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Development of Corporate Governance Practices and Capital Market Reforms in China

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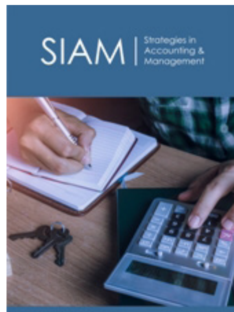

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Abstract

This paper delineates the development of corporate governance practices in China from four perspectives: historical evolution, current progresses, existing issues, and future direction. Firstly, we provide an in-depth analysis of the progression of corporate governance in China, from the introduction of corporate governance concepts at the early stage of opening-up and economic reform in 1978, through the development of incorporation structures and governance mechanisms, to the enhancement of effectiveness at the present. This demonstrates that the development of corporate governance in China has undergone significant changes and has gradually formed a governance system adapted to the requirements of the socialist market economy. Secondly, we outline the outcomes of market reforms in shareholder governance, mixed-ownership experiment, board governance, quality of information disclosure, and sustainable development. We also explore internal issues such as the effectiveness of independent director system, dividend payout policies, and ESG disclosures, as well as the external challenges including oversight role by institutional investors, banks and other financial institutions, and the efficacy of market intermediaries. Lastly, we propose future directions for deepening corporate governance reforms, i.e., strengthening information disclosure and new governance models under the digital economy in China. These measures aim to promote the advancement of Chinese corporate governance towards greater efficiency, transparency, internationalization, and digitalization.

Keywords: Corporate governance; Regulatory compliance; Equity structure reform; Information disclosure; ESG performance; Digital transformation

Introduction

With the rapid development of Chinese economy and continuous advancement of globalization, corporate governance has emerged as a pivotal mechanism in business management in China. It plays an essential role in ensuring the healthy development of enterprises, safeguarding the rights of investors, and enhancing the efficient operation of capital market. The corporate governance practices in China have not only exerted a profound impact on the growth and transformation of domestic business enterprises but have also made unique contributed to corporate governance theory and practice in the world. This paper aims to provide a comprehensive summary of corporate governance development in pace with recent capital market reforms in China, to examine its current achievements and challenges, and outline the direction for future advancement. The practical outcomes of corporate governance in China are also analyzed from four dimensions: shareholder governance, mixed-ownership reform, board governance, and quality of information disclosure and sustainable development. We also discuss the deficiencies in Chinese corporate governance, such as internal issues of ineffectiveness of the role of independent director system, the rationality of cash dividend payout, the inadequacy of ESG disclosure, as well as deficiencies in external governance mechanisms for institutional investors, banks and financial institutions, and market intermediaries.

By examining the history and current state of corporate governance corresponding to the capital market reforms in China, we also propose future development directions such as deepening governance reforms, enhancing information disclosure quality, and exploring new developments in corporate governance in the context of the digital economy, aiming to provide guidance for the continuous improvement of Chinese capital market operations and corporate governance practices. Against the backdrop of globalization, innovation and improvement in Chinese corporate governance will not only help enhance the international competitiveness of Chinese enterprises but also contribute Chinese wisdom and solutions to the advancement of capital market to promote corporate governance practices in the world.

Historical evolution of corporate governance in China

Following "opening-up and economic reform" policies in 1978, corporate governance in China has been undergoing an evolutionary process spanning over four decades, characterized by four distinct phases: "Introduction of Corporate Governance Concepts," "Construction of Corporate Governance Structure," "Establishment of Corporate Governance Mechanisms," and "Enhancement of Corporate Governance Effectiveness." Throughout this evolution, the governance structure of listed companies in China has transitioned from a traditional singular state-owned model to diversified corporate governance models. This transformation not only demonstrates the continuous advancement of corporate governance in China but also reflects the mutual influence and integration of domestic and international governance practices.

Introduction of corporate governance concepts (1978-1992)

Prior to the economic reform in late 1970s, China's enterprises and economic system were predominantly characterized by state- and collective ownership, with a singular e governance structure of direct governmental control and management over enterprise operations. In pace with the economic reforms, China gradually transitioned from a planned economy to a market-oriented economy, leading to the diversification of enterprise systems and the emergence of various business forms such as shareholding companies, privately-run enterprises, and foreign-invested enterprises [1,2]. State-Owned Enterprises (SOEs) began to transform, implementing the policies that decentralized power and allowed for profit retention by enterprises. Measures such as expanding autonomy and implementing economic responsibility systems were adopted to gradually enhance the market competitiveness of business enterprises. In order to better adapt to the development of the market-oriented economy, Chinese enterprises started to establish more effective and standardized corporate governance structures [3-5].

At the beginning in 1984, some SOEs initiated pilot reforms of incorporation system, permitting capital raising through the issuance of stocks and gradually establishing the basic framework of a modern enterprise system. The pilot shareholding reforms facilitate the separation of business ownership and management rights, accumulating experience for the subsequent formulation of the Company Law and the refinement of corporate governance structures in China. The enactment of the "Law on Industrial Enterprises Owned by the Whole People (e.g. SOEs)" in 1988 marked the beginning of the legalization of incorporation system and corporate governance, laying a legal foundation for the reform of SOEs and the establishment of modern corporate governance structures. The 14th National Congress of the Communist Party of China, held in 1992, explicitly proposed the goal of establishing a socialist market-oriented economy system, emphasizing the need to carry out enterprise reforms and enhance the vitality and competitiveness of business enterprises, thus providing direction for the subsequent reform of SOEs in alignment with the progress of a market-oriented economy system [6,7]. The policies and reform measures of this period laid a solid foundation for the transformation of China's enterprise system and the development of corporate governance, providing significant policy and institutional support for the market-oriented reforms and restructuring of enterprises and management.

Construction of corporate governance structure (1993-1998)

During this stage, China went through significant advancement in developing corporate governance structure, primarily evident through the official enactment of the "Company Law" and the "Securities Law." These two legislations provide the necessary legal framework and institutional support for Chinese enterprises to establish modern corporate systems and refine their governance mechanisms. Implemented in 1993, the "Company Law" set out the legal architecture for corporate governance in China, delineating the corporate governance structure that enterprises should adopt and specifying the roles and operational procedures of main corporate bodies such as the shareholders' meeting, board of directors, and supervisory board. The enforcement of the "Company Law" is pivotal in regulating corporate organization and conduct, thereby enhancing the transparency and efficiency of corporate operations [8].

In 1998, the introduction of the "Securities Law" signified the establishment of a formal legal system for the capital market to move towards standardized market management in China. This legislation put an end to the prolonged absence of dedicated legal oversight in the securities market, laying down the legal groundwork for market stability and healthy growth. The "Securities Law" provides explicit guidelines for essential market operations, including securities issuance, trading, and the acquisition of listed companies, thereby setting forth a standard of conduct for all market participants. This contributes to the maintenance of market order and the protection of investor rights, bolstering investor confidence and attracting additional capital flows into the market that, in turn, fosters the expansion and intensification of the capital market, offering more efficient financing avenues for the broader economy [3]. By emphasizing the principles of openness, fairness, and equity, and through measures such as regulating information disclosure and prohibiting insider trading, the "Securities Law" that enhances market transparency and credibility in the country.

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Establishment of corporate governance mechanisms (1999-2012)

The China Securities Regulatory Commission (CSRC) issued the "Rules of Corporate Governance for Listed Companies" in 2002, which is a set of normative documents designed to regulate the governance operations of listed companies, enhance company quality, and protect the rights and interests of investors. It covers various aspects, including the conduct of general meetings of shareholders, boards of directors, supervisory boards, senior management, controlling shareholders and related parties, corporate independence, related-party transactions, information disclosure, internal control, risk management, social responsibility, and environmental protection [5]. The Rules aim to promote the establishment of modern enterprise systems for listed companies, increase governance transparency and efficiency, safeguard the legitimate rights and interests of investors, especially small and medium-sized investors, foster a fair and transparent capital market, boost market participants' confidence, and provide institutional support for the stable and healthy development of the capital market.

To adapt to the rapid development of the market-oriented economy and the new requirements following China's accession to the World Trade Organization (WTO), the government significantly amended the "Company Law" of 1993 in 2005 respectively. The revised "Company Law" further clarifies the corporate governance structure, strengthens the protection of shareholders' rights, small and medium-sized shareholders in particular, and provides more detailed provisions on the responsibilities and obligations of directors, supervisors, and senior management [9]. In addition, it introduces regulations on company information disclosure and financial reports, in order to enhance the transparency of corporate operation and governance. The original split share structure had long affected the healthy development of Chinese capital market. The coexistence of tradable and non-tradable shares led to an unbalance in market supply and demand, preventing stock prices from accurately reflecting the value of companies. Non-tradable shares (mainly shares held by state-owned and legal entities) were not circulated in the market, and their value could not be realized through market transactions. The conflict of interest between tradable and non-tradable shareholders has resulted in an overly concentrated company control, which was not conducive to optimizing the corporate governance structure and market-oriented operations. To address these issues, the Chinese government implemented the "Split-share reform" in 2005, aiming to achieve full circulation of all shares and eliminate difference in the liquidity of varied types of stocks. This reform has significantly revitalized the stock market, enabling stock prices to reflect the company's value and market supply and demand relationship more accurately. By allowing the circulation of shares held by major shareholders, the market's regulatory power over corporate governance was enhanced, promoting the optimization of corporate governance structures [7,10]. Concurrently, the reform improves corporate equity structure and strengthens the role of market mechanisms in enterprise reform and resource allocation, providing a solid foundation for a rapid growth development of Chinese capital market.

Enhancement of corporate governance effectiveness (2013-Today)

To further deepen the reform of SOEs, Chinese government initiated a new round of mixed-ownership reform in 2015. In August of the same year, the Central Committee of the Communist Party of China and the State Council issued the "Guiding Opinions on Deepening the Reform of SOEs," with the introduction of non-state capital to participate in the reform of SOEs to affirm the significant role of non-state capital in the reform process. In September, the State Council released the "Opinions on the Development of a Mixed-Ownership Economy in SOEs," encouraging non-state capital to engage in mixed-ownership reform. It also proposed specific measures for classified and tiered reform progress, further clarifying the approaches to SOEs reform, including "introducing non-state capital to participate in the reform of SOEs," "encouraging state-owned capital to take various forms of equity in non-state enterprises," and "exploring the implementation of employee stock ownership in mixed-ownership systems." In 2019, the newly amended "Securities Law" was officially promulgated, with the implementation of a securities issuance registration system, which further advanced the marketization of securities issuance and enhanced market efficiency and transparency [11]. The new "Securities Law" has also increased the penalties for securities violations, tightened legal restrictions on corporate governance, and prompted companies and their management to place greater emphasis on operation compliance s and fulfillment of information disclosure obligations. These reforms and legal enhancements have collectively propelled the stable and healthy development of China's capital market, setting a more equitable and transparent jus\ market environment for businesses and investors. In short, Chinese corporate governance has undergone a developmental path from exploratory practice to systematic construction over the forty years since the opening-up and economic reforms initiated in 1978, and finally approached international common practices. This evolution not only reflects the transformation and upgrading of Chinese economy but also demonstrates the efforts of Chinese business enterprises in continuously absorbing international experiences, adapting to market changes, and promoting managerial innovation.

Achievements of Corporate Governance Development in China

The governance standards of listed companies in China have been steadily improved, attributable to the refinement of regulatory policies, optimization of market mechanisms, and reforms of internal corporate governance structures. This section will review and analyze the main recent accomplishments in the development of corporate governance in China, showcasing its notable successes in driving enterprise reforms, enhancing market efficiency, protecting investor rights, and fostering economic stability and growth [12,13].

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Shareholder governance

The conflict of interests between controlling shareholders and minority shareholders has long been a salient issue in Chinese corporate governance since the early 2010s [2]. The protection of the legitimate rights and interests of minority investors has been further emphasized and positioned as the top priority agenda of the CSRC. This clear stance not only reflects the regulatory authority's high regard for the protection of minority shareholders' rights but also sets the direction for future corporate governance reforms and development in China. In this aspect, the market regulatory authorities have implemented a series of innovative measures. The CSRC has established the China Securities Investor Services Center (ISC) and a representative litigation platform for special representatives, thus, ISC can act as \a more robust protection mechanism for minority investors to mitigate the interest conflicts between controlling and minority shareholders. The CSRC established the ISC in 2014, marking a significant institutional innovation in China's securities regulatory framework. The establishment of ISC aims to enhance the participation of small and medium-sized shareholders in corporate governance, which is characterized by a dual mechanism that is "semi-public and semi-private[1]." It can act as "regulatory small shareholder," as per the Law, by holding a minimum of 100 shares in listed companies. The ISC adopts market-based approaches to promote the interests of small shareholders, exercise various shareholder rights either independently or in conjunction with other investors [10,14].

The ISC's rights exercise can be categorized into two modalities: firstly, on-site activism, i.e., participating in shareholders' meetings, attending significant corporate restructuring consultation sessions, and conducting company visits; secondly, online advocacy, that is to be involved in the process to solicit shareholder suggestion l and public announcements. As of April 2023, the ISC held shares in a total of 5,164 listed companies nationwide, participated in 3,604 governance corporate activities, and cumulatively exercised shareholder rights 4,624 times. Through resolving 13,000 disputes or illegitimate actions by the controlling shareholders, the ISC has helped other investors recover their losses of approximately RMB 3.132 billion through litigations, and additional RMB 2.52 billion in legal compensation. The Special Representative Litigation System (SRLS) is a significant complementary policy to the registration-based reform of Chinese securities market and represents a top-level institutional innovation in the investor protection system, often referred to as Chinese version of collective litigation. The revised "Securities Law" of China in 2019 introduced a new Chapter VI of "Investor Protection," which notably establishes the SRLS with distinctive Chinese characteristics, and it draws on the "opt-out, opt-in" principles from group litigation systems in western countries, e.g., the United States, and it substantially increase the costs associated with illegal and non-compliant activities in the capital market [3,15].

The first case in China's capital market to apply the SRLS is of the Kangmei Pharmaceutical Corp.,[2] which tested the efficacy of SRLS in investor protection. The case, from litigation to judgment and enforcement, spanned less than eight months in 2020. The judgment results in a compensation of RMB 2.459 billion for its securities investors, with 52,037 affected investors receiving compensation through cash payments, stocks, and trust benefit rights, among other methods. The percentage of the compensation, the amount awarded, and the number of investors compensated have been unprecedented, leaving a significant impact on the capital market in China [16].

Mixed-ownership reform

The mixed-ownership reform for SOEs has made significant progress and yielded notable outcomes, exhibiting a positive development trend in terms of scale, industrial sectors, and restructuring approaches.

The scale of mixed-ownership reform has been expanding steadily. In industries and business segments characterized by fierce competition, the reform has been actively and cautiously implemented. By 2020, SOEs run directly by the central government had completed over 4,000 cases of mixed-ownership reform, attracting more than RMB 1.5 trillion in social capital inflows. Over 70 percent of SOEs run by the central government has undertaken the mixed-ownership restructuring, marking an increase of nearly 20 percentage since the end of 2012. For SOEs run by local governments, the portion of mixed-ownership entities has reached 54%, with over RMB 700 billion in social capital inflows. Within the total equity of SOEs run by the central government, the minority equity attributable to social capital has increased from RMB 3.1 trillion at the end of 2012 to RMB 9.4 trillion in 2020, rising from 27% to 38%, which indicate a substantial integration of the state and social capital for corporate property rights[3]. Additionally, the scope of industries involved in the mixed-ownership reform is extensive. Beyond actively promoting the reform in highly competitive industrial sectors such as construction, real estate,

[1]The "semi-public and semi-private" characteristic of the ISC refers to its dual nature and functions, embodying both the attributes of a public regulatory institution and a private shareholder simultaneously.

[2]During the years 2016 to 2018, Kangmei Pharmaceutical Corp. fabricated its financial statements through a variety of means, including inflating operating revenues, interest incomes, and operating profit, as well as misrepresentation of cash and cash equivalents. The cumulative misstatement of cash and cash equivalents reached an astounding scale of RMB 88.68 billion, with an overstatement of operating revenues by RMB 29.128 billion, an exaggeration of operating profit by RMB 4.101 billion, and a surplus of interest income by RMB 510 million.

[3]The data source is from the speech made by Mr. Peng Huagang, Secretary-General and Spokesperson of the State-owned Assets Supervision and Administration Commission (SASAC), during a press conference held by the State Council's Information Office regarding the economic performance of business enterprises run by the central government in 2020.

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manufacturing, and wholesale and retail trade, where over 70% of SOEs have completed the transition to a mixed-ownership system, and the reform has also been systematically experimented in pillar business sectors, including electricity, civil aviation, telecommunications, and defense, with the orderly introduction of non-state capitals.

Lastly, the approaches to mixed-ownership reform have diversified. In 2020, Chinese government established the State-owned Enterprise Mixed-Ownership Reform Fund, which raised RMB 70.7 billion in its initial phase and has reached a total scale of RMB 200 billion. The Fund is designed to facilitate restructuring, transformation, and upgrading of state-owned enterprises, as well as to advance the process of mixed-ownership reform through market-oriented means. The SOEs run by the central government are also actively exploring “reverse mixed-ownership reform,” flexibly promoting “two-way mixed-ownership reform” and “second-round mixed-ownership reform.” This involves injecting state-owned equity into privately-run enterprises and collaborating with the latter to achieve joint growth at critical stages in business valuation chain [16,17]. Historically, listed SOEs in China have suffered from problems of absence of effective ownership and insider control. The mixed-ownership reform, by introducing non-state capital and diversification of equity structure, has been instrumental in establishing and refining modern enterprise systems for Chinese enterprises. This kind of diversified equity structure can enhance the effectiveness of corporate governance. By leveraging the complementary strengths and checks and balances of different ownership forms, a more rational and effective decision-making mechanism can be formed. As a result, the mixed-ownership reform help to mitigate the risks associated with insider control prevailing in SOEs in China.

Board governance

Board independency is a key mechanism for corporate governance. The independent director, as a crucial element of the governance structure for listed companies, aims to enhance corporate governance by introducing external independent opinions and oversight, thereby protecting the legitimate rights and interests of investors, especially small and medium-sized investors. Although the Company Law in China has mandated the independent director system, i.e., not less than one-third of board members should be independent directors, its effectiveness has long been questioned, since the majority of companies treating the independent director system as a formality to meet regulatory compliance[4] rather than genuinely fulfilling their intended roles in supervision and checks and balances in corporate operation and governance. In the major financial fraud of Kangmei Pharmaceutical Corp., five independent directors were found to have failed in their supervisory duties and were adjudged to bear partial joint compensation liability, with the total amount of RMB 2.459 billion. This court judgment has reignited market discussions on the role and efficacy of independent director system and prompted market participants to pay more attention to the issue.

In response to market concerns on the effectiveness of the independent director system, the CSRC amended the “Administrative Measures for Independent Directors of Listed Companies” in September 2023, aiming to improve the performance of independent directors in fulfilling their duties, ensuring their role in supervision and checks and balances is effectively exercised. This amendment intends to elevate the governance standards of listed companies, safeguard the legitimate rights and interests of investors, and foster the stability and healthy development of the capital market in China [13]. The newly amended “Regulations on Independent Directors” covers various stages of the operation of the independent director system and refine the qualification requirements for independent directors. The main content can be summarized into the following seven key areas: 1) specification of the composition requirements and role for independent directors; 2) detailing the qualifications and conditions for appointment; 3) enhancement of the selection and dismissal procedures for independent directors; 4) establishment and improvement of platforms and corresponding work mechanisms for the performance of duties by independent directors; 5) specification of special rights for independent directors; 6) clarification of duties for independent directors in operation; and 7) establishment of standards for assessing administrative responsibilities and exemptions for penalties. Notably, the establishment of a dedicated institution and corresponding operating mechanisms for independent directors, particularly the institution of special meetings by for independent directors, represents a significant improvement. The changes in the independent director duty performance framework signify a pivotal shift from individual to institutional performance models. Such a transition not only allows individual director to execute their responsibilities with greater comprehensiveness and efficacy but also requires listed companies to set up needed institution to support and safeguard their independent directors to fulfill responsibilities. In addition, the new “Regulation” has raised the standards for substantive independence and engagement of independent directors by reducing the maximum number of listed companies from five to three, both domestic and foreign listed companies, that one independent director can concurrently serve. Furthermore, an independent director can only continuously serve in tow terms of six years in total at a listed company, to ensure the independency and full engagement of independent directors in corporate governance.

Quality of information disclosure

In response to market reforms and the requirements of the new “Securities Law,” the CSRC revised the “Administrative Measures for Information Disclosure of Listed Companies” and implemented it on May 1, 2021. The main revisions include the refinement of basic information disclosure requirements, periodic reporting

[4]Chinese Company Law stipulates that the number of independent directors should constitute no less than one-third of the total membership of the board of directors.

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systems, ad hoc reporting standards, and the management system for information disclosure affairs. Additionally, the revisions aim to enhance the effectiveness of regulatory enforcement and provide more detailed guidance on voluntary disclosure of information by listed companies. In 2003, the “Guidelines for Investor Relations Management of Listed Companies” issued by the Shenzhen Stock Exchange firstly introduced the concept of “voluntary information disclosure”. Subsequently, guidelines from both the Shanghai and Shenzhen Stock Exchanges have encouraged listed companies towards voluntary disclosure practices. The 2013 “Opinions on Further Strengthening the Protection of the Legitimate Rights and Interests of Small and Medium Investors in the Capital Market” issued by the General Office of the State Council explicitly stipulate the need of rules for voluntary disclosure. The 2019 amendment of the “Securities Law” formally recognized voluntary disclosure from the legislative perspective. As stated in Article 84, Paragraph 1, companies may voluntarily disclose information relevant to investors’ value judgments and investment decisions, beyond what is legally required. As a result, Chinese listed companies have gradually increased voluntary disclosures to the capital market [14].

In terms of the extent of disclosure, the number of Chinese listed companies engaging in voluntary information disclosure on the Shanghai, Shenzhen, and Beijing stock exchanges has increased from approximately 1,600 in 2019 to about 3,000 in 2022, according to the annual reports of the listed companies from 2019 to 2022. This represents a rise in the percentage from 64% in 2019 to 73% in 2022. Regarding the format of disclosure, Chinese listed companies predominantly rely on regular reports, complemented by interim announcements. For example, the number of interim announcements in the Shanghai Stock Exchange, with “voluntary” in the title issued in 2021 and 2022 were 648 and 1,079, accounting for 0.21% and 0.41% of the total disclosures respectively. The corresponding figures for the Shenzhen Stock Exchange were 515 and 565, maintaining a consistent percentage of 0.15%. Although there has been an uptick in the number of interim announcements for voluntary disclosure, regular reports remain the primary vehicle for conveying voluntary information by Chinese listed companies at present. In terms of the information content, voluntary disclosure encompasses a wide range of areas, including progresses in significant project investments, strategic planning, environmental, social, and governance (ESG) aspects. Over 80% of companies voluntarily disclose their social responsibility performance, more than 60% of disclosed information is about customers, suppliers, and related party relationships, Disclosure of key performance indicators and their calculation assumptions is over 40%, while over 10% of disclosure is about operational and debt repayment capabilities. These figures indicate that Chines listed companies are progressively moving towards extensive and more in-depth information their voluntary disclosures. Overall, both the quantity and quality of voluntary information disclosure are positively increased. By engaging in voluntary disclosure, listed companies not only enhance communication with investors and increase transparency but also provide more comprehensive and useful references for investors’ decision-making. This move certainly contributes to enhancing the overall image and market competitiveness of the listed companies in China.

Sustainable governance

In 2019, the CSRC issued the revised “Corporate Governance Code for Listed Companies,” which includes provisions in Chapter 8 on stakeholders, environmental protection, and social responsibility. Article 86 stipulates that “listed companies should integrate ecological and environmental protection requirements into their development strategies and corporate governance processes, and play a leading role in pollution prevention, resource conservation, and ecological protection.” It is explicitly states in Article 87 that “while maintaining the company’s sustainable development and protecting shareholders’ interests, listed companies should actively fulfill their social responsibilities in areas such as community welfare, disaster relief, and public service.” The new “Corporate Governance Rules for Listed Companies” encourages listed companies to participate in ecological civilization construction and the fulfillment of social responsibilities such as poverty alleviation, establishing a basic framework for the disclosure of ESG information. The CSRC has sequentially issued regulatory rules and guidelines to further clarify the requirements and supervisory measures for corporate ESG practices. For instance, on April 11, 2022, the CSRC published the revised “Guidelines for Investor Relations Management of Listed Companies,” and incorporates ESG information as a key component of investor communication by listed companies.

To further regulate the disclosure of information related to the sustainable development of listed companies, on February 8, 2024, the Shanghai, Shenzhen, and Beijing Stock Exchanges each issued respective draft guidelines for corporate sustainability reporting (collectively referred to as the “Draft Guidelines for Sustainability Reporting”) for public consultation. The Draft Guidelines emphasize the “double materiality principle,” which requires listed companies to consider both the significant financial impact issues on the enterprise and the broader implications for the economy, society, and environment when disclosing information. The application of the double materiality principle aligns with the European Union’s “Sustainability Reporting Standards (ESRS)” and the Global Reporting Initiative (GRI) standards, which reflects a balanced response to the impact of sustainability issues on corporate enterprise value as well as on economic, social, and environmental impact.

Renaming Issues in Chinese Corporate Governance Practice

Internal issues

Effectiveness of independent director system: As previously mentioned, the role of independent directors in Chinese corporate governance has long been challenged by researchers [2]. Firstly, the median percentage of independent directors on the boards of

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Chinese listed companies is 33%[5], with an average of 37%, which are in compliance with the minimum legal requirement (e.g., at least 1/3 of the Board composition). However, the appointment of independent directors by listed companies is primarily to meet the legal threshold requirement. In contrast, in the developed economies, (e.g., the United States), where the corporate governance system is more mature, independent directors constitute the majority of the board in the vast majority of companies (approximately 94% in the manufacturing industry), and the average percentage of independent directors in the S&P 500 companies is as high as 85%. In many well-known companies, all board members except the CEO are independent directors. For instance, at Amazon, there are 11 board members, with 10 being independent directors besides the founder, Jeff Bezos. The Chairperson of the board in many companies is also an independent director. This comparison illustrates that the proportion of independent directors on the boards of Chinese listed companies is relatively low, which may hinder their ability to provide effective external oversight over controlling shareholders and the management. In terms of compensation, the remuneration for independent directors in Chinese listed companies is generally low. According to the 2022 annual reports of listed companies, the median annual salary for independent directors of the CSI 300 constituent companies is approximately RMB 150,000. The majority of listed companies in China utilize an "all-inclusive" compensation model for independent directors, which provides the same remuneration irrespective of the actual workload and responsibilities undertaken. Less than 30% of the CSI 300 composing companies have adopted a differentiated compensation model for independent directors, and the variance in individual compensation among independent directors within the same company exceeds 20% in some f cases.

Furthermore, of the regulatory authority has prohibited independent directors from participating in equity incentive plans to ensure their independence, resulting in their compensation being composed entirely of cash remunerations. The significant penalties imposed on independent directors in the Kangmei Pharmaceutical financial fraud case have shown a discrepancy between the risks associated with the independent director duties and the compensation they receive, leading to a rash of resignations among independent directors and creating negative perceptions in the market [18]. In response, some listed companies have begun to provide liability insurance for their independent directors as a means to alleviate the risks associated with their duties. Regarding the supervisory role of independent directors, most of them rarely to act professionally in the respect of their willingness to accept the management proposals regardless of whether those agenda items are in the best interest of all shareholders. A study examining the voting patterns of independent directors in Chinese listed companies with at least one independent director abstained or voted against the proposals in the sample, including 609 board meetings with 859 proposals being voted on, found that only 6% of independent directors expressed dissent on the board meetings. Despite this, 92% of the management proposals were ultimately approved. This high approval rate is not surprising, given that major shareholders or actual controllers often dictate the board meeting agenda, and independent directors have little say in the board meetings [19,20]. In summary, independent directors have not played a desirable role in corporate governance in Chinese listed companies, which warrants further examination and actions to enhance the effectiveness of independent director system within the corporate governance framework.

Rationality of cash dividends: As discussed earlier, 0the market regulatory authorities require listed companies to make dividend distribution to investors. Over the past five years, A-share listed companies have distributed a cumulative total of RMB 8.2 trillion in cash dividends, with the annual dividend payout to exceed the amount of equity financing raised in the same year. In 2022, a total of 3,291 companies from the Shanghai and Shenzhen Stock Exchanges declare cash dividends, amounting to RMB 2.1 trillion, of which RMB 1.6 trillion was distributed to domestic investors, marking a year-on-year increase of 22.7%. The proportion of companies with dividend payouts was 67.1%, and the dividend payout ratio is, on average, at 32.5% and the dividend yield at 1.97%, matching the middle levels of dividend payout in terms of the main capital markets worldwide. However, compared to more mature markets, there is still room for improvement in the payout ratio and stability of dividend distribution for Chinese listed companies, in order to raise investment returns for investors in the capital market in China. In terms of dividend payout, some companies either do not pay dividends[6] or pay a very low ratio of dividends, which may prevent shareholders from receiving the adequate returns on investment. At the same time, a few companies pay dividends at unusually high ratio[7], which could potentially harm their debt repayment capacity and sustainable operating growth. Regarding the stability of dividend distribution, most companies in the U.S. stock market implement quarterly or semi-annual dividend

[5]Source of the data is the China Stock Market & Accounting Research Database (CSMAR).

[6]Statistics reveal that among companies listed for over the recent decade, more than 100 have had a total cash dividend payout of zero from 2013 to 2022. During the past three years (based on dividend payout data disclosed in the annual reports from 2020 to 2022), 1,203 companies did not pay any dividends. Excluding the 257 companies that went public in 2023, there are still 946 companies that have not paid dividends in the last three years. Companies such as Berry Genomics, Guizhou Zhongyida CO., LTD., and Xueda Education Group have maintained a record of not paying dividends for over 20 years. Notably, Shenyang Jinbei Automotive Company Limited has never made a cash dividend distribution during its 31 years since going public.

[7]Huabao Flavors & Fragrances Co., Ltd. distributed a total of RMB 4.387 billion in cash dividends from 2016 to 2018, which exceeded the company's cumulative net profit of RMB 3.59 billion during the same period.

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payouts, whereas the vast majority of Chinese listed companies pay dividends only on annual basis, with a small number of listed companies offer interim dividends. According to data from the China Listed Companies Association, as of August 31, 2023, 162 listed companies in the Shanghai and Shenzhen Stock Exchanges had announced interim cash dividend plans for 2023, accounting for only 3.05% of the total 5,305 A-share companies. Much could be done to enhance stable and rational dividend distribution to protect investors' interest and their returns on investment in the Chinese market.

On December 15, 2023, the CSRC issued the "Regulatory Guidance No. 3 for Listed Companies-Cash Dividends of Listed Companies" (hereinafter referred to as the "Cash Dividend Guidance") and the "Decision on Amending the 'Guidance for the Articles of Association of Listed Companies'", to further optimize regular dividend payout mechanism for listed companies and raise the level of investor returns. The CSRC will extend institutional restriction for on companies that do not pay dividends, paying particular attention to companies with substantial financial investments but low dividend payout ratio to encourage an increase in dividend distribution. Also, companies that distribute dividends abnormally will be under more serious monitoring to promote the practice of reasonable and continuing dividend policies.

ESG information disclosure: The ESG information disclosure by listed companies in China is primarily voluntary. However, some companies in main key polluting industries and their subsidiaries are mandated to disclose more relevant information. The Shanghai Stock Exchange (SSE) enforces the disclosure of social responsibility reports for companies listed on the STAR Market Index. Composing companies of the "STAR 50 Index" are specifically required to disclose either a social responsibility report or an ESG report separately. Furthermore, the Shenzhen Stock Exchange (SZSE) mandates companies listed in the "Shenzhen 100 Index" to issue social responsibility reports. Table 1 shows the current state of ESG reporting among Chinese listed companies. It is argued that the current ESG disclosure regulations in China should be further standardized and refined. On one hand, disclosure of ESG information by listed companies is voluntary and there is no mandatory requirement for all Chinese listed companies to make ESG disclosure at present. On the other hand, while regulatory authorities and self-regulatory organizations have preliminarily established an ESG disclosure framework, there is a lack of detailed disclosure standards and guidance, leading to inconsistencies in the scope and depth of existing ESG disclosures. This may deprive investors from obtaining high-quality, standardized, and comparable ESG data and mislead stakeholders' decision-making.

Table 1: The percentage of ESG report publication by listed companies in China.

	2022	2021	2020	2019
Shanghai Stock Exchange	40.54%	41.81%	37.92%	39.2%
Shenzhen Stock Exchange	21.89%	22.64%	20.48%	18.4%
Total	39.87%	31.12%	28.04%	27.06%

Regarding the quality of disclosure, firstly, the ESG information disclosed by Chinese listed companies is often superficial and incomplete, lacking substantive content that corresponds to the requirements of the stock exchanges and professional guidance. Secondly, the quality of environmental information disclosure is insufficient, with only aggregate carbon emission data provided, or in some cases, there is no disclosure at all. The ESG information is often descriptive with a scarcity of actual data, and there is a lack of horizontal comparison. Lastly, the information of social governance tends to be overly positive, avoiding detailed disclosure of negative aspects. The reports present, in general, "what has been done" rather than "what has not been achieved" In regard of corporate ESG performance. ESG reports issued by Chinese listed companies are still be reviewed through internal process, with less than 4% of ESG reports have been assured by third-party auditors. Compared to the robust internal and external comprehensive audit mechanisms in the developed countries, Chinese practices fall far behind. The absence of external audits diminishes the credibility of ESG reports, which is not helpful to bolster investors' confidence in the Chinese market.

External issues

Efficacy of supervision by institutional investors: In China, the term of "institutional investors" typically encompasses a variety of entities including mutual funds, Qualified Foreign Institutional Investors (QFII), insurance companies, securities firms, social insurance funds, trust companies, corporate pensions, and private equity funds. Most listed companies in China have ownership structures characterized by a high degree of concentration. Although the average holding percentage of the largest shareholders has been declining in recent years, it remains above 30% at present. Chinese regulatory authorities stipulate that a single institutional investor is not permitted to hold more than 10% of total shares in a listed company. By examining the data from 2003 to 2018, Jiang [2] reveal that the average ownership percentage held by all institutional investors in a listed company is of 6%, in contrast to the average of 36% held by the controlling shareholders. Consequently, institutional investors may lack both the incentive and the capability to engage in active and effective corporate governance to monitor the controlling shareholders and the management. Moreover, due to relatively low shareholding ratios, institutional investors in China struggle to exert an influence over controlling shareholders or internal corporate managers. This situation has led to a short-term vision among Chinese institutional investors, with a pronounced inclination towards speculative motives rather than participating in long-term corporate governance activities [2].

Supervisory role of financial institutions: Commercial banks are significant creditors of Chinese listed companies, and they have exhibited a diminished interest to fulfill supervisory duties. This has been exemplified in the Evergrande Real Estate debt crisis, where the company's liabilities to banks and other financial institutions, amounted to over RMB 500 billion. Despite the involvement of so many commercial banks and a relatively dispersed creditor base, individual risk exposure of each financial institution is not

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substantial. However, this case showcases a deficiency in the oversight of corporate governance by financial institutions. Major commercial banks in China are predominantly state-owned and have to bear social responsibility of assisting business enterprises through difficult times and stabilizing employment. Yet, this role has the potential to distort their duty of efficient resource allocation and diminish their supervisory impact on companies. It is necessary to reexamine the political and social role of financial institutions to ensure their involvement does not compromise governance and financial health of their debtors.

Roles of market intermediaries: The debt default by Evergrande Real Estate has precipitated a crisis of confidence in the capital market regarding the role of market intermediaries, as CITIC Construction Investment Securities[8] and Price Waterhouse Coopers (PWC) are on the center of scrutiny. Most market participants have questioned why these two intermediary institutions continued to assist Evergrande Real Estate in issuing bonds, despite being aware of the company's imminent risk of bankruptcy. Furthermore, the market has expressed skepticism about the quality and reliability of professional services provided by these firms. The quality of external audit is crucial for ensuring the stability and healthy development of the capital market. In the regulatory framework, external auditors are entrusted with the responsibility of assuring the truthfulness and fairness of corporate financial reporting. Their independence and professionalism form the foundation of market trust. However, in China, the independence and professionalism of external auditors face numerous challenges, which is clearly reflected in the Evergrande Real Estate debt default event. Price Waterhouse Coopers (PWC) has been the auditor for Evergrande Real Estate and provided continuous services for ten years, including six years of audit services, and consistently issued unqualified audit opinions during this time span. However, in February 2024, an investigation into Evergrande's financial fraud revealed that between 2019 and 2020, the Evergrande had inflated its revenues by RMB 564.1 billion through false financial reporting, thereby defrauding the issuance of RMB 20.8 billion in bonds. The long-term relationship between auditor and client may lead to a dependency of auditor on the client, potentially compromising the independence and professional judgment of the external auditors. Much should be done to enhance the independency of market intermediaries in regard of good corporate governance in China.

Directions of Future Development of Corporate Governance in China

Deepening corporate governance reforms

With the implementation of the new Securities Law, Chinese listed companies are confronting with stricter governance requirements and higher market expectations. In this context, the continuation of corporate governance reforms is pivotal for enhancing the overall quality and competitiveness of business enterprises. The essence of corporate governance reforms lies in the strict adherence to legal and regulatory frameworks, particularly those stipulated by the new Securities Law and related regulations. It should be more active to protect the interests of minority shareholders. Market regulatory authorities should also continuously experiment innovative monitoring mechanisms to curb potential tunneling behaviors by controlling shareholders from an institutional perspective and to ensure the rational allocation and utilization of corporate resources. The reform of mixed ownership should not just achieve a mixture of shareholdings structure but also delve into the reform of systemic governance mechanisms. By adopting diversified capital and management concepts, the innovation vitality and market competitiveness of state-owned enterprises can be stimulated. In terms of the independent director system, regulatory authorities should actively explore avenues for improvement, including increasing the proportion of independent directors on the board, strengthening their training and assessment, enhancing their responsibility on supervision, to ensure that independent directors can truly exercise their independence and professionalism in corporate governance. Concurrently, optimizing the compensation scheme for independent directors, in alignment appropriately with the risks they undertake, can motivate their proactivity in playing an indispensable role in the improvement of corporate governance.

Institutional investors, as significant market participants, should embrace the concept of shareholder activism and engage deeply in corporate governance. By combining the strategies of "voting with their feet" and active participation, they can elevate the quality of corporate governance, reduce speculative managerial behaviors, and foster the healthy and stable development of the capital market. Banks and other financial institutions are major creditors of business enterprises and should fully leverage their supervisory roles in corporate governance. It is beneficiary to enhance the motivation and approaches for financial institutions to involve in closely monitoring the financial health of listed companies, so they can identify and preempt potential risks and secure the financial robustness of business enterprises and the stability of the financial market. External market intermediaries, e.g., auditors, valuators, and legal service providers, should bear more responsibilities in corporate governance. They should diligently fulfill their duties and strictly adhere to the joint liability system for market intermediaries as stipulated by the Securities Law, which is critical ensure the professional services they provide are both independent and reliable. China's newly amended Securities Law has emphasized the due diligence obligations of market intermediaries by stipulating that the sponsors, underwriting securities companies, and their directly responsible personnel

[8]CITIC Construction Investment Securities, a comprehensive securities firm based in China, played a significant role as one of the lead underwriters in the fraudulent issuance of RMB 20.8 billion in bonds by Evergrande Real Estate. As a key participant in the transaction, CITIC Construction Investment Securities bears a certain degree of responsibility for the debt default events that transpired.

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should jointly bear the joint compensation liability with the issuer if they cannot prove their innocence. This measure is expected to strengthen the responsibility among market intermediaries and should be more effectively implemented in practice. In summary, corporate governance reforms should be comprehensively deepening across multiple facets in China. It not only needs listed companies to improve their governance standards but also demand for market regulators to strengthen monitoring and promoting healthy economic development. Through the adoption of these integrated measures, Chinese listed companies can move forward steadily and create greater value for shareholders, employees, and society at large.

Further improvement of information disclosure

The quality of ESG information disclosure is essential for a sustainable development of business enterprises and the society. Regulatory authorities should expedite the process of making ESG disclosure mandatory and standardized and stipulate the authoritative rules and guidelines for corporate ESG disclosure. In addition, information platforms with big data and other new information technologies should be established as the ESG information tracking database to further refine the quantity and quality of corporate ESG disclosures. Efforts should also be made to construct a standardized ESG assessment system with Chinese characteristics, taking consideration the unique national conditions and industry fundamentals. The design of assessment indicators, measurement methods, and weighting parameters should better represent the ESG performance of Chinese business enterprises.

Accelerating the capitalization and disclosure of data assets is also crucial. In the era of digital economy, data resource is not only the backbone of the digital economy but also a significant driver of high-quality economic development. For businesses, data resources will become strategic assets of future growth, and data assets have emerged as core component of business resources that should be capitalized and disclosed. In August 2023, the Ministry of Finance in China issued the "Interim Provisions on Accounting Treatment of Enterprise Data Resources," marking a milestone in encouraging and guiding business enterprises to account for data resources. Incorporating business data assets into financial statements is under experimentation, which can significantly enhance the recognition of the value of data resource and promote data transactions, and exploitation. The development can unleash new drivers of business growth and high-quality economic development. Correspondingly capitalization data resources will impact both business operation and governance. Business enterprises should be encouraged and guided to proactively strengthen the disclosure of information related to data resources or digital assets. This is a new critical task for improving corporate financial reporting, enhancing the quality of accounting information, and further increasing corporate valuation.

Explorations in corporate governance in the context of digital economy

The digital economy has given rise to numerous new technologies and business models, profoundly altering the development environment and modes of interaction for companies and the society. It challenges the traditional theory and practice of corporate governance that is based on agency problems and information asymmetry. Current research has begun to discuss the potential impact of new technologies such as big data, blockchain and AI, on managers, institutional investors, minority shareholders, auditors, and other parties involved in corporate governance Yermark [21], as well as the advantages and disadvantages of new technologies in mitigating agency problems [22]. The Chinese government is closely monitoring the development of the digital economy and has introduced a range of policies at both the national planning and capital market levels to support business enterprises in undertaking digital transformations. In the face of rapidly evolving business and operational innovations, traditional corporate governance concepts will be remained and testified. For instance, it is yet to be determined whether new technological tools in the digital economy can alleviate or even eliminate the problem of information asymmetry that is a key consideration in contemporary corporate governance. In addition, corporate demands for new technologies may lead to a greater emphasis on professional technical talent. It raises the question of whether and how the founders and business teams that hold core technology and key resources will supplant capital (shareholders) in the corporate hierarchy, to better fulfill the operational and governance objectives. This emerging research topic has many ambiguities that require further in-depth and systematic investigation to fully understand its practical implications. As the digital economy continues to rapidly evolve, it is imperative to full consider the impact of adaption and restructuring on corporate governance to ensuring that the current governance structures remain effective and relevant in this new era of business world.

Conclusion

This paper presents a comprehensive review of the historical evolution, achievements, and existing challenges of corporate governance in pace with the reopening of capital market in China and examine its practices and challenges in the context of economic transition. The development of corporate governance in China has undergone four distinct phases: the introduction of corporate governance concepts, the construction of corporate governance structures, the establishment of governance mechanisms, and the enhancement of effective governance practices. Significant accomplishments have been obtained, including optimization of shareholder governance, deepening of mixed-ownership reform, improvements in board governance, enhancements in the quality of information disclosure, and advancement of sustainable development [23-26]. However, internal issues such as the effectiveness of the independent director system, the rationality of cash dividend distribution, and the external and quality of ESG information disclosure, along with external issues like the supervision effectiveness of institutional investors, monitoring by financial institutions, and the efficacy of market intermediaries, will require further exploration and refinement. Looking forward, we outline the direction for the future development of corporate governance in China and advocate that attention and efforts

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should be made to deepen corporate governance reforms, improve information disclosure, and explore new models of corporate governance in the context of the growth of digital economy. Measures such as increasing the proportion of independent directors, optimizing compensation structures, enhancing activism of institutional investors, strengthening supervisory role of banks and other financial institutions, and increasing accountability of market intermediary, should contribute positively to improve corporate governance effectively. The further optimization of corporate governance can better protect investor rights and promote market stability and healthy development in China. Moreover, we propose that it is crucial to enhance mandatory and standardized disclosure of ESG corporate performance, experimentation of capitalization and disclosure of business data resources, construction an ESG assessment system of corporate performance with Chinese characteristics, and exploration of new corporate governance issues under the digital economy. All of these efforts should help Chinese business enterprises better adapt to the developmental needs under the rapidly changing business environment and enhance corporate competitiveness and contribute Chinese wisdom and solutions to the global progression of corporate governance. Through the implementation of these comprehensive measures, corporate governance in China will proceed steadily on in light of the rule of law and creating greater value for shareholders, employees, and society. As a result, it will provide robust support for the high-quality economic development.

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