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# Corporate Governance with Chinese Characteristics: Party Organization in State-owned Enterprises

Kasper Ingeman Beck<sup>\*</sup> and Kjeld Erik Brødsgaard<sup>†</sup>

## Abstract

This article analyzes the role of the Chinese Communist Party (CCP) in the corporate governance of Chinese state-owned enterprises (SOEs), including a case study of a central-level SOE holding group. Relying on official documents, secondary literature, and interviews with enterprise managers, government officials, and academics, the article documents how the CCP has actively formalized its role in Chinese business by embedding itself into the corporate governance structure of SOEs. Through the application of Chinese indigenous administrative corporate governance concepts such as “bidirectional entry, cross appointment” and “three majors, one big”, the CCP has consolidated its dominance of enterprise decision-making procedures and personnel appointment and created a hybrid Party-led model of corporate governance. While this hybrid model can secure enterprise compliance, communication with higher state and Party organs, as well as long-term development planning, it is unlikely to help solve SOE efficiency problems and might undermine other SOE reforms.

**Keywords:** Corporate governance; Chinese Communist Party (CCP); State-owned enterprises (SOEs); political control; cadre management.

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## Introduction

State-owned enterprise (SOE) reform and management is one of the most debated topics among economists and scholars in the China field. Discussions range from external market competition to ownership structures and corporate governance.<sup>1</sup> Since the 1980s, power delegation reforms have taken several forms, including management responsibility systems, boards of directors systems and establishment of joint-stock companies. During the 1990s and early 2000s, corporate governance in Chinese SOEs generally converged towards international “best practices” based on a stylized Anglo–American model.<sup>2</sup> According to an influential study, China’s economic rise and integration into the global economic order were based on emulating Western rules and regulatory systems.<sup>3</sup> However, this trend seems to have reversed since 2012, when Xi Jinping 习近平 took charge. We now observe a formalization of the Chinese Communist Party’s (CCP) role in SOE management as it advances what it calls a “modern state-owned enterprise system with Chinese characteristics”.<sup>4</sup> A new regime of “corporate governance with Chinese characteristics” is being consolidated, with vast consequences for corporate operations.<sup>5</sup> This raises an important question: what form of SOE corporate governance is emerging under Xi Jinping, and how the role of the CCP is institutionalized into modern corporate governance structures? Which key measures and institutions have been developed to ensure Party dominance, and what does this tell us about the nature of the Chinese corporate world?

In the literature, the role of the Party organization is the least understood aspect of corporate governance in China. This gap in extant research not only creates challenges for private and foreign investors alike,<sup>6</sup> but also limits our understanding of how the Chinese economic system works. As such, there is a need to understand the role of the Party in SOEs, including the Party organization’s relations to existing corporate organs and the relationship between the Party’s leadership of SOEs and modern corporate governance rules.<sup>7</sup> Extending previous work by McNally,<sup>8</sup> Yeo,<sup>9</sup> Zhang,<sup>10</sup> and

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<sup>1</sup> Lin and Zhu 2001; Li and Putterman 2008; Nolan 2012; Oi 2011; Tricker and Li 2019.

<sup>2</sup> Tam 1999.

<sup>3</sup> Steinfeld 2010.. See also Chen, Liu, and Li 2010., who argues that Chinese corporations have corporate governance arrangements and structures based “largely on the regulations and practices of the west.”

<sup>4</sup> CCP 2020.

<sup>5</sup> Allen and Li 2018, 21; Sappideen 2017.

<sup>6</sup> Allen and Li 2018, 39.

<sup>7</sup> Ibid., 107.

<sup>8</sup> McNally 2002.

<sup>9</sup> Yeo 2013.

<sup>10</sup> Zhang 2012.

Wang,<sup>11</sup> we argue that the informal political governance structure of SOEs (the Party organization) is becoming an institutionalized element of legal SOE governance (e.g., through amendments of SOE Articles of Association, new laws, and new Party regulations). In particular, new policy directives from 2015, 2017, and 2020 mark important changes in SOE governance not previously addressed in the literature.

The article contributes an updated comprehensive review (up to January 2020) of the most important CCP documents, national laws, and regulations related to the role of the CCP in corporate governance. It provides examples of the application of new laws and regulations in SOEs, including revisions of enterprise Articles of Association in listed state-controlled enterprises and decision-making and appointment procedures in non-listed SOE holding groups. The article also examines the application of Chinese indigenous administrative corporate governance concepts such as “bidirectional entry, cross appointment” (*shuangxiang jinru, jiaocha renzhi* 双向进入, 交叉任职) and “three majors, one big” (*sanzhong yida* 三重一大). Furthermore, the article discusses the Party’s control over the selection and appointment of SOE executives by way of the nomenklatura system. Each of these points is made theoretically, through presentation of illustrative empirical evidence, and via a case study of the China Energy Conservation and Environmental Protection Group (CECEP). We document the institutionalization of Party leadership in a new hybrid model of corporate governance. In addition to official documents and secondary works, we draw on interviews with enterprises managers, academics, and government officials.

We find that a unique, hybrid model of SOE governance is institutionalizing in the form of a legal governance structure, in accordance with Western (Anglo–American) standards and co-existing with a political Party-led governance structure. Extensive vertical and horizontal managerial interlocks exist between the CCP organization in the enterprise and other corporate organs. It is part of Xi Jinping’s broader agenda to re-establish Party control over all aspects of society and under which the Party is increasingly morphed with the state.

We argue that the roots of this change are in the Xi administration’s search for a way to combine market-oriented institutions, law-based governance, and continued reform with stronger Party leadership in all areas of society. The CCP is mixing market-oriented institutions with tight Party

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<sup>11</sup> Wang 2014.

oversight. This has led to the standard corporate governance structure being mixed with strong Party Groups (*dangzu* 党组) and Party Committees (*dangwei* 党委) within enterprises. They appoint senior management and take part in strategic decisions. Under the Xi administration, the principle of “separation of government and business” (*zhengqi fenkai* 政企分开) still applies, but clearly does not mean “separation of Party and business”. Indeed, Party-defined policy objectives are at the heart of SOE operations and management.

## Literature review

Overall, two types of literature on Chinese corporate governance have emerged. Studies in the first group take their starting point in international/Western best practices corporate governance models and in particular the Anglo–American model of corporate governance. They point to problems and troublesome practices in China while making recommendations to improve effectiveness, accountability, transparency and efficacy of corporate governance.<sup>12</sup> They generally predict continued convergence towards the Western model of corporate governance.<sup>13</sup> These studies do not take into account the key role of the Party in leadership appointments and decision-making procedures. In contrast, a second group of studies addresses governance from an institutional embeddedness perspective, acknowledging the Party organization as an important corporate governance organ.<sup>14</sup> Most of these studies concentrate on listed state-controlled companies, which are subsidiaries of SOE holding groups.<sup>15</sup> However, the holding groups or parent companies themselves are beginning to come into focus.<sup>16</sup>

Discussing local (Shanghai) regulations on overlaps between the Party Committee and modern corporate organs, McNally argues that Chinese reforms have allowed for continued interference of Party institutions in the governance of corporatized SOEs, leading to ineffective corporate governance setups.<sup>17</sup> Lin and Milhaupt focus on institutionalized mechanisms linking the SOE business groups with other organs of the Party-state, e.g., SASAC’s behavior as a controlling

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<sup>12</sup> Mar and Young 2001; Wong 2016; Yang, Chi, and Young 2011; Sabbaghi 2016; Moreck and Yeung 2014; Sappideen 2017.

<sup>13</sup> Gilson 2001; Hansmann and Kraakman 2001; Chen, Liu, and Li 2010.

<sup>14</sup> Keay and Zhao 2018; Fu 2016; Wang 2014; Brødsgaard 2012; Chan 2009; Zhang and Liu 2019; McNally 2002; Naughton and Tsai 2015; Leutert 2018.

<sup>15</sup> Zhang 2012; Yu 2013; Chang and Wong 2004; Oppen, Wong, and Hu 2002; Zhang and Liu 2019.

<sup>16</sup> Leutert 2018.

<sup>17</sup> McNally 2002, 93.

shareholder.<sup>18</sup> Lin and Milhaupt describe “two parallel personnel systems in all Chinese SOEs: the regular corporate management system and the party system”,<sup>19</sup> including a brief mention of the important principle of “bidirectional entry, cross appointment” (BECA). In a similar vein, Wang finds that “SOEs in China are subject to a system of corporate governance that features two parallel structures, one for legal governance and the other for political governance”.<sup>20</sup> Wang analyses the content of the October 2004 CCP policy document that contains the first outline of the BECA principle, arguing that the two parallel structures run separately.<sup>21</sup> Leutert<sup>22</sup> empirically analyzes the BECA principle in 53 central SOE holding groups, while Zhang and Liu<sup>23</sup> study the recent amendments of listed SOEs’ charters.

McNally, Wang, Leutert, and Zhang and Liu all point to the increasing importance of the Party organization in corporate governance. In contrast, Milhaupt and Zheng argue that the Party-state exercises less control over the state sector than is commonly assumed – mainly due to insider control and the control challenges inherent to large pyramid-shaped corporate organizations.<sup>24</sup> However, Brødsgaard<sup>25</sup> and several chapters in Naughton and Tsai<sup>26</sup> maintain that the control mechanisms posed by organization departments of the Party (nomenklatura and Party Committee appointments of managers) ensure control over the state sector. Naughton and Tsai find that the Chinese system is fundamentally “Communist Party-managed state capitalism”.<sup>27</sup>

Important insights have been gained from this group of studies regarding the Party’s role in corporate governance. However, only Leutert and Zhang & Liu address the period after Xi Jinping’s assumption of power in 2012,<sup>28</sup> leaving us with a lack of research on recent developments. During Xi’s tenure, more than 70 percent of all Party rules have been revised or reformulated, including important regulations on Party–SOE relations.<sup>29</sup> In particular, the main policy directives from 2015,

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<sup>18</sup> Lin and Milhaupt 2013.

<sup>19</sup> *Ibid.*, 737–738

<sup>20</sup> Wang 2014, 648

<sup>21</sup> *Ibid.*, 648–658

<sup>22</sup> Leutert (2018)

<sup>23</sup> Zhang and Liu (2019)

<sup>24</sup> Milhaupt and Zheng 2015.

<sup>25</sup> Brødsgaard 2012.

<sup>26</sup> Naughton and Tsai 2015, 9–10, 38–39, 60–61, 105; Brødsgaard 2012.

<sup>27</sup> Naughton and Tsai 2015, 10.

<sup>28</sup> Leutert 2018; Zhang and Liu 2019.

<sup>29</sup> Trivium China. 2020. “Trivium Newsletter” 14 December. <https://triviumchina.com/2020/12/14/national-security/>. Accessed 18 December 2020.

2017 and 2020 mark important changes in SOE governance not previously addressed in the literature.<sup>30</sup> For example, the 2020 document provides crucial information on the detailed work of Party Committees, Party General Branch Committees, Party Branches, and Party Groups.<sup>31</sup> The regulations intend to get the Party out of the shadows by increasing the institutionalization and formalization of the Party's role in corporate governance. As such, we argue that the two parallel structures, described by Wang and Lin & Milhaupt, are now merging into one hybrid model under Xi Jinping.<sup>32</sup>

### **SOE corporate governance in China: between economic and administrative models**

The concept of “corporate governance” (*gongsi zhili* 公司治理) was officially endorsed by the Party in 1999<sup>33</sup> and, in the early 2000s, the China Securities Regulatory Commission (CSRC) introduced an independent-director system and specialized board committees for all listed companies. The establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003 intended to secure uniform representation of the interests of the state in corporatized SOEs. With the 2005 Company Law revision and various SASAC-led initiatives, additional Anglo–American market-based mechanisms gradually strengthened SOE corporate governance and monitoring of SOE managers. In 2004, the SASAC initiated a pilot program selecting seven central SOEs (central holding groups) to implement “standardized boards”. Board committees – including nomination, remuneration and evaluation, and audit committees – were established to act as advisory bodies to the board.<sup>34</sup> Also, the company's general manager would remain on the board but would no longer serve as its chairman, and managers involved in the day-to-day operations of the company were entirely excluded from Board seats.<sup>35</sup> The introduction of a standardized board system with a majority of external directors has been considered the centerpiece of the SOE governance reforms.<sup>36</sup> By mid-2019, all 96 central SOE holding groups controlled by central SASAC had implemented this system, while 90 percent of the local SASAC groups had established boards of directors.<sup>37</sup>

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<sup>30</sup> CCP 2015b; CCP 2017a; CCP 2020.

<sup>31</sup> CCP 2020.

<sup>32</sup> Wang 2014; Lin and Milhaupt 2013

<sup>33</sup> CCP 1999.

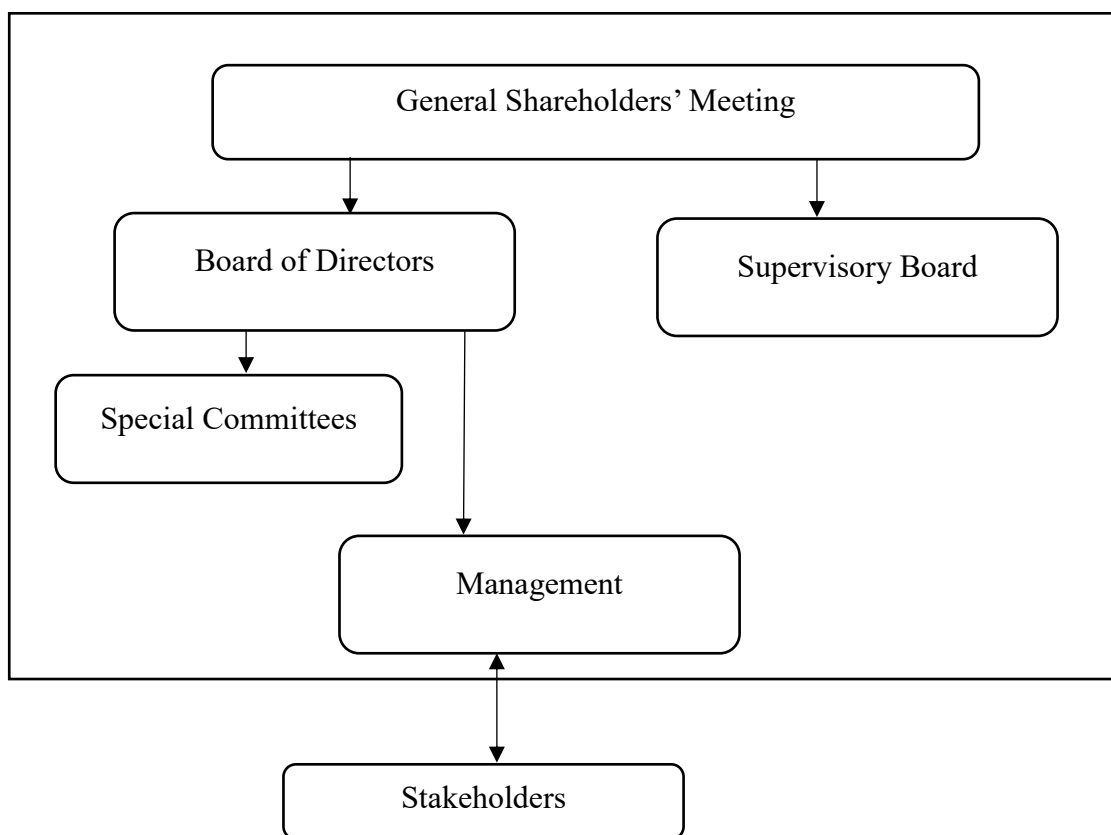
<sup>34</sup> Fu 2016, 154.

<sup>35</sup> SASAC 2004.

<sup>36</sup> Fu 2016, 154.

<sup>37</sup> Economic Observer 2018.

In short, Chinese SOEs have for the most part been corporatized into limited liability companies and stock-holding corporations subject to the Company Law<sup>38</sup> in a similar manner as private and foreign companies operating in China. Some SOEs are listed on stock exchanges in order to raise capital, and to improve governance and transparency. In this process, corporatized SOEs are subjected to “Western-style” standard internal and external supervision through a more or less direct application of Western-style (Anglo–American) corporate governance models (see Figure 1). Scholars who have addressed the extent of implementation of this model expect the trend toward Western governance structures to continue.<sup>39</sup>



**Figure 1: Formal corporate governance structure of state holding companies as presented on official webpages**

Source: OECD 2011, 18.

<sup>38</sup> SASAC 2018. According to SASAC, 92.94% of SOEs in the SASAC-system have been corporatized by end of 2017.

<sup>39</sup> Steinfeld 2010; Chen, Liu, and Li 2010; Pope and Meyer 2015.



However, the understanding of Chinese corporate governance gained from the perspective of an Anglo–American Western model is incomplete and can be misleading due to the governance structures of the Chinese political economy, which increasingly centers on the CCP.<sup>40</sup> First, SOEs and corporate organs in SOEs are regulated not only by laws and formal state regulations, but also by internal CCP regulations. Notably, Party organizations inside SOEs are primarily regulated by the Party’s internal rules and regulations rather than the Company Law or CSRC regulations. Secondly, modern-day SOEs have grown out of the socialist planned economy, and aspects of the former management philosophy and practice still exist today. Political logics rather than economic rationales often set the direction of SOEs. Despite the crucial role of the Party organization, current regulations do not require disclosing even simple information such as the composition of the enterprise Party Committees or their meeting dates. Indeed, the Party organization is not included on official webpages or in company presentations (see Figure 1 above). With a focus on the role of the Party organization, we will analyze: 1) the legal and regulatory frameworks of SOE governance, 2) decision-making procedures, 3) and appointment mechanisms.

### **Regulatory frameworks of Party involvement in SOE governance**

The legal basis justifying CCP involvement in enterprise governance can be found in the Company Law of the People’s Republic of China. Article 19 reads:

Companies, according to the Constitution of the CCP, shall establish Party organizations to carry out Party activities. The company shall provide necessary conditions to facilitate the activities of the Party organization.<sup>41</sup>

The Party formally plays a similar role in listed SOEs. The 2018 revision of the “Code of Corporate Governance for Listed Companies” stipulates that listed companies should establish internal Party organizations and facilitate their work. Moreover, the code requires state-controlled listed companies to incorporate Party-building work into their Articles of Association.<sup>42</sup>

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<sup>40</sup> Brødsgaard 2018.

<sup>41</sup> NPC 2018, Art. 19.

<sup>42</sup> CSRC 2018, Art. 5.

This regulatory framework provides a legal foundation for the CCP's penetration into all Chinese companies, but it does not specify the Party's exact role and relations with other corporate organs in different types of enterprises. Except for Article 19 in the Company Law and Article 5 in the CSRC regulations, the Party is not mentioned in Chinese laws governing corporate governance. The Party's influence is better judged on the basis of the Party's internal rules and regulations specifying the Party organization's role in corporate governance, as well as in "guiding opinions" from the SASAC and the State Council. Even though the Party's internal regulations in principle are not legally binding, in practice they are often superior to national laws and government regulations.<sup>43</sup> A comprehensive overview of the most important laws, regulations, and guiding opinions regulating the Party's role in SOE corporate governance is shown in Table 1 below.

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<sup>43</sup> Zhang 2012, 4.

**Table 1: Selected regulations and laws on the Party's role in SOE corporate governance**

Date	Name of document	Type of document
January 2020	Regulations of the Communist Party of China on the Work of Primary Organizations of SOEs (Trial Implementation) <sup>i</sup>	Party regulation
October 2018	Company Law of the People's Republic of China (2018) <sup>ii</sup>	Law
September 2018	Code of Corporate Governance for Listed Companies (revised 2018) <sup>iii</sup>	Administrative regulative
June 2018	Provisions on the Management of Central Enterprise Leaders (revised 2018) <sup>iv</sup>	Party circular
October 2017	Constitution of the Chinese Communist Party (revised 2017) <sup>v</sup>	Party constitution
May 2017	Notice of the SASAC of the State Council to promote the transformation of functions with the focus on capital management ( <i>guobanfa</i> , 国办发 [2017], no. 38) <sup>vi</sup>	Administrative circular
May 2017	Guiding Opinions of the General Office of the State Council on Further Improving the Corporate Governance Structure of SOEs ( <i>guobanfa</i> [2017], no. 36) <sup>vii</sup>	Administrative circular
May 2017	Notice on revised guidelines for central financial enterprise to write the requirements for Party-building work into the enterprise Articles of Association, ( <i>Caijin</i> , 财金 [2017], no. 48) <sup>viii</sup>	Administrative notice
March 2017	Notice of Central Organization Department and SASAC of the State Council on the requirement for strongly promoting the writing of Party-building work of SOEs into enterprise Articles of Association ( <i>zutongzi</i> , 组通字 [2017], no. 11) <sup>ix</sup>	Party notice
October 2016	A Fundamental Guide to the Construction of the Party in the SOEs in the New Era ( <i>Qiushi</i> , 求是) <sup>x</sup>	Party guide
September 2015	Guiding Opinions on Upholding Party Leadership and Strengthening Party-building while Deepening Reform of SOEs ( <i>zhongbanfa</i> , 中办发 [2015], no. 44) <sup>xi</sup>	Party circular
August 2015	Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening the Reform of SOEs ( <i>zhongbanfa</i> [2015], no. 22) <sup>xii</sup>	Party circular
June 2015	Party Group Working Regulations of the Communist Party of China) (revised 2015) <sup>xiii</sup>	Party regulation
April 2013	Opinions of the Central Organization Department and the Party Committee of the SASAC of the State Council on the Central Enterprise Party Committees Fully Playing the Political Core Role under the Modern Enterprise System ( <i>zhongbanfa</i> [2013], no. 5) <sup>xiv</sup>	Party circular
July 2010	Guiding Opinion of the General Office of the Central Committee of the CCP on further advancing the implementation of the “three majors and one big” decision-making system for SOEs, <i>zhongbanfa</i> [2010] No. 17) <sup>xv</sup>	Party circular
October 2004	Opinions of the Organization Department of the CPC Central Committee and the Party Committee of the SASAC of the State Council on Strengthening and Improving the Party-building Work of Central Enterprises ( <i>zhongbanfa</i> [2004], no. 31) <sup>xvi</sup>	Party circular

Source: <sup>i</sup>CCP 2020; <sup>ii</sup>NPC 2018; <sup>iii</sup>CSRC 2018; <sup>iv</sup>CCP 2018; <sup>v</sup>CCP 2017b; <sup>vi</sup>SASAC 2017; <sup>vii</sup>State Council 2017; <sup>viii</sup>MOF 2017; <sup>ix</sup>CCP 2017a; <sup>x</sup>SASAC 2016; <sup>xi</sup>CCP 2015b; <sup>xii</sup>State Council and CCP 2015; <sup>xiii</sup>CCP 2015a; <sup>xiv</sup>SASAC and CCP 2013; <sup>xv</sup>CCP 2010; <sup>xvi</sup>SASAC and CCP 2004. Restricted to Oct. 2004 – Jan 2020 period.

## Decision-making procedures

The basic principle for Party involvement in SOE corporate governance can be found in Article 33 of the Constitution of the CCP. The 2012 version of the Party Constitution stipulated that the basic Party organization of the enterprise was to play a “political core role” (*fahui zhengzhi hexin zuoyong* 发挥政治核心作用) and “supervise” (*jiandu* 监督) the implementation of the guidelines and policies of the enterprise. The revised 2017 Party Constitution changed the role of the enterprise Party organization to “play a leadership role” (*fahui lingdao zuoyong* 发挥领导作用) in terms of discussing and deciding on major issues (*zhongyang shixiang* 中央事项).<sup>44</sup>

In order to make sure that Party leadership and Party-building are fully reflected in the SOE reform, the Central Committee in 2015 released a set of new regulations on the role of Party organizations in the corporate governance of SOEs and mixed-owned enterprises.<sup>45</sup> These indicate in unequivocal terms that the Chinese leadership is firmly committed to tightening Party control in the corporate sector. The regulations emphasize that in order to clarify the legal status of Party organizations in the corporate governance structure of state-owned companies, it is necessary to incorporate the overall requirements of Party-building work into SOE charters.<sup>46</sup> Following the new regulations, most larger SOE holding groups and their subsidiaries (see example below) amended their Articles of Association. A number of additional documents on central and local levels followed, which further clarified the position of the CCP in SOE corporate governance.<sup>47</sup>

In 2016, Xi Jinping reiterated that the enterprise Party organization’s prior research and discussion is a pre-procedure for decision-making by the board of directors and managers.<sup>48</sup> In fact, according to Xi, the “special element” in the state-owned Chinese enterprise system is, “in particular, the integration of the Party’s leadership into all aspects of corporate governance.”<sup>49</sup>

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<sup>44</sup> CCP 2012a; CCP 2017b.

<sup>45</sup> CCP 2015b; State Council and CCP 2015. Relevance to mixed-owned enterprises confirmed during an interview with a scholar of Chinese corporate governance, Beijing, April 2019.

<sup>46</sup> CCP 2015b.

<sup>47</sup> SASAC Beijing 2019; SASAC 2016; State Council 2017; CCP 2020.

<sup>48</sup> Xi Jinping 2016.

<sup>49</sup> Ibid.

## Organizational setup

Although the party had been steadily inserting itself into SOE corporate governance, its first comprehensive release of information on the organizational setup of increased Party presence appeared in January 2020. The “Working Regulations of the Communist Party of China Concerning Primary Party Organizations in State-Owned Companies” is the first public clarification of how the Party sees its corporate role to be implemented in organizational terms and updates previous working regulations for Party groups.<sup>50</sup> They are the culmination of five years of measures and initiatives, and provide us with unique insight into the Party’s current thinking on its role in Chinese business governance.<sup>51</sup>

According to the new working regulations, Party members employed in companies with more than 100 members should establish a Party Committee (*weiyuanhui* 委员会). They should establish a Party General Branch Committee (*dang zhibu weiyuanhui* 党支部委员会) in companies with 50–100 members and, in case of 3–50 members, a Party Branch (*dang zhibu* 党支部). With the approval of the Central Committee, centrally managed enterprises should also establish a Party Group (*dangzu* 党组).

The regulations stipulate that the Party secretary of the Party Committee (Party Group) should serve as chairman of the board of the company and the general manager should serve as deputy secretary. In general, and in accordance with the principle of “bidirectional entry, cross appointment”, members of the Party Committee (Party Group) should enter the board of directors, board of supervisors and the management team, and vice versa. The Party organization of subsidiaries of central enterprises guides and supervises Party organizations in their own subsidiaries.

Article 15 in the 2020 regulations states that major matters (referring to *sanzhong yida* 三重一大) of SOEs must be discussed in the Party Committee (Party Group) before the board of directors can make a decision. This includes: (i) major measures to carry out Central Committee decisions; (ii) the implementation of the national development strategy, as well as the implementation of

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<sup>50</sup> CCP 2020; CCP 2015b.

<sup>51</sup> The most recent CCP (2020) regulations apply to sole-state funded enterprises (国有独资), wholly state-owned enterprises (全资企业) and enterprises with more than 50% state ownership (国有资本绝对控股企业).

enterprise development strategies and plans; (iii) property rights transfers, large investments, and restructuring of corporate assets; (iv) establishment and adjustment of corporate organizational structure; and (v) major matters involving production safety, employee rights and interests, and social responsibilities of the enterprise.<sup>52</sup>

The 2015 regulations emphasized that decision-making in SOEs should be carried out “collectively” by the relevant Party Committee, the board of directors, and senior management, in accordance with the *sanzhong yida* decision-making principle (see discussion in relation to figure 2 below). While the 2020 regulations still refer to the *sanzhong yida*, they emphasize a decision-making structure that is less collective in the sense that ultimate decision-making authority is vested in the Party Committee (Group).

The Party’s embeddedness in enterprise organization is reflected in the structure of departments and offices. In our case study of the central-level SOE, China Energy Conservation and Environmental Protection Group (CECEP), we found that four of the 17 departments are directly related to the CCP organization and its lower-level work (see figure 2 below). First, a “Party Committee Organizational Department” (*dangwei zuzhibu* 党委组织部) is embedded in the Human Resources Department and controls appointments. Second, a separate “Party Work Department” (*dangqun gongzuobu* 党群工作部) consisting of a Corporate Culture Department, Trade Union Office, the Veteran Cadre Office is in charge of Party-building activities throughout the enterprise.<sup>53</sup> Third, a “Party Committee Inspection Office” (*dangwei xunshiban* 党委巡视办) is in charge of securing decision implementation. Finally, a member of the enterprise Party Committee heads a “Discipline Inspection Office” (*jiwei bangongshi* 纪委办公室), which investigates corruption and ensures Party discipline.

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<sup>52</sup> CCP 2020.

<sup>53</sup> Interview with central-level Party official, Beijing, August 2019.

## **Appointments and personnel management**

Control of personnel is one of the most important ways in which the Party institutionalizes its power over all economic and political organs in China.<sup>54</sup> Through the nomenklatura system, the CCP controls all appointments, promotions, transfers, and removals of officials in China. Top executives are often reshuffled between Party, business and government positions.<sup>55</sup>

The CCP's Central Organization Department (COD) directly controls personnel of the central SOEs that are ranked at either the ministerial or vice-ministerial level (the general manager and the chairman), currently 51 out of 96 central SASAC enterprises.<sup>56</sup> Consequently, although the nominally controlling shareholder, SASAC does not control top appointments in its own companies. Deputy-level positions such as deputy chairman and deputy general manager in the largest central SOEs are appointed by the Party's organizational department within SASAC, assisted by a separate SASAC division called the First Bureau for the Administration of Corporate Executives. SASAC's Second Bureau for the Administration of Corporate Executives appoints the remaining central SOE top executives. Appointments are made with inputs from the individual SOE Party committees and are for central SOEs subject to approval by the State Council.<sup>57</sup>

At lower levels, the local CCP organization departments and local SASAC organizations control the appointment and dismissal of local cadres, including the top three leadership positions in local SOEs.<sup>58</sup>

## **Bidirectional entry, cross appointment**

The principle of "bidirectional entry, cross appointment" (BECA), which is essential for enterprise corporate governance, demands special attention. According to a local SASAC official, BECA is the main principle for the Party's leadership over SOEs.<sup>59</sup> The principle implies extensive horizontal interlocks between the Party organization and other corporate organs. One person simultaneously holds the positions of Party Committee secretary and chairman of the board.

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<sup>54</sup> Brødsgaard 2012; Brødsgaard 2018.

<sup>55</sup> Brødsgaard 2012; Wang 2014, 658.

<sup>56</sup> In addition to 19 out of 27 central Huijin financial enterprises.

<sup>57</sup> Interview with local-level Party official, Nanjing, November 2018.

<sup>58</sup> Interview with local-level SASAC official, Nanjing, November 2018.

<sup>59</sup> Ibid.

Furthermore, the general manager, the chairman of the supervisory board, and the head of the discipline inspection team (the secretary of the Discipline Inspection Office) must have seats in the enterprise Party Committee. In addition, one to two other managerial deputies (such as the chief accountant) should also be members of the Party Committee.<sup>60</sup>

The outlines of this institutional arrangement were first proposed in 2004,<sup>61</sup> and were later specified in 2013 and 2015.<sup>62</sup> The 2004 document was released in connection with the first experiments with boards in state-owned sole proprietorship companies. By the end of 2017, 90 percent of the leaders of China's core central SOEs served simultaneously as board chairman and Party secretary.<sup>63</sup> This is up from about 20 percent during the Hu administration (2003–2012), when general manager–Party secretary interlocks were the norm.<sup>64</sup>

For example, as of October 2019, the Party group in China National Petroleum Corporation (CNPC), a central SOE holding group, had eight members (see Table 2), six of whom simultaneously held top management positions: the chairman of the board, the general manager, the chairman of the supervisory board, the head of the Discipline Inspection Office, the Chief Accountant (i.e. Chief Financial Officer), and the Chief Safety Monitor. With this level of insider control, the Party group dominates corporate decision-making. In addition, many of these Party group members simultaneously held positions in the publicly listed subsidiary company – as board members and/or members of the subsidiary Party organization (vertical interlocks). For example, Liu Yuezheng 刘跃珍 was simultaneously Party group member, chief accountant of the parent company and non-executive director of the subsidiary. Similarly, in addition to being a member of the Party group, Liu Hongbin 刘宏斌 was deputy general manager of the parent company and non-executive director of the listed subsidiary. Wang Yilin 王宜林 also held three powerful positions: Chairman of the board and Party Secretary in the CNPC holding group, and Chairman of the board in the listed CNPC subsidiary company. This structure secures both horizontal managerial interlocks within the holding group according to the “bidirectional entry and cross appointment” principle, but also vertical interlocks between the holding group and its listed subsidiary.

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<sup>60</sup> CCP 2015b.

<sup>61</sup> SASAC and CCP 2004.

<sup>62</sup> CCP 2015b; SASAC and CCP 2013.

<sup>63</sup> Leutert 2018.

<sup>64</sup> Ibid.



**Table 2: Example of “Bidirectional entry and cross appointment” principle applied in CNPC**

<b>CNPC holding group (中国石油天然气集团有限公司)</b> <i>Horizontal managerial interlock</i>			<b>Position in listed company:</b> <b>CNPC listed company</b> <b>(中国石油天然气股份有限公司)</b> <i>Vertical managerial interlock</i>
<b>Board of directors (董事会) position</b>	<b>Party group (党组) position</b>	<b>Management (管理) position</b>	
Chairman	Wang Yilin 王宜林 Party Secretary	NA	Chairman of the Board and Party Secretary
Vice Chairman	Zhang Wei 张伟 Deputy Party Secretary	General Manager	Vice Chairman of the Board and Party Group member
NA	Xu Wenrong 徐文荣 Party Group member	Deputy General Manager, Chairman of the Supervisory Board	Chairman of the Supervisory Board and Party Group member
NA	Liu Yuezhen 刘跃珍 Party Group member	Chief Accountant (CFO)	Non-executive director
NA	Liu Hongbin 刘宏斌 Party Group member	Deputy General Manager	Non-executive director
NA	Jiao Fangzheng 焦方正 Party Group member	Deputy General Manager	Non-executive director
NA	Duan Liangwei 段良伟 Party Group member	Deputy general manager, Chief Safety Monitor	Non-executive director
NA	Xu Jiming 徐吉明 Party Group member Head of the Discipline Inspection Office	NA	NA
Wang Shihong 汪世宏 Employee Director (职工董事)	NA	Assistant to the general manager	NA
NA	NA	Hou Qijun 侯启军 Deputy General Manager	Executive Director and President (总裁)
Wang Jiuling 王久玲 External Director	NA	NA	NA
Liu Guosheng 刘国胜 External Director	NA	NA	NA
Wang Yongsheng 王用生 External Director	NA	NA	NA

Source: webpage of CNPC holding group, personal profiles of top leaders. Positions as of October 2019. NA=no position.

## **Changes to Articles of Association to integrate the Party into corporate governance structures**

In 2017, the COD and the Party Committee of the central SASAC issued a notice to all local- and central-level enterprises that provided guidelines on the process of changing the enterprise Articles of Association to accommodate a direct role for the Party in corporate governance in terms of decision-making and corporate appointments and supervision.<sup>65</sup> The Ministry of Finance issued a parallel notice for financial enterprises a few months later.<sup>66</sup>

The COD notice stresses that writing the Party into the Articles of Association is an important institutional arrangement for implementing the statutory status of the Party organization in the corporate governance structure of the company.<sup>67</sup> It further stresses that the requirements for Party-building work should be clearly defined in every company's Articles of Association, including the legal status, role, and responsibilities of the Party organization and the Party organization's staffing and funding.<sup>68</sup>

The January 2020 regulations on the work of primary Party organizations in SOEs clarify that charter amendments must include a formal statement that the Party organization's investigation and deliberation of major issues is pre-procedure for board directors' and managers' discussions and decisions.<sup>69</sup> In the period August 2015 through September 2018, 84 percent of all listed SOEs – the public face of SOE holding groups – had amended their charters.<sup>70</sup> Examples include the main listed subsidiary companies under Baosteel Group and Sinopec.<sup>71</sup> The same is true of listed mixed-owned enterprises with less than 30 percent state-ownership, 75 percent of which have amended their charters.<sup>72</sup> This broad implementation implies that the institutionalization of the role of the Party in corporate governance extends far beyond SOE holding group companies.

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<sup>65</sup> CCP 2017a.

<sup>66</sup> MOF 2017.

<sup>67</sup> CCP 2017a.

<sup>68</sup> Ibid.

<sup>69</sup> CCP 2020, Chapter 4.

<sup>70</sup> Zhang and Liu 2019, 6.

<sup>71</sup> Sinopec 2019; Baosteel 2017.

<sup>72</sup> Zhang and Liu 2019, 6.

## Case study of China Energy Conservation and Environmental Protection Group

Figure 2 below shows the Party's embeddedness in the corporate governance structure of China Energy Conservation and Environmental Protection Group (CECEP), a central-level, non-listed SOE holding group with a board of directors system. The figure illustrates the horizontal and vertical interlocks of the Party organization and other corporate organs, the actual decision-making in the CECEP holding group (in particular, the relationship between the Board and Party Committee/Group), and the functions of lower- and higher-level enterprise Party organs. Interviews with CECEP officials highlighted the actual scope of the Party's role in internal decision-making procedures.

Lower-level enterprise Party functions concern various Party-building activities, corporate culture initiatives, trade union work, veteran cadre's management, tracking of decision implementation, and investigation of Party discipline in the entire group. Organizationally, lower-level Party functions are placed in separate offices that are integrated among the conventional offices and departments (see Figure 2). Direction for lower-level Party functions is set out by the group Party Committee. The Party Committee Organizational Department has replaced a traditional Human Resources (HR) department and controls all appointments in the entire CECEP group.<sup>73</sup>

Higher-level Party functions are strictly defined by the *sanzhong yida* principle formulated in 2010 under Hu Jintao.<sup>74</sup> In CECEP, the principle applies to first- through third-tier subsidiaries (including Party General Branch Committees) and covers:<sup>75</sup>

- *Important strategic decisions* concerning implementation of Party-state principles, policies, laws and regulations, and matters related to security and stability, in addition to enterprise development strategy.
- *Appointments and dismissals of important personnel* of mid-level or above in the enterprise holding group and in directly subordinate enterprises and units.
- *Major project arrangements*. Projects that have an important impact on the scale of assets, capital structure, profitability, production equipment and technical conditions.

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<sup>73</sup> Interview with central-level Party official.

<sup>74</sup> CCP 2010.

<sup>75</sup> Interview with central-level Party official.

- The “one big” (*yida* 一大), which refers to *large-scale capital operations*, meaning “the transfer and use of funds exceeding the fund limit that enterprise leaders have the right to mobilize and use”.<sup>76</sup>

*Sanzhong yida* decisions have to be submitted to the Party Committee (Group) before they are discussed by the board of directors.<sup>77</sup> All other operational issues do not go through the Party Committee, but are submitted directly to the board of directors.<sup>78</sup> CECEP officials emphasized that the main task of the Party Committee is to set a strategic direction for the company and not to interfere in day-to-day management:

What the Party Committee actually manages is governing principles (*yuanze* 原则) and supervision (*jiandu* 监督). Pre-announcement in decision-making is to set the direction [for the board of directors]... It is similar to a supervisory department.<sup>79</sup>

Despite the dominance of the Party Committee, CECEP officials also emphasized that the firm’s decisions are made on a commercial basis, and that the independent directors have an important say in evaluating the commercial feasibility of major projects.<sup>80</sup>

CECEP officials also highlighted that Party Committee members who enter the board are responsible for ensuring that board decisions are in line with the Party Committee’s recommendations, higher-level Party principles and policies, and laws and regulations, as well as ensuring that they do not damage national and social interests:

The biggest feature of state-owned enterprises is that they consider problems from the perspective of the country... The Party Committee considers corporate social responsibly. This is the advantage of management with Chinese characteristics [i.e., with a Party Committee]. I think it is necessary.<sup>81</sup>

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<sup>76</sup> Ibid.

<sup>77</sup> Ibid.

<sup>78</sup> Ibid.

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

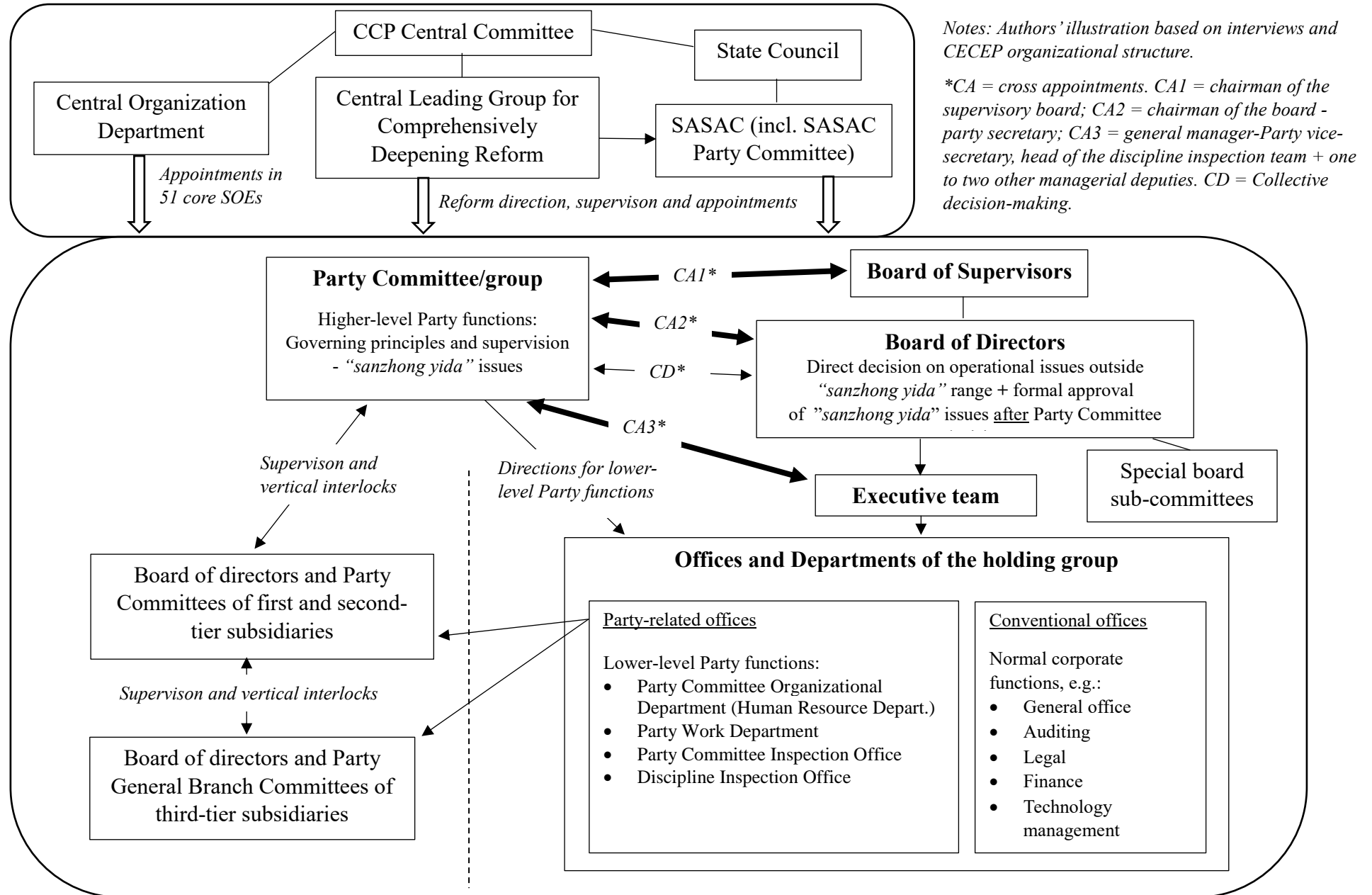
In terms of the internal workings of the enterprise Party Committee, interviewees emphasized that the committee makes decisions based on a principle of democratic centralism: “The entire Party Committee meets, and everyone puts forward a unified opinion. The Party Secretary does not have the final say.”<sup>82</sup> The interviewees highlighted the strengthened direct affiliation between higher-level Party organs in the central SASAC and the CECEP group-level Party Committee.

Taken together, the CECEP case points to a Party apparatus that is now more vertically integrated and can exercise effective control over lower-level SOEs, thus potentially forestalling insider control and corruption.

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<sup>82</sup> Ibid.

**Figure 2: Corporate governance structures in SOE holding groups with board of directors system**



## **Advantages and disadvantages of China's hybrid model**

After decades of reform and opening-up, including mass corporatization and installation of a modern corporate governance system in the state-owned sector, the Party is now reasserting its control over Chinese businesses. As documented above, we are witnessing a movement towards a hybrid model of corporate governance that merges a Western corporate governance structure with a Party-centered political model. This fits with an overall trend of increased CCP oversight and control over all parts of Chinese society.

What are the advantages and disadvantages of the hybrid model? Viewed through a standard Anglo–American lens, stronger Party Committees in corporate governance might be problematic for several reasons. First, they potentially undermine other reforms, such as the mixed-ownership reforms where private capital, management and talent are intended to make the SOEs more market-orientated and efficient. By weakening the position of the SOE board, private investors have even weaker incentives to invest in SOEs. The Party will have the decisive say in all major enterprise decisions as long as the enterprise is state-controlled (absolutely or relatively).

Second, with the maintenance of the traditional political control elements in SOEs, the intended performance effects of other corporate reforms will likely not materialize. The problems that hold back SOEs (e.g., lack of management incentives due to rigid administrative systems and soft budget constraints) are not likely to disappear with increased Party control.<sup>83</sup> The implications of standard management theory therefore suggest that increased Party control will undermine progress towards the goal of improving SOE profitability and performance.

Third, since lines between the Party and legal governance organs are blurred, it is not clear whether the board of directors or the Party organization takes the final decision. Despite the effort of institutionalization of the Party into Articles of Association, SOE corporate governance rules remain uncertain, nontransparent, and unpredictable, especially in the eyes of international and private investors.

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<sup>83</sup> Lardy 2019, 75–77.

However, we acknowledge that increased Party control over SOEs can generate a number of advantages. First, the Party Committee's increased strength in SOEs can help facilitate smoother interaction with higher-level Party and government organs (notably the SASAC) and provide a better understanding of government policies and Party-state objectives. In this way, compliance with laws and regulations can be secured. In addition, the increased vertical integration in the Party-state hierarchy might work as a check on insider control and corruption.

Second, long-term strategic development goals can be facilitated by more direct intervention of Party Committees (Groups) in SOE decision-making. Pressure to create short-term profits might ease. This includes ensuring that SOEs lead the way in China's newly announced green transition; if "green and sustainable" become key governing principles in SOEs, Party dominance in decision-making might generate society-wide benefits.

Third, to the extent that the Party Committee (Group) only sets "the governing principles" and conducts "supervision" of misconduct, leaving the board of directors to make commercial decisions (as indicated in the CECEP case study), the Party-led structure of the hybrid model might allow SOEs more market autonomy. Ironically, acquiescence to formal Party supervision might lead to greater informal commercial autonomy, especially in competitive, open sectors. In addition, Party control of SOEs in "key" resource and utility industries with extensive non-profit objectives is both ideologically suitable for the Party-state and an economically good alternative to attempting to regulate large private monopolies. The hybrid Party-led model of corporate governance might be a reasonable alternative form of market regulation in very large firms that operate in oligopolistic markets.

## **Conclusion**

In line with the Xi Jinping era's general recentralization of the role of the Party in Chinese society, the Party has reasserted its control over Chinese big business. This time, the vehicle for strengthening the Party's role is the internal enterprise Party organization in the form of Party Groups and Party Committees. Starting in 2015, the CCP formulated an overlapping system of internal regulations actively embedding itself into the formal governance structure of SOEs.



In SOEs and all companies controlled by SOEs (including listed and mixed-owned enterprises), the Party exerts its influence through the enterprise Party organization (Party Group or Party Committee) and its role in decision-making mechanisms, personnel appointment mechanisms and supervision mechanisms. Party Committees no longer focus only on trade unions and welfare issues; they are now actively involved in management issues. The result of legislation and regulations issued since 2015 is that the Party's dominance over SOEs has been strengthened, while the companies' legal governance structure has been weakened. In place of a convergence with the Anglo–American model of corporate governance, a hybrid, Party-led model of corporate governance with Chinese characteristics has emerged. Some call this system “CCP Inc.” or “Party-managed state capitalism”.<sup>84</sup> In China, it is called Socialism with Chinese Characteristics for a New Era.

The advantage of this hybrid model lies in its strength in securing enterprise compliance, communication with higher state and Party organs, and in long-term development planning. As such, the Party's leadership inside SOEs can actively underpin the state-led model of economic development. The Party therefore continues to treat SOEs as its main “ruling foundation” (*zhizheng jichu* 执政基础).<sup>85</sup> On the other hand, the hybrid model is unlikely to help solve efficiency problems and can potentially undermine other reforms, such as efforts toward mixed ownership. The Party-state needs to find a balance between its ambitions to maintain ultimate control and its desire to improve the performance, management, and efficiency of the state sector.

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<sup>84</sup> Blanchette 2020; Naughton and Tsai 2015.

<sup>85</sup> Interview with Chinese corporate governance scholar.

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**摘要：**本文以的非上市中央国有控股公司为例，分析了中国共产党在国有企业公司治理中的作用。本文通过搜集官方文件、次要数据以及与企业经理、政府官员和学者的访谈，分析了中共如何将其纳入国有企业的公司治理结构中，从而积极地使其在国有企业中的作用正式化。通过运用中国本土行政公司治理概念，例如“双向进入，交叉任命”和“三重一大”，中共巩固了在企业决策程序和人事任命方面的主导地位，建立了由党领导的混合公司治理模式。虽然这种混合模式可以确保企业合规性，与上级国家和党机关的沟通以及长期发展规划，但它无法协助解决国有企业的效率问题，并且可能破坏其他国有企业的改革。

**关键字：**公司治理；中国共产党（CCP）；国有企业；国有控制；干部管理

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