since the state legacy continues to exert a profound influence on SOEs, both regimes will have to coexist within the same company for quite a long time albeit with different levels of influence. Thus, in some enterprises shareholders-centered regimes are nominal while the state-centered regimes remain as powerful as before; in others, neither the state- nor shareholders-centered regimes can dominate so their respective responsibilities fall into a state of chaos (Yu, 1995). Another development is shareholders-centered regimes blindly pursuing international standards while casting aside the traditional advantages of state-centered regimes, creating tension between those two. For instance, it has been estimated that slightly over half of SOEs may have experienced conflict between their two regimes coexisting (Association of Chinese Enterprises and Survey System of Chinese Entrepreneur, 2001). In short, the proper relationship between state- and shareholders-centered regimes remains important.

3. Governance perspectives: Traditional and beyond

Corporate governance is concerned with incentives to improve organization efficiency and market competitiveness. This is best done by permitting owners to exercise property rights to maximize shareholder value, conducting financial audits and being transparent, a market for corporate control via takeovers of under-performing companies, executive compensation based on performance and threat of removal, board of directors membership and structure, stakeholder and investor relationships, social responsibility and reputation, and sanctions for misconduct and malfeasance. According to the Organization for Economic Cooperation and Development (OECD, 2004):

> Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.

More simply, Daily et al. "define governance as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in organizations" (2003: 371). Standard and Poor's (http://www.governance.standardandpoors.com) rates corporate governance based on board oversight, the audit process, financial disclosure, and executive compensation.

Regardless of definition used, Peng (2004) suggests that multiple perspectives such as agency and institutional theories and resource dependence are necessary to gain a fuller understanding of governance as these will continue to influence enterprise decision making (Child and Lu, 1996). *Agency theory* is based on the moral hazards of large publicly-owned corporations resulting from separation of ownership from control. Adam Smith suggested in his famous *Wealth of Nations* (1776) that managers cannot be as deeply committed as private owners. In questioning how investors might get managers to look out for their interests, Shleifer and Vishny (1997) recommend giving legal rights to investors or vesting countervailing power in concentrated ownership. Berle and Means (1932) noted widely-dispersed shareholding in large U.S. publicly-held enterprises, but more recent evidence suggests that pyramid structures, management appointments, and cross-holdings result in concentrated control today. For instance, most large companies in wealthy economies are ultimately controlled by families or the state regardless of shareholding (La Porta et al., 1999). "Crony capitalism" is especially rampant in East Asia with over two-thirds of firms controlled by a single shareholder and managed by family relatives (Claessens et al., 2000) or managed collectively as in Japan's *keiretsu* and South Korea's *chaebol*. Owners have similarly controlled management in mainland China with an economy traditionally dominated by family-run businesses and SOEs that are biased by nepotism and state patronage, owned by labyrinthine groups containing shell companies and false names, and managed within an opaque symbiotic network of relationships between public and private enterprises.[3] Moreover, communism does not recognize the concept of private property rights.

In either event, managers with large discretion are viewed as opportunistic who are motivated to pursue their own self-interested agendas (including expropriating or stripping assets, concealing information, or other behaviors that are contrary to the owners' best interests). To make company decisions on behalf of investors, executives must be reined in to behave as stewards for stockholders and other stakeholders who protect their interests and improve the firm's financial performance. So fundamentally agency concerns are valid in China's transitional economy. The principal-agent model (Jensen and Meckling, 1976) deals with governance of large publicly-held corporations in advanced economies where widely-held ownership is separated from control. However, situational specific factors must be taken into account when applying it to developing economies, high-trust societies, state-owned and not-for-profit organizations, and firms that are owned privately either by families or managers. For example, the traditional agency assumption about the primacy of maximizing shareholder wealth is not relevant in traditional Chinese SOEs because the principal is invisible (who is really the "state" and who represents it?). With no one truly responsible for or caring about maximizing value, SOE managers do not always seem to behave as rational, profit-maximizing agents. Nonetheless, a general normative governance structure in most countries is composed of executive incentives, contracts, and oversight by a board that has an audit, compensation, nominating, and sometimes even a governance committee.

In response to the recent spate of U.S. scandals (e.g., Adelphia, Enron, Tyco, WorldCom), the U.S. Congress enacted The Public Company Accounting and Investor Protection Act (Sarbanes-Oxley) of 2002 that mandates corporate responsibility, a governance structure, and financial disclosure (http://www.sarbanes-oxley.com/). Because market mechanisms can mitigate various agency problems, such as shirking and adverse selection, the market for corporate control and the market for managerial talent are effective alternatives to enacting legislation or developing institutions. For instance, activist U.S. institutional investors (e.g., CalPERS, TIAA-CREF, etc.) may pressure boards to effectively prevent shirking.

China has similarly seen many recent high-profile cases of companies engaging in numerous fraudulent activities and financial scandals: Yin Guang Xia Industry Co. Ltd. (the biggest economic scandal in mainland China's history), Lantian Co. Ltd., Sanjiu Pharmaceutical Co., Zhengzhou Baiwen Co. Ltd., and Macat Optics and Electronics Co. Ltd. (Shi and Weisert, 2002). Following agency theory prescriptions, concentrated shareholdings by the Chinese government or large institutions can assume greater monitoring responsibilities. Clarke (2003) warns that independent SOEs free from government meddling will result in unaccountability. Considering that the state is China's dominant shareholder, should it not have a voice in how the enterprise is managed? Furthermore, all of China's citizens should be considered as principals, too dispersed and powerless to exercise any control over SOEs. Also in the U.S., aggressive stock options as executive incentives not only align controlling interests with owners but also let companies compete for the best talent available, avoiding adverse managerial selection. Properly structured stock options can attract the best talent and inspire their long-term loyalty.

Whereas agency theory emphasizes board monitoring the managers on behalf of shareholders via appropriate incentives, *resource dependence theory* views board members as important boundary spanners who provide critical resources (Pfeffer and Salancik, 1978). In their desire to attain autonomy, managers co-opt these actors by appointing them to their boards of directors, often resulting in interlocking directors who offer mutual support rather than oversight especially with increasing size of the firm, debt, and environmental turbulence. These boards are often dysfunctional, however, causing financial performance to deteriorate. All Chinese state-centered regimes (the Communist Party Committee, the labor union, and employees' representatives meetings) remain in powerful positions since they possess key resources. Keister (2004) found that former Chinese SOEs preferred borrowing externally over using retained earnings, presumably to avoid relying on resources controlled by the state. More informally, social networks are common in China with its relationship-based culture (*guanxi*) that gets things done in the absence of institutional constraints (Peng, 2004).

But institutional constraints exist, with a country's unique historical context, political ideology, social structure, industrial legacy, and cultural tradition having profound influence on its corporate governance approach. The third approach to governance is *institutional theory* that posits society is comprised of many establishments and pressure groups that limit and shape organization action. These are conventionally classified into laws (e.g., corporate, securities, etc.) and regulations as the most formal, followed by norms that pressure compliance to behave in socially acceptable ways, and finally cognitively realizing the many advantages of social conformity (Peng, 2004).

There is a symbiotic relationship between organizations and institutions, culture, and ideology, all changing slowly during transition. According to North (1990), the ideology, values, and mindset that the citizens possess greatly impact the formation, acceptance, and characteristics of their institutions. With governance being in part embedded in the firm's national institutional context, each country can expect to develop its own distinct governance approach. But how institutionalized is today's Chinese firm? Keister (2004) found that borrowing and strategic decision making behavior of former SOEs imitated their peers. Tsui et al. observe: "History and institutions render the Chinese conception of the firm very different from the Western conception, so different that it is uncertain whether commonplace assumptions, e.g., that firms have definite ownership and boundaries, hold in China ... the magnitude of economic and enterprise reform in China has no precedent and that its evolution is quite distinct from that of post-Soviet Eastern Europe" (2004: 135).

China's traditional culture is one of the main factors that impact the reform and performance of its SOEs. Traditional Chinese cultural values such as loyalty (Wong and Kung, 1999), *guanxi* (Beamer, 1998; Law et al., 2000; Xin and Pearce, 1996), and reciprocating good deeds are still important in Chinese societies, play an important role in business practice (Mallin and Rong, 1998), and exert a strong influence in the development of corporate governance. A prominent feature of Confucian culture is filial piety to family members, elders, and to an authoritarian leader with a presumably "mandate from heaven." This heritage has continued with Leninist democratic centralism's blind obedience to the "Red Emperor." China's market-oriented legal system (and the corporate and securities law framework in particular) has been developed only over the past two decades and is still relatively untested in many aspects. *Privatization* (dispersed principals) and *corporatization* (governance mechanisms that encourage agents to be stewards for principals) might have brought about new institutional ways to exercise corporate control without dismantling old representative bodies, but the division of labor between old and new governance structures remains unclear and is further complicated by many companies combining such positions as board chair with secretary of the Communist Party Committee (Tenev et al., 2002). As a result, key decision-making powers tend to be vested in informal mechanisms with some institutions such as the boards of supervisors assuming largely decorative functions.

Shleifer and Vishny (1997) note that state enterprises, managed by powerful government bureaucrats pursuing political agendas, fail on two counts: they do not achieve social objectives and their inefficiencies are expensive to the public. Williamson (2002) notes that alternative governance approaches, while possessing characteristics of markets and hierarchies, are "defined by an internally consistent syndrome of attributes – which is to say that each mode of governance possesses distinctive strengths and weaknesses" (175). For instance, a market approach to governance emphasizes shareholdings in an efficient financial market where the stock is liquid and corporate conduct is transparent. In this situation, the market for corporate control is a check on the firm's behavior. But in China, stock ownership resembles a pyramid scheme whereby control is disproportionate to ownership. In any event, with only 30% of shares publicly-traded the stock price bears little relationship to a company's underlying value, performance, or governance (Allen and Roy, 2001; Leahy, 2006). A hierarchical approach to governance emphasizes a board of directors whose members are experts, are well-connected boundary spanners, and are independent of management. Here, stock options can align board interests with the owners. But in China, many boards are interlocks of personal relationships.

The integration of these three theoretical perspectives, when examining Chinese SOE corporate governance, is meaningful for two purposes. First, as discussed above, these theoretical perspectives appear to have important bearing to our understanding of the Chinese SOE governance research, especially when we consider factors unique to China's transitional economy. It is clear that conflicting forces are affecting Chinese SOE corporate governance reform and evolution. Second, our discussion demonstrates that Chinese SOE corporate governance may need to be understood from a combination of multiple theoretical perspectives, alluding clearly to the reality in China's institutional environment – briefly stated – that combines the political and market pressures, especially on the SOEs.

It will be further informational once we bring these important contextual considerations and multiple theoretical perspectives into the broader debate in the corporate governance literature regarding convergence, divergence, cross-vergence, and beyond. Two competing views have gained much scholarly attention (Bebchuk and Roe, 1999; Gilson, 2001; Hansmann and Kraakman, 2001; La Porta et al., 1998; Roe, 2000). One point of view, armed with an economic efficiency argument, predicts eventual convergence of corporate governance systems. Another, emphasizing an institutional perspective, portrays ultimate divergence of such systems. Still, scholars also foresee the possibility of hybridization or cross-vergence (Van Den Berghe, 2002). This perspective seems to seek a middle ground between the two pure predictions by highlighting the fact that firms may adopt innovations (specifically corporate governance practices) from others with needed adjustment or translation (e.g., Buck et al., 2004).

While we see relevance of all these governance perspectives, they have been viewed as idealize forms that are mutually exclusive. With proper conditions it might indeed be possible for corporate governance practices to converge on a limited scale even as drastically different institutional environments diverge. Globalization and economic integration may create necessary conditions for multiple combinations of property rights and coordination mechanisms that Grandori (1997) refers to as "combinative" as seen in clans, trusts, and networks that predominate Chinese culture. Grandori (1997) suggests that effective combinations of mechanisms, in addition to being contingent, can also exploit greater discretion in combining elements selectively taken from different contexts and models. An insightful alternative to the three central positions identified above is the possibility for neither convergence nor divergence because "non-proximate" external and internal factors will prove to be influential in determining the evolution of corporate governance in different environments, suggesting that corporate governance systems evolve over time and may be influenced by powerful contingencies (Grandori, 2004). We term this perspective "meta dynamic contingency theory" so as to differentiate it from the "contingency theory" in classic organizational theory. We do not expect the emerging (and potentially effective) governance solutions in China to conform to any predefined "pure," "perfect," or allegedly "consistent" archetype. The reason for this is that organization and governance attributes can combine in much more varied ways than is usually admitted and conceived, and it is not even clear what makes for a consistent and stable governance model or organization form.

Our integration of three theoretical perspectives with consideration to realities in China's transitional economy provides a hint of how SOE governance might evolve. We repeatedly emphasized, in our description of Chinese SOEs' background and Chinese economic reform as well as the discussion of three traditional theoretical perspectives, that Chinese SOEs are confronted with conflicting forces of both market pressure and political pressure. We believe those to be powerful contingencies that will contribute to the evolution of Chinese SOE corporate governance systems over time. This perspective will become clearer as we examine alternative governance approaches in Chinese SOEs. Furthermore, through this examination we will also attempt to assess the relative strengths and weaknesses of each system. We must, however, caution readers that it will be more challenging to posit unequivocally performance implications before we develop a more systematic understanding of these corporate governance systems together with their external and internal contingencies.

4. Governance approaches in Chinese state-owned enterprises

Although corporate governance systems differ across countries, there is still general agreement on certain principles and basic practices (Allen, 2000). The Anglo-American arm's-length, market- and rule-based, "know-what" model used by the U.S. and the U.K. is in sharp contrast to the insider, relation-based, "know-who" model used by Confucian societies. Li et al. (2004) use these different models to explain East-West differences in corporate strategies, organization designs, decision-making styles, technological innovations, global trade, and market structures. The Anglo-American system reflects both the advanced stage of industrialized economies of some English-speaking countries as well as their leadership in developing new standards of corporate governance including aligning owners' interests with those of managers, complete financial disclosure and operating transparency, and independent audits (Allen, 2000). Carter and Lorsch (2004) complain about secret boards behaving badly, both as a group and with their relationship with management. Most corporate governance scholars agree that even with their imperfections these Anglo-American standards are the basis for a workable governance system and that it is worthwhile for transition economies to adhere to them (Broadman, 1999).

But there is no inherent reason for Chinese SOEs to favor this approach over others. Indeed, it is likely that they will develop their own governance forms. Comparing two European countries to the U.S., Lubatkin et al. (2005) found national institutions determined each country's unique approach to corporate governance. Interestingly, in spite of different histories, cultures, and institutions, Sweden and France share Chinese governance characteristics. For instance, Sweden values collective responsibility through cooperation, long-term relationships, trust, reciprocity, voluntary compliance, and an egalitarian culture. These have resulted in interlocking networks of relationships. France values an egalitarian culture and collective self-interest, and respect for hierarchy, authority, and status. The result is centralized public administration of ownership of private corporate assets based on personal relationships to further the elite group's interests as well as serve the state. While China and Russia might share significant similarities as far as transitional economy is concerned, governance scholars observe substantial differences in both practices and evolution (Lu and Lazonick, 2001; Luo, 2006; Wright et al., 2003). China, for example, followed a path of gradual economic reform while Russia experimented with a "Big Bang" privatization approach. Chinese governments remain intimately involved in governing at least SOEs while Russian businesses are free to experiment with a market economy. Based on these comparisons, it is futile for one country to adapt to another's corporate governance policies.

Nonetheless, Chinese authorities generally consider the Anglo-American legal and regulatory systems to be the prototype for their "modern" institutional and enterprise reforms (Tam, 1999), with most Chinese enterprises required to establish shareholders-centered regimes as their standard for corporate governance. Some scholars contend that this approach is flawed and has not worked in China because the commercial and regulatory contexts (e.g., rule of law) this model requires are still rudimentary in China. As Tam (1999) emphasizes, the various corporate governance systems used in industrialized countries are products of their histories, cultures, and institutions. One major factor impacting corporate governance in China – as is common with other transition economies – is the relatively underdeveloped market and legal institutions and processes which act as powerful complementary, external mechanisms for corporate governance in advanced market economies (Qian, 1999).

So the issue is whether China's corporate culture is ready to trust managers to their own devices (Shi and Weisert, 2002). According to the International Monetary Fund, many Chinese firms are characterized by excessive CEO power, insider control and collusion, insufficient safeguards for minority shareholders, and weak transparency that cause such problems as stripping assets, an eroding capital structure, wage manipulation, and tax evasion (Broadman, 1999). Corruption in SOEs is widespread, with excessive entertainment, embezzlement, bribery, and moonlighting (Snell and Tseng, 2002; Ziegler, 2000). The prevalent mindset among SOE managers is that capital raised from the financial markets is free money that can be squandered with impunity. Analyzing firms' annual reports from 1999 to 2001, Bai et al. (2004) found that the following had statistically significant, negative effects on market valuation: (1) the largest shareholder in each firm holds a significantly large stake, (2) over one-third of CEOs are also either chairman or vice chairman of the board of directors, and (3) over half the companies are controlled by the government. They also found (4) while the mean proportion of outsider directors was 71%, this had no significant effect on a firm's market valuation suggesting that outside board members may not really be independent of management. Moreover, (5) top managers owned on average only 0.1% of their companies' shares, so that increasing their relatively small shareholdings may not be value enhancing. Additional findings were that (6) 79% of the publicly listed firms in China had a parent company, and (7) neither dual listing nor multiple listing was common for Chinese firms which would serve as a proxy for a better legal environment and financial transparency.

Lacking self-control and with inadequate investor pressures on SOEs, the Chinese government enacted two requirements in 2001. The *Code of corporate governance for listed companies in China* (CSRCa, 2001), based on guidelines issued by the Shanghai Stock Exchange at the 2000 International Conference on Corporate Governance, stipulates requirements for shareholders and their meetings, directors and boards, and the supervisors and supervisory board for listed companies. "The Code" also specifies rules for establishing performance assessment, incentive and disciplinary systems, disclosing information and maintaining transparency, and cumulative voting for listed companies with more than 30% shares owned by controlling shareholders. The *Guidelines for introducing independent directors to the board of directors of listed companies* (CSRCb, 2001) require that boards of directors appoint independent outside directors. In 2003, China created the State-owned Assets Supervision and Administration Commission (SASAC) to represent its 189 major SOEs (China's SOE reform focuses on corporate governance, 2004). Among its measures to improve corporate governance was implementing an evaluation method that assesses SOE management performance using financial indicators and rewards managers accordingly. It will also appoint SOE directors who better represent the state. Also in 2003, The Third Plenum of the Sixteenth Party Congress issued the "Decision of the CCP Central Committee on Several Issues in Perfecting the Socialist Market Economy" that assured the government's intent to emphasize market principles, govern financial markets according to law, improve public and private administration, and strengthen legal interpretations (Fewsmith, 2004).

Failures or shortcomings of corporate governance and leadership systems are attributable to many factors, including poor law enforcement, monopolistic or oligopolistic product markets, an inadequate market for managerial talent, and weak stock markets (Lin, 2001). These necessary institutional conditions for the shareholders-centered regimes, including the laws of finance and industrial regulation, are still evolving slowly and with great difficulty. The Western approaches to corporate governance will be insufficient in the absence of corresponding institutional and cultural changes. In contrast, the state-centered regimes maintain their advantage in moral and political education. Hence, any system of corporate governance which develops in China is likely to embody the special role of the state and contain certain idiosyncratic cultural aspects while taking on certain characteristics of the Anglo-Saxon corporate governance model (Mallin and Rong, 1998). We next examine alternative governance approaches Chinese SOEs have actually taken.

5. The study and findings

This study asks the following research questions to better understand how these governance approaches differ, might converge, or develop independently: "What are the alternative governance approaches unique in transitional China?" and "What are the characteristics of these respective approaches, including their advantages and disadvantages?" This section validates the existence of governance approaches and distinguishes their characteristics (including advantages and disadvantages) by examining specific case examples. Our methodology was to first interview the senior managers (CEOs, top management team members, or board members) of well-known companies that represent different ownership structures in China. These semi-structured discussions probed the current role that state- and shareholders-centered regimes play in corporate governance, including the interrelationships between them and the problems encountered if both coexist, and are used to develop our taxonomy. Next, we surveyed over one thousand SOEs to validate the distribution of four approaches we developed. Then we used the results of these preliminary interviews to conduct subsequent in-depth case analyses of four companies representing these approaches that provided greater richness and depth of understanding. We were able to obtain cooperation since, confronted with the challenges of managing complex enterprises in a turbulent environment, Chinese business executives are eager to learn from each other and are keen on attending executive seminars at various universities. They are also interested in receiving university research teams for consulting and/or business process diagnoses. Furthermore, many Chinese business graduates go to various Chinese companies, becoming liaisons between companies and universities.

5.1. PERSONAL INTERVIEWS

To better comprehend the issues surrounding SOE governance in a transition economy, we met with twenty top managers attending an annual 4-day "current events" seminar hosted by Zhejiang University's Center for Technological Innovation and Industry Development (http://www.cma.zju.edu.cn/ctiid/). First, we interviewed executives, many of whom had frequently attended prior seminars and had become familiar with faculty and fellow students involved in the program. During their brief stay, we were able to interview them whenever the opportunities arose. Obviously, we also consulted faculty and other graduate students regarding corporate governance practices in various Chinese SOEs, and we also had extensive first-hand experience visiting SOEs. Furthermore, we surveyed the relevant literature. Thus, our semi-structured interview with these executives had a specific focus as well as generated additional insights. We explored the specific forms and relevant factors with those executives to form the basis of our subsequent survey. Through these personal interviews, we better appreciated the alternative governance approaches, their main characteristics and the roles played, the major problems and conflicts between them, and other governance features and results.

Using the state-centered vs. shareholders-centered regimes as our framework, we identified four possible governance approaches and their characteristics that are typical in China during its transition. By splitting the roles of governance systems into political (old) and economic (new) functions, and also considering the intensity of these functions as being strong or weak, we derive the framework in Figure 1. Interestingly, the resultant four governance types parallel Quinn and Rohrbaugh's (1981) Competing Values Framework (CVF). Our state-centered regime is similar to traditional hierarchy/bureaucracy that exercises control combined with an internal orientation. Our open/entrepreneurial systems are similar to adhocracy that is flexible combined with an external orientation. Our hybrid system is similar to a consensual clan that is flexible combined with internal orientation. Our shareholders-centered regime is similar to competitive markets that exercise control combined with external orientation.

5.1.1. *Strong state-centered regimes*

The characteristics of this approach are that the state-centered regimes continue to dominate both business decision-making and political education, while shareholders-centered regimes have not yet been set up or their role remains weak. For most enterprises with this approach, the government and the traditional hierarchy/bureaucracy still retain influence on corporate operations with the employees being politically active and highly involved. This approach is predominant in older SOEs and those in traditional industries.

5.1.2. *Open/entrepreneurial systems*

Here, neither state- nor shareholders-centered regimes have specific functional responsibilities and powers with both playing a minimal role in the enterprise's decisions. Unable to balance each other, a power vacuum will be created. The adhocracy might fall into chaos as it fails to control its environment or internal operations. This is a temporary phenomenon that could possibly arise during the reform process, but should not be a large problem if the enterprise can get through it quickly. If a powerful individual exercises *de facto* control in the governance vacuum left by the state- and shareholders-centered regimes, the enterprise may not only continue to operate but even improve its performance in the short term by accepting the "rule of man" instead of the "rule of law" (Mallin and Rong, 1998).

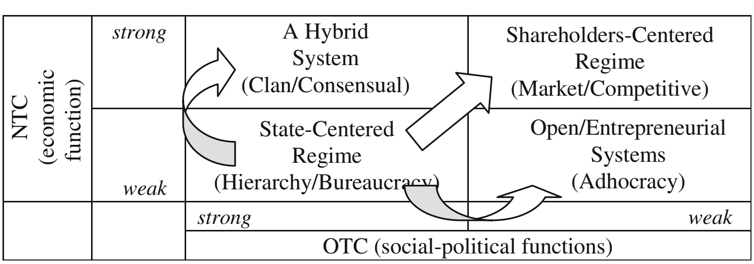

Figure 1. SOE Governance Framework for Transitional China.

5.1.3. *Hybrid approach*

The coexistence of various ownership structures and growing SOE autonomy is a distinct feature of China's market-oriented reforms. Within individual enterprises, some will allocate precise and rational divisions of work to their state- and shareholders-centered regimes, with the shareholders-centered regimes dominating business operations while the state continues to play an important political role as before. In this consensual clan approach, the advantages of the state-centered regimes complement well those of the shareholders-centered regimes as the two systems equally supplement each other. For example, state-centered regimes can prevent managers from corruption via political education for the party members, while the shareholders-centered regimes can help retain employees and improve the cohesiveness of the entire enterprise with monetary rewards emanating from the business instead of the spiritual rewards derived from political education. According to Wedeman (2003): "As state institutions became market-oriented actors individual cadres also became 'bureaucratic entrepreneurs.' Yet, because state institutions and cadres remained politically and socially embedded they tended to pursue economic, political, and social goals that provided public goods for their communities and private goods for themselves and their units simultaneously." In these hybrids, party and state officials generate revenues from the vast institutional power and resources the communist system bestowed upon them.

5.1.4. *Strong shareholders-centered regimes*

The final approach is for the shareholders-centered regimes to completely replace state-centered regimes. This competitive market situation may occur as the shareholders dominate business decisions while the state has a diminished political role. Even if both regimes jointly govern the enterprise, the original political functions are weakened thereby forcing state-centered regimes to abdicate their traditional functions. In either event, shareholders-centered regimes will dominate the enterprise while the state becomes nominal. It is reasonable to expect that this strong shareholders-centered regime approach will have Chinese characteristics rather than international standards. Still, we do not think shareholders-centered regimes can avoid conflicts in their relationship with state-centered regimes.

5.2. THE QUESTIONNAIRE SURVEY

When we were planning to construct a questionnaire, the Association of Chinese Enterprises and the System of Investigation on Chinese Entrepreneurs asked us to suggest items for their annual survey to SOE managers (Association of Chinese Enterprises and Survey System of Chinese

Entrepreneur, 2001). This Association also had long-term associations with the university, and it was looking for guidance for survey design and questionnaire construction. We were allowed in exchange to include as part of that survey questions both parties would be interested in. We asked respondents the degree of importance of select characteristics of the state- and shareholders-centered regimes as well as additional information about their enterprises, including which of these four approaches their company follows. This survey was conducted from November to December in 2000, obtaining 1,075 usable responses from their sample of 4,000. The questionnaires were completed by the general managers, factory directors, or chairman of the board. The respondents were involved in virtually the entire mainland covering various types of SOEs in different industries, scale of operation, and performance. The sample has good representation thereby reflecting the situation facing all SOEs and provides a clear picture of the possible roles state- and shareholders-centered regimes might play in China (see Table I). We shaded the cells in our attempt to graphically depict our subjective views of where on the bureaucratic/political to market/profit continuum each type lies. As can be seen, for the most part they parallel the traditional-emerging continuum.

There is no single objective measure of success for SOEs, and we do not suggest that any taxonomy determines performance since contingency factors (age, history, industry, corporate culture, financial structure, strategy, processes, etc.) might dwarf the governance approach (Grandori, 2004), especially during such changing times over such a short period. Indeed, the governance literature itself has not demonstrated a strong connection between governance and performance (Daily et al., 2003). The resource-based view of the firm (Barney, 1991) argues that resources that are valuable, rare, hard-to-imitate, and non-substitutable are often intangible and asymmetric, hence conferring a monopolistic position to the owner – precisely those conditions (such as relationships, reputation, loyalty, or knowledge) existing in SOEs. During economic transition, old relationships are necessary but not sufficient conditions for success; firms must also have a sustainable competitive advantage in their market. Relations are very personal, time-consuming, and difficult to increase with the size of the firm (Li et al., 2004), all of which confer a disadvantage on SOEs and require governance reforms. In contrast, rules require transparency, trust, and an efficient information infrastructure provided by accounting, auditing, and codes.

Beyond considering an individual firm's short-term success, we may consider its long-term success in multiple dimensions. Furthermore, considering that economic reform is as much a prescriptive exercise as an experiment in which improvisation and learning are more critical for overall success, we are cautious when considering the performance-related

Table I. Characteristics of SOE governance taxonomy*

Characteristics	Bureaucratic/Political	↔		Market/Profit
	Traditional: state-centered regime (23.7%)	*Vacuum*: open/entrepreneurial system (11.4%)	*Mixed*: hybrid system (53.8%)	*Emerging*: shareholders-centered regime (11.1%)
Negotiability of property rights (depends on proportion of stock owned by state)	None/low	Medium/high	Medium/high	Low/medium
Direct government business decisions	High	Low	Medium/low	Medium/low
The dominant governing body	Communist Party Committee	Entrepreneur	The board/Communist Party Committee	Board of directors
Mechanism to harmonize conflict between committees	Administrative	Strong leadership	Balance of six committees	Balance of three committees
Degree of centralization	Highly centralized	Highly centralized	Highly decentralized	Partly decentralized
Relationship between politics and business	Focus on politics	Diminished political influence	Integrated roles with mutual support	Focus on business
Culture	Traditional Chinese	Transition and change	Integrating native and Western	Transition and change
Contexts of economy and institution	Planned economy and traditional institutions	Transition economy; developing modern corporate institutions	Transition economy; developing modern corporate institutions	Transition economy; developing modern corporate institutions

*The proportion of governance approaches in parentheses based 1,075 usable responses indicating which of these four approaches their company follows.

implications of any governance form. We feel strongly that a pluralism of corporate governance forms may indeed be meaningful as we can begin to concentrate on each type of corporate governance form for SOEs in China, which we amplify in the next section.

5.3. THE INDIVIDUAL CASE STUDIES

We next validate the existence of these governance approaches and probe into their specific characteristics through observing case companies. We used this information for our fine-grained analysis to obtain a greater understanding and provide richer illustrations of the implications of these different governance approaches. We conducted in-depth interviews and observations with four prominent Chinese enterprises that represent sectors that have strategic value to China and have also been largely deregulated. Table II summarizes our views about these four illustrative companies (they requested anonymity) and compares their corporate governance characteristics. We recognize that as is true of many grounded theory studies, it relies on subjective impressions. Still, given the convergence of patterns we believe it enhances our understanding of alternative governance approaches. Moreover, given the dynamic nature of this phenomenon it is not possible to confirm governance structures that require stability over time. Our purpose here is to develop a taxonomy to understand and classify this phenomenon and not to test specific hypotheses or causal relationships. We once again shade the cells to graphically depict where on the bureaucratic/political to market/profit continuum each type lies.

5.3.1. *State-centered regime: "Alpha" steel company example*

Nearly one-fourth of SOEs have a state-centered regime, but it is most common in traditional industries such as "Alpha" steel company. As an enterprise completely owned by the state, all thirteen of this company's directors represent the country and the chairman was appointed by the government. Moreover, there are several dual structures as the party director serves as vice board director, the chairman of the labor union serves on the supervisory board, and the board chairman is also the CEO (albeit whose autonomy is not very high since most important decisions have to be reported to the government).

The Communist Party Committee in this company plays a key role, and all the important corporate development decisions are negotiated and discussed adequately by the joint meetings of the party and administration. The party committee is influential in nominating and electing cadres (directors and managers) to the board, despite the fact that the party no longer controls the personnel system. The labor union follows the party committee and acts

Table II. Comparison of SOE governance cases

Characteristic	Bureaucratic/Political		↔	Market/Profit
	State-centered regime: "Alpha" steel	Open/entrepreneurial system: "Beta" comm.	Hybrid system: "Gamma" pharma	Shareholders-centered regime: "Delta" mobile
Proportion of state-holding	State owns fully (100%)	State owns (57.9%) but private operating	State has large share (36.8%)	State dominates as a large-block shareholder (63.2%)
Direct government business decisions	High	Low	Low	Medium
Actual role of shareholders-centered regime	Poor	Medium	High	Medium
Body responsible for business decisions	Communist Party Committee	Board of Directors	Board of Directors	Board of Directors
Body responsible for political decisions	Communist Party Committee	Communist Party Committee	Communist Party Committee	Communist Party Committee
Role of the board	Weak	Weak	Strong	Strong
Role of the Communist Party Committee	Strong	Weak	Medium	Weak
Board monitoring primary leader (board chair or CEO)	Medium	Low	Medium	Medium
Duality of leadership structure	Director of Communist Party Committee and Vice-board chair	CEO and Vice-board chair	Director of Communist Party Committee, Vice-board chair, and CEO	Director of Communist Party Committee and V ice-board chair
Insiders vs. outsiders on board	13:0	4:8	5:6	7:4
CEO autonomy	Low	Very high	High	Medium (depending on the chair's power)

Table II. Continued

Characteristic	Bureaucratic/Political		↔	Market/Profit
	State-centered regime: "Alpha" steel	Open/entrepreneurial system: "Beta" comm.	Hybrid system: "Gamma" pharma	Shareholders-centered regime: "Delta" mobile
Managers' incentives	Weak	Medium	Strong	Medium
Advantages to employees from share-holding	Medium	Low	High	Medium
Integration of duty, power, and interests	Good	Medium	Excellent	Medium
Democratic management	High	Poor	Good	Medium

as its bridge to employees. Democratic management tends to be institutionalized and standardized, with all employees participating in decisions. The employee representatives are from a wide range of positions with half being front line workers. All the board members – including the CEO, Communist Party Committee director, two vice-CEOs, and the union chair – are company insiders. This structure ensures the dominant role of the state while still allowing shareholders-centered regimes to develop. This company attaches a lot of importance to the state, but it is also beginning to introduce and perfect the shareholders-centered regimes in order to improve its rational decisions.

The advantage of this approach is that SOEs have inherited favorable traditions that ensure its stability and continuity, especially valuable in markets where it cannot compete but continues to enjoy government protection as long as its members accept party education. But a disadvantage is these SOEs inadequately develop a modern corporate institution that motivates and controls its managers. As a result they divert their capital resources into social burdens instead of investing in more efficient productions. To sum up, "Alpha" company's pattern is in the early stage of transition. It enjoys the protection accorded by its SOE status, but would be more successful by moving from low-profit, state-dominated sectors and adopting a profit-oriented management culture necessary in global and competitive markets.

5.3.2. *An open/entrepreneurial system: "Beta" communications company example*

Just over one-tenth of SOEs follow the open/entrepreneurial approach created by a vacuum of regimes. "Beta" communications is unique in that its state-owned assets are privately operated: It has two SOEs holding stock shares, and one non-SOE that owns shares is in charge of daily operation. It is also unlike other SOEs in that it is young, beginning as a semiconductor company in 1985 and reorganized in 1993 as a communication equipment firm co-owned by these three companies. Developing quickly over the next 3 years, it followed a practice common in China at that time: it disregarded a committee responsible for strategic planning and operating decisions because good management then was less important for success than were courage and luck. Traditional bureaucratic institutions and a state-centered regime weakly influence politics in such a high-tech company with a short history, while the shareholders-centered regimes play a nominal role and are still developing.

This company has eleven members on its board of directors, with nine insiders (including five managers and the director of the labor union) and the two outsiders appointed by the two state-owned stockholders. Its CEO and vice-board chair, having led the company's development since its founding, dominates most of the strategic decisions. He always consults with the board chair and they jointly make policies for the company whenever he encounters a pivotal decision. The CEO has also played an important role in promoting innovation throughout the company's growth, including formulating and promoting an innovation strategy, cultivating an innovation culture throughout the entire company, and participating in key decisions and their implementation.

When neither state- nor shareholders-centered regimes are able to exert corporate leadership, the personal authority or charisma of the entrepreneur becomes the primary force that leads and controls corporate development. One individual can especially fill a vacuum in a company in the start-up stage when institutions are not yet developed. For instance, since one or two individuals can make decisions without discussing them with others in a complex procedure, strategies are coherent, consistent, and continuous; there is a short chain of strategic decision-making, implementation, and evaluation; and it can quickly correct an aberrant action. All these benefits enable the company to adapt well to environmental changes, which is why this approach prevails in many enterprises and results in successful performance in the early stages of transition. But when one person cannot control rapid growth, the company has to introduce a new mechanism for making decisions. "Beta" is now making every effort to develop and perfect its shareholders-centered regime along with all its advantages and disadvantages.

The potential disadvantages of a strong entrepreneur are very prominent. "Bounded rationality" limits any individual's ability to deal with the complexities of environmental change. For example, the decision-maker cannot alone recognize, judge, evaluate, and use efficiently the massive amounts of information, possibly resulting in making wrong decisions. Modern high-technology enterprises are confronted with diverse market demands, quickly evolving technologies, and intense competition, all of which greatly challenge the company's ability to correctly assimilate and act on the information. The impact of a wrong decision on the company will increase with the size of the company. In addition, the effect of this approach depends on the consciousness and responsibility of the primary leader who has few restrictions from others. This is very dangerous when there is insufficient institutional control as is exemplified by the many examples of Chinese corruption cases.

5.3.3. *A hybrid system: "Gamma" pharmaceutical company example*

Over one-half of SOEs follow the hybrid approach. In 1995, this company's predecessor along with four other institutional companies founded "Gamma" pharmaceutical company with stock shared by all five companies. Its capital stock structure consists of state stock (36.8%), institutional stock

(43.6%), and employee stock (19.6%), in contrast to when the state held all the shares. The company's board of directors has eleven members, of which five are insiders. Prior to reform, the factory director (*changzhang*) was appointed by the government.

First, the stock structure enables the institutional shareholders to monitor the executives and their decisions, as the board of directors selects the chairman and CEO and appoints top executives rather than politically as before when the state's "one hand dominates a fistful" (it was the only vote that counted). Now that one of the institutional owners has the same 36.8% share as the state, every hand plays an equal decision-making role. The quality of decisions greatly improved.

Second, this company reformed the board by appointing an entrepreneurial leader with a lot of prestige from the employees as the board chair, CEO, and party director. While such duality is common in SOEs, the person is typically a bureaucrat. In spite of such concentrated power, he cannot alone influence the enterprise as the board of directors began to play an increasingly important role in business decisions. The political core and economic core are now integrated, forming a powerful leadership entity.

Third, the company reformed the organizational structure by replacing the finance section with an asset finance department, labor and personnel section (common in China) by the human resource department, and the engineering section by an enterprise development department, as well as setting up new departments for plan evaluation, auditing, supervising, etc. These do not merely change titles of existing departments but is a radical change of operating mechanisms throughout the entire organization with the departments interacting reciprocally, both supplementing and restricting each other. This organizational structure cast away the traditional SOE structure and is now moving toward an international standard.

Fourth, most employees own shares of the company's stock enabling a coincidence of the entire company's interests with those of its workers. Furthermore, the company replaced its old inefficient incentive system with one that has multiple standards. Although it resulted in increased income inequality the workers gradually gave up their prior social equality and enthusiastically undertook innovation and participated in democratic management with the Communist Party Committee, employee representative meetings, and labor union all running quite well. Productivity increased greatly.

Its hybrid approach contains some semblance of property rights from successful reforms but as an old and the largest SOE in its province, this company also retained most of the SOE characteristics (especially its shortcomings). For example, its employees shared a "big rice bowl" (*daguofan*), the company remained mostly egalitarian, and many reforms were resisted. To sum up, this company maintains some traditional advantages of state-centered regimes, which allows for a smooth reform as it simultaneously develops its shareholders-centered regime. The state focuses on monitoring the operation of shareholders-centered regimes through cultivating, politically educating, encouraging, and supervising the cadres as party members. This makes the enterprise conducive to operating the new shareholders system, which will then help consolidate the other reforms it has achieved. While the shareholders-centered regimes are still somewhat imperfect with few independent or committed directors, this hybrid approach exploits the advantages of both state- and shareholders-centered regimes.

5.3.4. *Shareholders-centered regime: "Delta" mobile communications company example*

Over one-tenth of SOEs follow the strong shareholders-centered approach, which is popular in high-tech industries such as "Delta" mobile communications at the time. As an extremely large SOE, this company developed quickly during institutional reform. In 2000, the company's board had 11 total directors, with 3 outsiders recently placed on the board indicating a movement toward international corporate governance norms. The functions of its state-centered regimes have by-and-large been converted to shareholders-centered regimes, and the board dominates most business strategy decisions with a prestigious board chair. The state-centered regimes diminish as the Communist Party Committee's role is titular in supervising and educating the cadres. Similarly, employee representatives and the labor union play a weak role in protecting the interests of employees and the degree of employee involvement is low.

The advantage of this company's approach is that by following the trend of an integrative economy, it lays an institutional foundation for continuous development. The disadvantages lie in failing to achieve traditional benefits, ignoring the importance of employee involvement in management, and disregarding the moral education of managers. Furthermore, institutions exercise their roles well only when they are accepted by society-at-large and the dominant culture; but the low operating efficiency to date of shareholders-centered regimes threatens to impede the development of a modern corporate institution.

6. Summary and conclusions

In this paper, we empirically developed a taxonomy of four governance approaches in Chinese SOEs during their transition, and subsequent case interviews and observations elaborated their specific characteristics. Although China's state-centered regimes worked well in a planned economy, the development of a market economy – along with its corresponding institutional and macro-economic changes – requires corporate governance to similarly adjust. For instance, the old governance approach seems unable to attract investments from capital markets and there is discontent over the inability of managerial appointments to achieve market potential. While some enterprises maintaining their state-centered regimes can succeed, we do not believe this approach is conducive to their long-term development. In contrast, the shareholders-centered approach has the potential to standardize, rationalize, and objectively make business decisions and improve operational efficiencies.

A system of corporate governance exists within a political, legal, historical, and cultural framework and many of the shortcomings in actual SOE governance practices derive from weaknesses in their policy and institutional environment as well as from peculiar local traditions (Lin, 2001). China's unique cultural and political context has historically influenced its commercial activity (Huang and Snell, 2003; Lin, 2001; Mallin and Rong, 1998) and these institutional constraints will continue to exert a powerful influence on enterprise decision making (Child and Lu, 1996). But significant developments in the legal, regulatory, economic, and political arenas have not been matched by the development of corporate governance structures, with problems emerging endlessly (Mallin and Rong, 1998). The market-oriented legal system protecting property rights that is necessary for shareholders-centered regimes to work efficiently remains rudimentary and untested.

Beginning from the existing strong state-centered regimes, there are three possible paths to reach the desired shareholders-centered regimes: Weakening existing state-centered regimes, moving directly to strong shareholders-centered regimes (with Chinese characteristics), or a compromise of the best of the initial state-centered regimes blended with global pressures for shareholders-centered regimes. To maintain economic and political stability while still prodding the reforms, we expect governance approaches during transition to be neither purely shareholders- nor purely state-centered regimes. Although capitalism greatly changes society's cultural orientation, some essentials remain. Chinese society will likely retain Confucianism's emphasis on personal relationships, the unwillingness to trade off costs and benefits between social and economic activities, the absence of a rational disposition, and other cultural characteristics. These remnants of Confucian ethics impede the development of new laws and regulations necessary for the transformation to a rational market economy, thereby mitigating the governance role of shareholders-centered regimes. Various approaches can coexist that retain the characteristics of China's institutional and cultural legacy while its economic and political reforms continue. SOE governance can conceivably be a hybrid, thereby integrating the shareholders-centered regime's business role with the state-centered regime's political education role similar to business reforms coexisting with political stability, like the Yin and Yang paradoxes in Chinese philosophy.

Perhaps the many corporate governance scandals in both emerging and developed markets indicate that there is no perfect corporate governance model (Tenev et al., 2002). Li et al. (2004) offer Hong Kong's "one country, two systems" as an example of a hybrid between relation-based governance and rule-based governance. They also argue that countries lacking both types of governance face war or chaos. As state support for SOEs is reduced, privatization will increase and issues of governance will be taken more seriously. This is consistent with findings that traditional hierarchical and bureaucratic Chinese SOEs have substantially reformed, and now possess "many, but not necessarily all, of the values found in Western market-oriented organizations" (Ralston et al., 2006: 832). However, we maintain that SOEs will selectively adapt features from mature market economies based on a clear understanding of the paths through which such systems have evolved. Installing a governance template derived from an idealized model is unproductive and unlikely to meet the demands of China's economic and social development (Tam, 1999). Shock therapy in Eastern Europe has only killed the patients. Is it a coincidence that the 1989 Tiananmen crackdown of the pro-democracy movement occurred around the same time as Eastern Europe's "fall of the wall"?

State-centered regimes retain certain advantages and will for years to come in the face of a slowly-changing institutional environment. Since the communist party has controlled Chinese politics for over 50 years, it has great prestige in Chinese moral and political education today and is considered competent for developing, educating, and supervising the cadres since most of them are party members. Furthermore, the necessary institutional conditions for the shareholders-centered regime, including the securities and accounting laws and industrial regulations, are still being developed. As a practical matter, the distinctions our taxonomy highlights will help SOEs understand any shortcomings they have and benefit by learning from their counterparts so they can continue to develop smoothly. Finally, regulatory authorities can use this taxonomy as a guide to modify their codes and principles of corporate governance.

Restructuring of SOEs will continue, and governance approaches along with it. Wu claims that "an evolving China faces a number of challenges: solving the remaining problems of the old system, resolving the contradictions generated during the period when the new and the old systems coexisted, and establishing a suitable environment for the new one" (2006: 1). So even as the state-centered regime diminishes, the state will continue to retain influence over these enterprises as shareholders, making board appointments, and intervening in market transactions. With China's accession to the World

Trade Organization, its markets will open and its firms will have no alternative but to increasingly adopt global standards and respect international laws and norms. Global economic integration will force Chinese enterprises to abide by international principles of corporate governance, but a continuing powerful state hierarchy and its legacy of a command economy will create a unique blend of "capitalism with Chinese characteristics."

The final question posed at the end of Shleifer and Vishny's (1997) survey of corporate governance is: "What are the political dynamics of corporate governance?" Political and economic market forces increase efficiency but powerful interest groups preserve inefficient governance systems, and this dynamic is especially pronounced in developing economies. We have shown how governance structures in SOEs can evolve from bureaucratic/political-oriented systems to market/profit-oriented systems and the challenges posed by this process, especially in more collectivist, Confucian societies. We have also shown that the hybrid governance form may indeed thrive in an environment where both political and market pressures coexist. What implications are there if indeed Chinese SOE governance continues in a pluralistic fashion? Will there be innovation diffusion of governance practices among these firms and, if so, in what direction? Furthermore, what about the governance of other types of Chinese enterprises? Foreign-invested enterprises (FIEs), township and village enterprises (TVEs), small and midsize enterprises (SMEs), and family businesses are all undergoing a transition from operating in a centralized socialist economy to a mixed market economy. Their governance approaches are also very interesting and important, especially with an increasing role in the national economy. In addition, while "hard" regulations are being introduced and their role is increasing, "soft" regulations are evolving such as a sense of social responsibility and how to deal with the interests of "new" stakeholders (for example, knowledge owners, institutional investors, etc.). Finally, numerous other developing countries in Latin America, Eastern Europe, and the former Soviet republics are facing similar transitions to market capitalism by way of privatization. We hope this article spurs future research that incorporates the contingencies our taxonomy has developed, further enriching our understanding of governance types.

Notes

1. According to Goetzmann and Köll (2005), shares of foreign-registered corporations doing business in China began trading in Shanghai in the 1860s and the Shanghai Stock Exchange became a market for domestic Chinese companies during the 1870s only to suffer from insider trading.

2. China created and adopted a code of corporate governance a century ago with its first Company Law (*gongsi fa*) in 1904 that brought business structures more in line with global

practice. Following Japanese and English corporate codes after three decades of adapting Western-style business models, it granted limited liability in exchange for transparency, separation of ownership and control, and annual auditing and reporting requirements intended to protect the rights of shareholders, but failed to install essential structures and features of the Western corporate system (Goetzmann and Köll, 2005) such as legal protections, property rights, and merger and acquisition of listed and unlisted companies.

3. There were very large family businesses during the Ming (1368–1644) and Qing (1644–1911) dynasties, and all industrial enterprises founded prior to 1895 required government sponsorship (*guandu shangban* and *guanshang heban*) replete with bribes, corruption, and mismanaged funds (Goetzmann and Köll, 2005).

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