

# Research on the Governance of the State-owned Proprietorship Companies

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**Abstract:** As a symbol of the innovation of modern enterprise system in China, the state-owned proprietorship company is a unique corporate form designed by the Company Law for the corporatization reform of all state-owned large and medium-sized enterprises. A solely state-owned company is a limited liability company established by the state with separate investment. Its unique equity structure and traditional governance experience of state-owned enterprises determine the uniqueness of its governance structure. In the process of establishing and improving modern enterprise systems, state-owned proprietorship companies have exposed many problems in governance, such as unclear responsibilities of investors, indistinguishable governance between government and enterprises, and incomplete corporate governance structure. The corporate governance structure is the core of a company, and without a sound corporate governance structure, it is not an excellent company, which directly affects its competitiveness. Improving the governance structure of state-owned proprietorship companies provides useful reference for the reform of state-owned enterprises in China, and is of great significance for enhancing the market competitiveness of state-owned enterprises and achieving the preservation and appreciation of state-owned assets. Based on the analysis of the current situation and existing problems of the governance structure of state-owned proprietorship companies, countermeasures are proposed to improve the governance structure of state-owned proprietorship companies in China.

**Keywords:** State-owned proprietorship Companies, Corporate Governance, Company Property Structure.

## 1. The Meaning and Characteristics of State-owned proprietorship Companies

A state-owned proprietorship company in China refers to a limited liability company that is solely funded by the state and authorized by the State Council or local people's government to fulfill the responsibilities of the investor by the state-owned asset supervision and management institution of the same level of people's government.

According to whether they are engaged in state-owned asset management or direct production and operation activities, wholly state-owned companies can theoretically be divided into wholly state-owned holding companies and grass-roots wholly state-owned companies specializing in production and operation activities. A sole proprietorship state-owned holding company is a state-owned holding company authorized by the state to hold all shares of other companies, with all shares of the parent company being state-owned shares. Its main function is to make equity investments and be responsible for maintaining and increasing the value of the invested state-owned assets. Grassroots state-owned sole proprietorship companies are relative to sole proprietorship state-owned holding companies. Although such companies can independently or cooperate with other forms of ownership to invest in other companies, they mainly engage in production and business activities, while sole proprietorship state-owned holding companies do not directly engage in production and business activities.

According to the concept of a solely state-owned company and the provisions of the Company Law, firstly, a solely state-owned company is a limited liability company, not a joint stock limited company, nor a sole proprietorship enterprise. Secondly, a wholly state-owned company is not an ordinary

limited liability company. Since the China is the only investor of a wholly state-owned company and only the state is the only shareholder, it belongs to the category of the one person limited liability company. Finally, a solely state-owned company is not one person limited liability company in the ordinary sense. one person company has only one shareholder controlling the company, and in principle only assumes limited liability. Due to the arrangement of the company system, shareholders of one person company may bear joint and several liability due to the abuse of the presumption system of legal personality. However, in China, the state, as the sole shareholder of state-owned proprietorship companies, enjoys shareholder rights. The Company Law does not provide for a presumption system for the abuse of corporate personality in state-owned sole proprietorship companies. This can be seen from the applicable legal provisions in the Company Law. There is no legal basis for state-owned sole proprietorship companies to apply special provisions for one person limited liability companies, and state-owned proprietorship companies do not apply the presumption system for the abuse of corporate personality, The state is not required to bear joint and several liability.

## 2. Governance Structure of State-owned Proprietorship Companies

### 2.1. Connotation of Corporate Governance Structure

There are several translation methods for "corporate governance" in China, including "corporate governance", "corporate governance mechanism", "corporate supervision", "corporate governance structure", and so on. [1] There are many definitions of corporate governance structure, and the following theories are typical: Professor Wu Jinglian's organizational structure theory, which believes that corporate

governance structure is an organizational structure composed of owners, the board of directors and senior managers, which forms a certain balance.[2] According to the institutional theory, the main proposer is Colin Mayer of the University of Oxford in the UK. Professor Mayer believes that corporate governance is an arrangement by which a company represents and serves the interests of its investors, including everything from the board of directors to executive incentive plans.[3] Professor Zhang Weiyang believes that the corporate governance structure, in a narrow sense, refers to the institutional arrangements related to the function and structure of the company's board of directors, the power of shareholders, and in a broad sense, refers to a set of legal, cultural and institutional arrangements related to the distribution of corporate control and residual claims.[4] Jia Heting believes that corporate governance structure refers to a set of organizational management systems that a company, as an independent legal entity, possesses to ensure its normal operation.[5] Tang Guangliang believes that the corporate governance structure is actually the organizational structure of a company, and the concept of organizational structure already includes the power structure or structure of the company's organs. This statement can be incorporated into the organizational structure statement represented by Professor Wu Jinglian. The scholar also pointed out that the concept of "governance structure" is not used in China's company law. In order to standardize legal terminology, it is believed that the concept of "governance structure" should not be used in law. [6] Nie Dezhong believes that the corporate governance structure is a system to coordinate the relationship between shareholders and other internal stakeholders, involving command, control and incentive. This statement involves the relationship between shareholders and stakeholders in joint governance. Stakeholders here specifically refer to internal stakeholders, and stakeholders such as banks and consumers are not included in the discussion of corporate governance structure. [7]

## 2.2. China's State-owned Asset Management System

The establishment of the State-owned Assets Supervision and Administration Commission in 2003 ushered in a new era for China's state-owned asset supervision and management system. The central and local governments manage state-owned assets at different levels, representing the state to fulfill the responsibilities of investors and enjoy owner's rights and interests. According to the requirements, the State owned Assets Supervision and Administration Commission, as an ad hoc directly affiliated institution of the government, performs the responsibilities of investors on behalf of the government, does not assume public management responsibilities, does not directly intervene in enterprises, and the invested enterprises, as market entities and legal entities, operate independently, bear their own profits and losses, and are responsible for the appreciation and preservation of state-owned assets. To achieve the separation of ownership and administrative power, the separation of ownership and management power provides institutional support. There are still problems in the operation of the current state-owned asset supervision and management system:

Firstly, the positioning of the State-owned Assets Supervision and Administration Commission is unclear. The state-owned asset supervision and management system involves the state as the investor of state-owned assets, the

state-owned asset supervision and management committee as the centralized representative of state-owned asset investors, state-owned asset management companies as the direct representative of state-owned asset investors, and companies enjoying legal person property rights. Under such a system, the establishment of the State-owned Assets Supervision and Administration Commission (SASAC) laid the foundation for the separation of government and enterprises. However, in actual management of the SASAC, due to its unclear positioning, its sequence belongs to the directly affiliated ministerial level institutions of the State Council, and its internal management and daily operations are no different from other government departments. As a result, some people in society, the State-owned enterprise community, and even the SASAC system believe that the SASAC itself is a government agency, The responsibility of its investors should be to directly carry out administrative management of the enterprise, and the State-owned Assets Supervision and Administration Commission is not a clean investor. If the State-owned Assets Supervision and Administration Commission directly appoints the chairman and vice chairman, and directly appoints the company's management team, in recent years, the State-owned Assets Supervision and Administration Commission has also selected senior managers of state-owned enterprises globally. According to the provisions of the Company Law, the power to hire and dismiss the management team should be the authority of the company's board of directors. The State-owned Assets Supervision and Administration Commission's direct intervention is also tireless, affecting its functions of fulfilling the layout of the state-owned economy, strategic adjustment of the state-owned economy structure, and paying attention to the safe operation of state-owned assets. This approach is actually achieved through the reform of the state-owned asset system, the establishment of specialized institutions, and the formal distinction between the government's social and public functions and the management functions of state-owned assets, which cannot ensure the separation of government, capital, and enterprises.

Secondly, there is a shortage of state-owned asset investors. In China, state-owned assets are not the assets of any individual or organization, but are owned by the state or the whole people. The state is the representative of the people, and the whole people are unable to directly exercise the rights of investors. This leads to the virtual nature of state-owned asset investors. The State-owned Assets Supervision and Administration Commission authorizes the exercise of the responsibilities of state-owned asset investors, and the State-owned Assets Supervision and Administration Commission itself is a government agency that affects the performance of its investor responsibilities. State owned asset investors lack an enterprise which oriented operation platform. Some scholars believe that the State-owned Assets Supervision and Administration Commission is to a greater extent the result of the merger of institutions and functions, with the phenomenon of functional vacancy and coexistence. [8] The State-owned Assets Supervision and Administration Commission is responsible for the combination of management of assets, personnel and affairs, and hopes to solve the dilemma of the Role conflict between the investor representative and the state-owned assets supervisor by the authorized operation of state-owned assets.

Thirdly, there is a lack of direct supervision by power organs. The State-owned Assets Supervision and

Administration Commission of the State Council is an ad hoc ministerial institution directly under the State Council approved by the National People's Congress. The SASAC was approved by the National People's Congress and should be responsible to the National People's Congress. The current system lacks direct operational provisions that directly serve the National People's Congress. The People's Congress of China is the direct trustee of the power of state-owned asset supervision and management, and should be the people's exercise of the state's decision-making power. Some government leaders hold concurrent or nominal positions as leaders of state-owned assets supervision institutions, such as heads and deputy heads of the government, heads and deputy secretaries of the government, heads and deputy secretaries of the party committee. The job arrangement seems reasonable, but it conflicts with the Role conflict of administrative organs.

### **2.3. Board of Directors of State-owned Proprietorship Companies**

Most state-owned proprietorship companies have a leadership system consisting of one team and two brands. The board of directors is actually the party and government leadership team of the company, and whether it is the board of directors, management level, or party committee, it is basically the same team.

Firstly, the administrative intervention of state-owned asset regulatory agencies in the board of directors. A state-owned proprietorship company has only the sole shareholder of the state, and the company does not have a shareholders' meeting. According to the law, the State Council, local people's governments, state-owned asset supervision and management institutions authorized by the State Council and local people's governments at the same level, and the company's board of directors share the powers of the shareholders' meeting.

Secondly, the management affects the board of directors. Article 50 of the Company Law stipulates the authority of the manager, who is mainly responsible for the daily operation and management of the company and the execution of the resolutions of the board of directors. In this corporate governance structure, it is clear that the board of directors is the decision-making authority, and the manager is the executing authority. The Company Law does not prohibit the manager from concurrently serving as a member of the board of directors. In wholly state-owned companies, the director and manager positions are too high, which is not conducive to mutual supervision. The result is a significant reduction in the supervisory function of the board of directors. Many of these companies also serve as the chairman and general manager, with the power of the chairman and general manager concentrated in one body, resulting in a high concentration of decision-making and execution, causing the general manager to take over the board of directors and even determine the fate of the board of directors. [9]

Thirdly, the internal composition of the board of directors is unreasonable. Too many senior management personnel concurrently serve as directors, which can easily lead to internal control and affect the functions of the board of directors. Many directors in the board of directors of state-owned enterprises come from government departments, and state-owned enterprise directors are used as institutional arrangements to compensate for the retirement of officials. These officials who are about to retire have no experience in business management, such as some former political cadres,

and it is unlikely that these directors can play an effective role. Such directors directly affect the board of directors and the operation of the entire enterprise.

### **2.4. Supervisory Board of State-owned Proprietorship Companies**

Firstly, the supervisory board has a low status and poor independence. Due to the actual situation in our country, traditionally, the factory director manager is responsible for manufacturing and the authority of the factory director manager is deeply ingrained in people's hearts. Due to cultural and historical reasons, the supervisory board cannot truly play a role overnight. There is a subordinate relationship, hierarchical relationship, and colleague relationship with the company, such as the Secretary of the Discipline Inspection Commission, internal auditors, union chairman, and the head of the finance department. The personal level of the supervisory board is lower than that of the majority of directors, and these individuals are essentially in a leading position. The supervisory board's actual status is lower than that of the board of directors, requiring them to exercise their supervisory power, making it difficult to constrain the board of directors and management.

Secondly, the quality of the members of the supervisory board is not high, and the work of the supervisory board is not standardized. The composition of the supervisory board is unreasonable, whether it is employee supervisors or expatriate supervisors, and the members lack professional knowledge, resulting in ineffective supervision. The company's supervisory board does not have a daily structure, and when supervisors do not perform their duties, the supervisory board becomes a shell. According to the Company Law of our country, the supervisory board is a typical conference body, which is collectively performed by supervisors. Legislation does not grant independent supervisory power to each supervisor. This collective system may result in supervisors having no motivation to actively fulfill their duties, feeling that doing more or less is the same, and not actively raising issues when discovered. Anyway, everyone takes responsibility together, resulting in no one taking responsibility.

## **3. Measures to Improve Governance Structure of State-owned Proprietorship Companies**

### **3.1. Improving the Board of Directors of State-owned Proprietorship Companies**

Firstly, enhance the independence of the board of directors. To truly achieve the separation of government and enterprise, state-owned sole proprietorship companies enjoy legal person property rights and operate independently. State regulatory agencies cannot directly intervene, and the board of directors and the government maintain an appropriate relationship. Standardize the system of chairman and general manager, prevent the phenomenon of general manager controlling the board of directors in the system of chairman concurrently serving as general manager, and avoid excessive monopoly of company operators. It is recommended that the chairman and general manager of a solely state-owned company be established separately, and the general manager also serve as the legal representative. The chairman is appointed by a professional external director, who can independently and

full-time contribute to the construction of the board of directors and the strategic management of the company. The board of directors has the right to hire and dismiss managers. If the general manager is unqualified, the board of directors may replace him. Returning to the general manager system under the authorization of the board of directors, the board of directors operates independently and makes decisions on important matters in the company's operation and management. The general manager actively implements the decisions of the board of directors.

Secondly, improve the internal construction of the board of directors. The members of the board of directors should choose from those who understand business operations, management, financial accounting, and law. The state should establish a talent pool for professional directors, attracting experts, scholars, professional managers, and private entrepreneurs to participate.[10]The selection of external directors can select talents from a wide range, even from abroad. Increase the proportion of full-time directors in the board of directors, with no less than half of them being full-time directors. These individuals can choose from professional managers, accountants, lawyers, and others.

### **3.2. Improving the Supervisory Board of State-owned Proprietorship Companies**

In order to prevent the board of directors and management from seeking personal gain and harming the company's interests, legislation has granted the supervisory board the statutory power to supervise the board of directors and management, and the supervisory board has become the company's statutory supervisory authority. Improve the system of the supervisory board by starting from the following aspects:

Firstly, strengthen the supervisory authority and expand the supervisory means of the supervisory board. Clarify that the board of directors and management regularly report their work to the supervisory board, and the supervisory board has the right to attend meetings of the board of directors and management to achieve process supervision. The supervisory board can express its opinions at any time. The supervisory board shall comprehensively and regularly supervise the legality and appropriateness of the business operations of the board of directors and management, with a focus on reviewing the company's accounts. It has the power to decide to file lawsuits against directors and managers who violate their obligations and infringe on the company's interests. After the compensation committee of the board of directors decides on the compensation of the management team, the supervisory board has the veto power. The supervisory board has the right to independently hire independent financial advisors, accounting firms, and legal firms to assist in the supervisory work of the supervisory board.

Secondly, innovate the leadership system of the supervisory board. A solely state-owned company is composed of the Secretary of the Party Committee and Chairman of the Supervisory Board, the Secretary of the Party Discipline Committee and Vice Chairman of the Supervisory Board, and the Director of the Supervisory Board Office. Supervisors are elected members of the Communist Party of China as members of the Commission for Discipline Inspection, and they can attend meetings of the Commission as nonvoting delegates. The Party Committee and the Discipline Committee of the Party Committee, as powerful

organs, can directly enhance the position of the Supervisory Board in the company by having the Secretary of the Party organization concurrently serve as the Chairman of the Supervisory Board. The Secretary of the Party Committee concurrently serves as the Chairman of the Supervisory Board, the Chairman of the Company, and the General Manager form a tripartite system. The party organization plays a political core role in the company and supervises the implementation of the party and national policies. At the same time, the party organization has a well-established disciplinary inspection agency that specializes in supervisory functions. [11]

Thirdly, external supervisors dominate. Introduce external supervisors and encourage personnel who understand business management, financial audit and legal knowledge to join the board of supervisors. In a wholly state-owned company, the number of employee supervisors shall not be less than one-third, and the rest shall be composed entirely of external supervisors, fully leveraging the strengths of external supervisors. The external supervisors of a solely state-owned company are dispatched by the state-owned asset supervision agency and the solely state-owned holding company.

Fourthly, the independence of the supervisory board. Maintaining the independence of the supervisory board is the key to effective operation, and maintaining independence can ensure the objectivity and impartiality of supervision. The supervisory board independently exercises its powers in accordance with the law and is not subject to interference from shareholders, board members, or management, providing legal and economic protection for the supervisory board to exercise its powers. In the Company Law, prohibitive provisions are added, stipulating that senior managers of other companies shall not concurrently serve as supervisors, such as employees of finance and audit departments. The law empowers supervisors to exercise their powers independently, so that the supervisory board not only exercises supervisory power through collective resolutions. This system has been adopted in both Germany, Japan, and Taiwan, which is conducive to avoiding some supervisors colluding with some directors and strengthening the supervision of directors. [12]

### **3.3. Integrating Company Resources**

Firstly, state-owned sole proprietorship companies have abundant supervisory resources, including not only statutory bodies such as the supervisory board, but also internal supervision and audit departments, disciplinary inspection and supervision of party organizations, etc. The dispersion of resources has led to numerous supervisory agencies and confusion of powers. If these supervisory resources can be integrated to form a supervisory force, the overall supervisory effect of the company can be improved.

Secondly, the audit committee system of the supervisory board. Nowadays, many state-owned sole proprietorship companies have established audit and supervision departments under the general manager. The Audit Department and the Supervision Department are under the leadership of the General Manager. If the general manager violates the company's financial rules or engages in other disciplinary actions, it is believed that these departments will not be able to effectively function. It is recommended to establish an audit committee in the supervisory board, with the company's audit department and the supervisory department reporting on the audit committee's work. Thus, the internal audit institution can be independent of the board of

directors and the general manager.

Thirdly, integrate supervision resources and leverage the joint efforts of supervision. Integrate the supervisory power of the supervisory board, disciplinary inspection and supervision, internal audit, and other supervisory forces into a unified supervision resource for the enterprise, forming a large-scale internal supervision pattern, and maximizing the role of the internal supervision department of the enterprise. The Secretary of the Party Committee also serves as the Chairman of the Supervisory Board, while the Secretary of the Party Discipline Committee serves as the Vice Chairman of the Supervisory Board and the Director of the Supervisory Board Office. The audit and supervision departments of the company directly accept the leadership system of the Supervisory Board, ensuring the maximum integration of resources.

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