The Agency Model and Corporate Governance in China:
In the Context of Privately-Owned Enterprises Transformed to Public Corporations

by

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Abstract:

In the context of transition, where the Chinese enterprises are seeking good models for the corporate governance, one Anglo-American corporate governance model, the agency model, seems to shed some light on enterprises that used to be privately-owned and have transformed into public corporations. Although the agency model might be a solution to the public corporations, it never the less fails to match the Chinese context in many respects. In light of the nature of the agency model and potential mismatches with the Chinese context, this thesis examines theoretical reasons that could account for the discrepancies between the two. It is argued that, despite the foreign nature of this model and the need for amendment, the Chinese public corporations are still be able to establish good corporate governance structure via it.
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Introduction

It has been the objective of the Chinese policymakers to reform and modernize the enterprise system\(^1\) as it has hitherto existed in China. In achieving this objective, the Chinese are confronted with such problems as the following: the reform of enterprises per se, the adoption and application of proper legal rules, the challenge from different markets and others.

Specifically, the corporate governance reform is within this system, which has attracted a number of researchers to contribute to the scholarship and generated fruitful thoughts and claims.\(^2\) One of major problems with the latter is presented by the difficulty of choosing the most appropriate corporate governance model. For example, there are the Anglo-American corporate governance model and the German/Japanese model.

There is a strong tendency for some Chinese economists and legal experts tend to favor and adopt the Anglo-American corporate governance model when it comes to the

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\(^1\) This objective is known as to establish a “modern enterprise system” in China, proposed in the Fifteenth National Congress of the Communist Party of China in 1997.

problems with corporate governance reform. To be precise, this group of scholars encompasses the agency model, which is a typical model in the US corporate governance regime, and intends to transplant it to the Chinese companies.

The rationale given by the Chinese researchers for adopting this model lies in the success of Anglo-American corporations. American corporations, for instance, are recognized as the world leaders in respective markets: Coca Cola, for example, dominates the beverage industry all over the world. This equally applies to Microsoft, General Electric and Nike. Examples of such companies can be multiplied. What is true for the American companies is, to a very large extent, also true for the British companies.

An inference that people could draw from them, as claimed by the Chinese researchers, is that the governance structure of American corporations should be accountable for the success. Similarly, examples that have happened in the UK can also be identified as corporate governance models that make the success possible. These corporate governance models are hence known as the Anglo-American corporate governance model.
A key characteristic of the Anglo-American corporate governance model lies in the relationship between the shareholders and the management, which, according to the masterpiece of Berle and Means in 1930s, is the separation of ownership from control. Namely, the shareholders, being the “owners” of the corporation, are relatively weak in the control of it, whereas the management enjoys the control having small or even no proportion of the ownership of the corporation. Another important feature that must be emphasized is the agency relationship between the shareholders and the management. There are numbers of implications underlying these characteristics and will be developed in the later sections of this thesis.

Although the agency model seems to be encompassed by some Chinese researchers without concern, one stream of literature inspired by the development of corporate governance theories as well as practical experiences in some transitional economies has posed challenge to it.\(^3\) One theory called “dynamic theory of corporate governance” has claims that “there is no universal path to a market economy” and “it makes great sense for the country to adopt a gradualist strategy for corporate governance reforms.”\(^4\)

According to this theory, the adoption and application of the agency model may be


\(^4\) Ibid. Leng at 18-20, 21-22.
problematic and result in a conflict of contexts. In other words, the Anglo-American corporate governance model, specifically the agency model, may not be able to, or at least not completely, fit into the Chinese context and replicate the success.

Such a potential conflict of contexts vis-à-vis the agency model has comprised to the initial proposition of this thesis. The main proposition, however, is whether we may identify some reasons that could ease the contemporary situations. In other words, are there any reasons or features that may be accountable for the potential challenges towards the Anglo-American model? As argued before, the anecdotal evidence of numerous successful American or British corporations can exemplify the successes of the Anglo-American governance model, in particular the agency model; however, certain aspects of the model still need to be re-considered in this thesis in order to shed light on the corporate governance reform in China. Although there are challenges confronted by the agency model, once we could differentiate them in parts, there should be room for its application. It is the proposal of this thesis to modify the agency model and thus make it appropriate for the Chinese context.

The alternative models that have also been bolstered by a lot of Chinese researchers concentrate on the German and Japanese corporate governance. The key feature of these two models lies in the involvement of other stakeholders. The large banks, for example,
resemble a significant bargaining power in the Japanese corporate governance regime, whereas, employees and the unions are more influential in German corporate governance. Nevertheless, it is not the intention of the thesis to explore, compare or identify an optimal model for the Chinese companies’, and there will be no further discussions and analyses on the German or Japanese corporate governance models.

Based on the aforementioned proposition, the thesis explores a number of factors that could contribute to the conflict of contexts, including the assumption and implication of the agency model, the Chinese corporate governance features and certain historical reasons. Admittedly, corporate governance is a broad issue, which covers a vast array of subjects. Merely discuss the potential problems could fulfill the entire thesis. Considering the open and reform policy in China as well as the rise of private ownership in its economy, the thesis decides to use the privately-owned enterprises that have been transformed to public companies as lenses to carry on.

The exploration of the corporate governance issues through the privately-owned enterprises that have been transformed to public corporations, known as the POE-PCs in this thesis, has discovered that: there are potentialities for the agency model to be applied to the POE-PCs as an advanced corporate governance model; however, this model shall be adapted to changes according to the Chinese features. This finding seems
to partly support the attempt of the Chinese corporate researchers, yet proposes
limitations and modifications for that model.

The thesis will proceed as follows. In the next section, Section 1, it reviews the agency
theory and the separation of ownership from control thesis in order to establish an
Anglo-American corporate governance model – the agency model. Though the agency
model has contributed a lot to the history and success of American corporations and may
further be transplanted to other transitional countries, it contains considerable limitations.
Section 2 discusses the corporate reform in China briefly. The practical calls in China
for good corporate governance models from western countries have provided an
opportunity for the agency model. However, the problems with the management in
corporations, addressed in Section 3, which used to be privately-owned and have
transformed to public companies do not correspond with the agency model completely.
Certain managerial problems in Chinese corporations seem to challenge this model and
require re-thinking. Section 4 hence seeks to trace and uncover the potential reasons and
insufficiencies of the agency model in explaining and controlling the management in
public corporations in China. A tentative proposal will be made in Section 5, which
considers a combination of both the agency model and Chinese features. The thesis
concludes in the last section.
1. The agency model and its limitations

1.1 The agency model

1.1.1. The agency theory

The agency theory, as a prevailing account, has been frequently discussed in corporate governance literature. It has become one of the focuses in corporate theories, attracting both corporate law and corporate governance researchers. The agency theory was developed mainly by the economists Jensen and Meckling to explain and account for the activities that an entrepreneur or manager may take though fail to maximize the value of the firm yet are consistent with efficiency. It also explains the rationale of two sources of capital, common stocks and debt, as well as that of the preferred stock; the rationale of voluntary accounting reports to stockholders and creditors and that of independent auditors and restrictions on loans; the rationale of the ownership structure in relation to the source of capital and that of security analysis. Starts from the agency costs, under a contractual relationship between one or more persons and another person (the principal(s) and the agent), given their self-interested utility maximization and the transaction costs,

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7 The utility maximization is an economic assumption, which can be simplified as to obtain the greatest value possible from expenditures of least amount of money.
the costs between the two are apparent. These costs are the sum of the monitoring expenditures generated by the principal, the bonding expenditures generated by the agent, and the residual loss.

Gradually, the agency costs have been considered as a theory “…is directed at the ubiquitous agency relationship, in which one party (the principal) delegates work to another (the agent), who performs that work.” (Eisenhardt, 1989) As of the corporate governance, the theory is often seen as a portrait of the internal relationship of corporations, in particular, of those large public corporations, for which the shareholders are known as the principals, and the management as the agent.

The identification of the shareholders as principals and the management as the agent counts only part of the theory, however. Commentators often seek to uncover some other characteristics. The fundamental characteristic is: the shareholders are the owners of the corporation by means of investing in the corporate equities (the securities or stocks); the management, known as the agent, is employed to run the corporation in accordance with the interests of the shareholders. In other words, the management is supposed to serve the best interest of the corporation in terms of fiduciary duties and other disciplines. Just like commentator Talbot has argued, “A director is a fiduciary who owes a duty of utmost honesty to the company,” and “the company is generally construed as the
The shareholders participate in the corporation in such critical issues as the establishment of the corporation, the determination of liquidation or not and the voting of important decisions concerning the management in annual shareholder meetings (Wei, 2003). By contrast, it is the management that is responsible for the day-to-day running of the corporation.

In addition to what is said in the preceding paragraph, the agency theory. Firstly, the management does not “own” the corporation and is merely employed by the shareholders to operate it, which seems to indicate that shareholders are in a superior position (the ultimate control or the residual control) within the corporate arrangement. The superiority of shareholders’ position can be translated into their more significant rights and powers. In other words, shareholders should be more influential in the corporation. Shareholders can be seen as the ‘last resort’ of the corporation and own the residual controls of it. Comparatively, the management is not designed to possess respective rights and powers over the shareholders. The shareholders are in fact the holders of the power.

Secondly, the management is presumed to be disciplined and could not behave without constraint (this is the origin of the agency costs). This observation seems to underlie that

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8 *Supra* note 5 Talbot at 107.
a control or regulation over the management is intrinsic to corporations. Unlike certain laws, regulations or best practices on corporate governance that vision the restrictions on the management from without (externally), the design of corporation itself, according to the agency theory, requires controls the management as a natural, internal and logical response. Therefore, the agency theory is also known as shareholder primacy compared to other corporate governance theories (e.g. the management primacy in the US in 1960s).

1.1.2 The thesis of separation of ownership from control

The agency theory can be broadly observed in financial literature as either corporate governance theories or corporate law theories. Within these literatures, the agency theory is often accompanied with a discussion of the separation of ownership from control thesis.

The thesis of separation of ownership from control has originated since 1930s, based on the masterpiece of Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property*. In this book, the two scholars have argued the rise of modern corporations as a “transition” for property, whereby the property is considered to be destroyed of the unity, and “has divided ownership into nominal ownership and the
power formerly joined to it.”⁹ In other words, there is a separation of ownership from control. Their main finding in this book is that large public corporations in America have been controlled by the managers who own only a small proportion of the corporate interest, whereas the shareholders, due to their scatter in amount and small in individual ownership, have been weakened in control over both the corporation and the management (Berle and Means, 1968). They term this phenomenon as a separation of ownership from control, for which “a large body of security holders has been created who exercise virtually no control over the wealth which they or their predecessors in interest have contributed to the enterprise.”¹⁰ They also argued that “the property owner who invests in a modern corporation so far surrenders his wealth to those in control of the corporation that he has exchanged the position of independent owner for one in which he may become merely recipient of the wages of capital.”¹¹ However, it must be noted that, although the managers are not the real owners of the corporations, for all practical intense and purposes, they appear to play the roles of owners as well. It is this fact that requires them to be controlled and disciplined, so that they would not be tempted to expropriate the shareholders and the corporations.

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¹⁰ Ibid. at 6.
¹¹ Ibid. at 4-5.
The separation of ownership from control thesis is more than an observation of the large corporations at the beginning of the twentieth century. It has raised an important question in corporate governance theory – how to control and discipline the management in public corporations. The proposition provided by the agency theory suggests that shareholders enjoy the residual control over the corporations since they “own” them; however, the residual rights of shareholders may be infringed if the corporations are too big.\textsuperscript{12}

\textit{1.1.3 The agency model}

The agency theory simplifies the relationship between the shareholders and the management with that of the principals and the agents. It requires the management to be controlled and disciplined accordingly. The separation of ownership from control thesis observes that the management teams are those who are in real control of the large public corporations in the US in effect, whereas the shareholders seem to be weakened from their ownerships. Hence, there is a possibility that the management could expropriate the corporations and consequently impair the shareholders.

\textsuperscript{12} Berle and Means have argued that two characteristics may be accountable for the separation of ownership from control, the size and the public market for its securities. The larger the corporation is, the more funding it requires. Meanwhile, the larger the corporation is, the more important the security market has become. \textit{Supra} note 3 at 6-7.
The connection between the agency theory and the separation of ownership from control thesis can be viewed from their emphases on the importance of shareholders: both theories have a tendency to strengthen the shareholder rights and somehow create a shareholder-friendly environment for corporate governance. In addition, the separation of ownership from control thesis serves as a root of the agency theory. One may wonder the relationship between the “members” and the managers in the context of the charter companies, which used to be created purposely by the authorities. Though the managers did perform the “agent” of the charter companies, the members were quite influential and powerful at that time. Therefore, it would be possible for us to unite the two theories under one cap – the agency model, with a foundation of separation of ownership from control.

In general, the agency model regards shareholders as the “owners” of the corporation and the management as the “agent”. The management owes fiduciary duties to the corporation and should behave in the best interest of it. However, due to the possibilities of the managerial deviation from the fiduciary requirement and expropriate the corporation, there are significant agency costs arising out of it.

1.2 The assumptions and implications of the agency model

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13 Ibid. at 11-17; Supra note 5 Dignam at 24-25.
Apparently, the primary implication of the agency model comes from those scattered, also known as “dispersed”, shareholders. Although the shareholders are the principals and the owners of the corporations, their rights and powers might be significantly deteriorated in the course of dispersion.

Secondly, it involves a robust and mature capital market, where the equity financing of corporations is possible. Ever since its rise, the conception of companies has closely related to a market with which they can be financed externally (rather than contribute the money of the founders’ own). Gradually, the capital market, apart from the bank loans, has become an important source of financing. Investors can invest their money in the capital market, becoming the shareholders, constituting a crucial supply to the corporations. In addition, the relationship between the shareholders and the capital market can serve as a means to discipline the management. To specify, the performance of the managers can be reflected through the performance of the corporations, which, furthermore, will be reflected by the prices of the stock in the capital markets. If the share prices are high, it is very likely that the corporation is in good condition and the managers are performing properly. As of those potential weakened shareholders, it would still be possible for them to be aware how the corporation is going on.

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14 Dignam, *ibid.* at 15-17.
Thirdly, it correlates with a managerial tradition. Historically, as demonstrated by the charter companies, the managers are separated from the members. Those who are in charge of running and directing the corporation, in a number of cases, turn out not to be those who contribute the proceeds. With this respect, it would be possible for us to trace a managerial tradition in this context. In other words, the third implication of the agency model hints a cultural heritage of having professional managers.

1.3 Summary

The discussion in this section focuses on the establishment of the agency model, which embraces both the agency theory and the separation of ownership from control thesis. The key issue of this model lies in the dispersed shareholders. It also has a relation to the stock market as well as a managerial tradition. The model distinguishes the shareholders and the management from the rest of corporate participants (such as the creditors, contractors and employees), and places a unique concern on shareholders. Whereas this model may be beneficial in protecting the shareholders in some respects, those implications might hinder it to be transplanted or applied to other countries.
2. The corporate reform in China

2.1 The transition of Chinese economy and the reform of the enterprises

The experience of adopting the market economy has proved to be fruitful in China since the end of 1970s, which has not only accumulated large amount of wealth in people’s hands, but also restructured the economy. It involves aspects such as the production, consumption, employment, trading and export. The principal approach is to introduce the market through establishing series of institutions, creating capital markets (stock markets), changing the ownership structure and alike.\(^{15}\) More specifically, the Chinese have called for a reform of “modern enterprise system” to revitalize Chinese state-owned enterprises, making them become profit-oriented and self-sustaining companies with limited liabilities.

Similar to other former planned economies, former Soviet Union for instance, the enterprises used to be owned by the state, which had carried on enormous policies concerns, and the influence of the markets had been greatly depressed. Consequently, the existence of the enterprises can be seen as an extension of the political state. Admittedly, the ideologies behind the planned economy and the market one are different, and account a lot for the differences in their performances. However, according to “the

\(^{15}\) Supra note 2 Wei at 29-30, 31-41; Lin et al., 2009 at 194.
direction of the enterprise reform of the country”, which has been set towards a market orientation, the enterprises need to transform themselves accordingly.

The objectives of establishing a “modern enterprise system” are to incentivize the companies to improve the productivity and performance of state-owned enterprises, and to end governmental capital injection into state-owned enterprises. One possible and natural response would be to reform these state-owned enterprises according to existing models, such as the Anglo-American model, the German model or the Japanese model. This movement broadened the freedom of enterprises. Thus, the transition has brought benefits to all sectors of the society.

In addition, being part of the economic transition, the introduction and emphasis on the non-state-owned sectors as a supplement to the economy have also been carried on. Although the establishment of the “modern enterprise system” focuses almost exclusively on those state-owned enterprises, the non-state-owned enterprises could also benefit from it. To specify, the principles, objectives and even governance models pertaining to the modern enterprise system can shed light on the non-state sectors,
especially at their early stages. This may give particular rise in witness of the development of the non-state ownership.\footnote{According to the report from National Bureau of Statistics of China, by December 6, 2005, the non-state ownership is 51.9\%, whereas the state ownership is only 48.1\%. The non-state ownership has exceeded its state counterpart. Note also that the private ownership counts 28\% of the entire ownership structure. See National Bureau of Statistics of China, “Diyici jingji pucha bogao” (Report on the First National Economic Census), online: National Bureau of Statistics of China <http://www.stats.gov.cn/zgjjpc/cgfb/t20051206_402294807.htm> at Graph 8 [translated by author].}

The economic transition and the establishment of the modern enterprise system, though placed more emphases on the state ownership, can also be viewed as an opportunity for the non-state ownership. With this respect, the introduction and development of the non-state ownership, in effect, has also brought a transition of the ownership structure.

2.2 The decision of Chinese policymakers to adopt the western models

As discussed above, the reform oriented towards a market economy is a reality in China. It is reasonable to carry out this transition in accordance with models of market economies. In contrast to the planned economy that had once prevailed in former Soviet Union, Eastern Europe and some Asian countries such as China, the market-oriented experiences may only be learnt from the western world. Though scenarios in Western Europe somehow differ from those in the North America and the UK, the fundamental
resolution is the same. They all feature in the involvement and significance of modern corporations.

China has also started to reform its enterprises in accordance with western corporate models since 1980s. There are a variety of aspects that need to be conducted, including the ownership issue, management issue, law and institution issues and so on. Recently, “corporate governance has been identified as the core element.” Thus, the western experiences in corporate governance have become particular important and valuable for the transforming Chinese enterprises.

Additionally, the Anglo-American corporate governance model (as discussed above, the agency model), due to the successful applications in modern corporations, manages to distinguish itself and attract wide range of attentions from the transitional world. Remember that the key elements of the agency model are the separation of ownership from control and the distinction between shareholders and the management. Remember also that shareholders are the owners of the corporation, whereas the management in effect takes the control. The agency model and those assumptions underlie it would be

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particularly innovative and fresh for the majority of Chinese enterprises that had for long been operated under the planned economy for decades.\textsuperscript{19}

In aggregate, the focus of the corporate reform as well as the establishment of “modern enterprise system” in China can be viewed as to reshape its enterprises in accordance with the western corporate governance model, especially with the agency model. It would not be surprising to see that a large chunk of the corporate governance literature in China is correlated with the agency model. Nor would it be surprising to observe a promotion of the separation of ownership from control thesis by Chinese scholars.

2.3 The problems faced by the “Mingying qiye”

2.3.1 “Mingying qiye”

As shown before, the focus of this thesis rests upon public corporations in China, especially corporations that have been transformed from privately-owned companies

\textsuperscript{19} One may argue that the conception of separation of ownership from control is not unique to the US and the UK corporate governance and hence not completely “new and fresh” to the Chinese companies, since, theoretically, these companies owned by the state while run by managers can equally be seen as a form of separation of ownership from control. That is to say, the state is the ultimate owner of the enterprise, whereas it employs representatives to direct it. However, such an analogy should not be regarded as the same relationship between the principals and the agent. Indeed, the managers in the state-owned enterprises are representatives of the state, for whom they should be responsible. Yet, due to the limited function that capital has played in this course as well as the welfare that managers may enjoy, I do not think that the so-called separation of ownership from control has existed. In addition, due to the direct intervention from the state, the enterprises are not conformed to the conception of companies or corporations; rather, they should be considered as the “brunch” or “expansion” of the political state.
(mingying qiye). The concept of “mingying qiye” has been frequently argued to indicate a distinctive ownership structure in China. That is to say, instead of being owned by the state and hence being recognized as state-owned enterprises (SOEs), which are typical in the transitional economies, this concept exhibits a dominant position of non-state ownership in the companies, in particular of the private ownership.

It is argued that there are six types of ownerships in China – state-owned enterprises (SOEs), collectively-owned enterprises, privately-owned enterprises (defined as private firm with more than seven employees), individually-owned enterprises (defined as private firms with no more than seven employees), foreign invested enterprises and other firms not included in the above five categories (Leng, 2005).²⁰

It may somehow be uneasy to reach a general definition when considering the two interpretations at the same time, however. According to the main concerns for companies of this type, such as family control, the squeeze of outside shareholders and insider control, as well as the purpose of the thesis, the term “mingying qiye” can be illustrated as companies that do not have state ownership and have been developed from individual/private owned enterprises. The thesis tends to use the term privately-owned enterprises (POEs) to refer to “mingying qiye” hereinafter, and use the term public

²⁰ Supra note 3 at 28.
corporations transformed from “mingying qiye” (POE-PCs) to indicate the subject of the thesis.

2.3.2 The problems

Like private enterprises in other countries in the world, POEs in China have emerged from private capitals and are “rational” to fall into family controls regime (Tang, 2004). As argued by a number of Chinese researchers, the main problems with POE-PCs have arisen from the governance of the families. For instance, one researcher Shen Qingtao has argued that the corporate governance of family control of enterprises could reveal a lot of insufficiencies and deficiencies in the course of development, though they may be beneficial at the first glance. Another researcher Wu Weiping has indicated that the deficiencies of family control in corporate governance shall be accountable for the underdevelopment of POEs.

The insufficiencies and deficiencies include: (1) the family governance may result in the failure of strategic plans of the enterprise; (2) there are strong tendencies of dictatorship and authoritarian, after reaching certain stages; (3) the family control causes the enterprises significant opportunistic behaviors in the short run; (4) the family control could not meet the requirements of the senior employees. See Qingtao Shen, “Mingying Qiye Guanli Moshi de Tiaozheng” (The model transition for the governance of privately-owned enterprises), (2004) 12 Modern Enterprise, 20 at 20, [http://scholar.ilib.cn/A-xydqv200412013.html] [translated by author].

Ibid. at 20.

The Chinese researchers have further explored the problems with family control in corporate governance (hereinafter: family governance) and pointed out that it may result in the corporations’ collapse. They argued that the failure in corporate strategic decisions, short-term opportunistic activities of the corporations, concentration and authoritative of management and control should all be attributed to the family governance.\textsuperscript{24}

\textsuperscript{24}\textit{Supra} note 21 at 20.
3. The discrepancy with the governance problems between the agency model and the POE-PCs

3.1 The plausibility of the agency model for the POE-PCs

The emergence of Chinese market, driven by the open and reform policy, has largely changed its economy since the end of 1970s. In addition, there has been a change in its ownership structure. The participation of private players and emergence of non-state-owned enterprises have added fuel to those changes. It is hardly denying that roles played by the POE-PCs would become more and more significant during this course.

The attention paid by the Chinese researchers to the POE-PCs addressed in last section is only one example. Additionally, they have correctly recognized some crucial problems with the POE-PC, which seem to be inborn with its unique ownership structure as well as the governance structure (family control). There seems to be a dilemma for the POE-PCs: they have been established by private capitals and attributed a lot to the rise of private ownership; nevertheless, the private ownership may turn out to harm the POE-PCs, with respect to the expansion and development in terms of the disadvantages of family governance. Simply put, the POE-PCs can arise from the private ownership in China, but may be constraint by the same reason.
Recall the characteristics underlying the agency model, which contain the disparity between the shareholders and the management, the principals and the agent, and the thesis of separation of ownership from control. The fundamental implication of this model is the dispersion of shareholders, or the “dispersed” shareholders. Although the shareholders are not presumed to be incapable of managing the corporation, their main responsibilities are “to invest”. In other words, shareholders are responsible for the supply of capitals in terms of capital contributions (in cash or other equivalents) to the corporation, rather than for the direct manage of it.

Recall the POE-PCs at the same time, which seem somehow to provide an appropriate context for the agency model in China. Though they used to be privately-owned enterprises with only a few members, they could embrace many more shareholders (usually the outside shareholders) after becoming public. The agency model seems to be plausible in this sense with the introduction of the new shareholders. Namely, shareholders have expanded after going public, which allows ownership to be somehow diverse or diluted.

Moreover, in order to combat the insider control, the majority control (the owner control), the tunneling problems and, most importantly, to direct the company, it makes great sense for the POE-PCs to apply the agency model and to introduce a new source of
power – the management – in the corporate arena, attempting to separate the “owners” from the “majority control” and to protect the shareholders.

In the third place, the agency model could solve the managerial problems with POE-PCs. As shown in previous sections, managers owe fiduciary duties to the principals and should take the responsibilities of directing and running the corporation. Meanwhile, those managerial problems that are quite common to the Chinese POE-PCs, for instance, the authoritative management, opportunistic activities of corporations, failure in strategic plans in the future and lack of balancing power in the corporate decision-making processes, all can be uncovered by the failure of its governance model, and require a transition with the agency model henceforth.

In general, comparing the assumptions and feasibility of the agency model with the POE-PCs in China, the Chinese researchers seem to be able to, at least to some extent, convince themselves by promoting it. Indeed, as argued frequently in the literature, the agency model can contribute to diversify the ownership structure of the POE-PCs, strengthen and protect the shareholders and separate the ownership from control.

3.2 The mismatch between the agency model and the POE-PC context

25 Supra note 21 at 20.
In light of the agency model and its feasibilities in the Chinese context, there remain concerns with whether this model can really help the POE-PCs to revive. It is presumed for the agency model that shareholders be “dispersed” and each does not own a controlling amount of shares in the corporation. This is designed to prevent the appearance of majority shareholders from both suppressing the minority shareholders and from intervening into the day-to-day management of the corporations. To this end, there should be considerable amount of shares available during and after the initial public offering (IPO) of the POE-PCs, and there should also be relatively large amount of investors available in the stock market. A robust stock market is hence a necessity for the agency model.

In addition, the agency model also risks the managerial expropriation in the case that the corporation is owned by dispersed shareholders. As argued by Berle and Means, “a large body of security holders has been created who exercise virtually no control over the wealth which they or their predecessors in interest have contributed to the enterprise.”26 That is to say that, by the introduction of the agency model, the corporation may fall into the conventional dilemma, for which the rights the shareholders might, undesirably though, be weaken.

26 Supra note 9 at 6.
In line with the challenges arisen from the agency model per se, the uniqueness of the Chinese context should also be considered. The most significant obstacle should be the family governance. Similar to private enterprises that manage to go public in other countries, the influence of the founders in the POE-PCs is quite prevailing. But for the majority of Chinese privately-owned enterprises, there has long been a tendency that the family members of the founders would like to be in controlling positions of the enterprises. Once the tendency proceeds after being public, the connection between the family members as well as the controlling power of them could become big obstacles for the application of the model, for it requires the separation of ownership from control and the protection of shareholders.

Another obstacle that may also obstruct the application of the agency model comes from the underdevelopment of the Chinese market. It has frequently been argued that a robust security market is essential to the modern corporations. According to Fox and Heller, “for a firm to raise capital by selling equity at a price worthwhile to its owners, a firm needs credibly to promise to abide by both principles of good corporate governance – striving to maximize its future residuals and guaranteeing shareholders some determinable proportion of these residuals as dividends or other distributions.”27 The

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function of the capital market therefore can be seen as a checkbox for the corporation, with which, one may be able to identify how well the corporation is. There are other roles that the capital market could play in revealing the condition of the corporation such as through the stock prices and their fluctuation, through the takeover bids and through availability of raising new capitals. The mismatch between the Chinese stock market and the applicability of the agency model thus can be reversely identified.

The third unfitness for the agency model rests upon the cultural heritage. Max Weber has once proposed “a ‘rational legal system’ as a precondition of the emergence of capitalism.” Apart from the rational legal system, he insisted that the development of western countries owe a debt to the so-called protestant history, which has endowed the western world with a spirit to develop freely and chase wealth on their own. Evolved from this “protestant” cultural heritage, the agency model seems to be presumed an individualism tendency. As a result, the disparity between the shareholders and the management is confined to the economic regime only. In contrast to the western “protestant” cultural heritage as well as its implication in the corporate world, the convention in China is embedded with Confucian views and emperor histories. In other words, there is historical tendency to worship those who are in power. As of those

\[\text{28} \quad \text{See Max Weber, } \textit{The Protestant Ethic and the Spirit of Capitalism} \text{ (London: George Allen & Unwin, 1948) at 21-22.}\]

\[\text{29} \quad \text{Supra note 2 at 18-19.}\]
in controls in the corporations, in particular in the POE-PCs, they are more prone to be satisfied psychologically and conceptually as someone in power than their western counterparts. Likewise, the shareholders and employees of the POE-PCs tend to be prepared for such a conception. This cultural heritage may be translated into a support for the existing governance structure and comprises to an obstacle for the agency model.

Admittedly, there are other potential or existing obstacles in addition to those mentioned above including the regulations on corporate governance and managerial traditions. The mismatch between the agency model and the Chinese context seem to be multi-dimensional and sometimes inevitable. Nevertheless, as the research question raised at the beginning of this thesis, is there any possibilities for us to trace some theoretical reasons to further discuss the agency model under the Chinese context?

3.3 The breakdown of the corporate governance model

The potential challenges and obstacles to the application of the agency model in the context of POE-PCs, especially with respect to the dispersed ownership structure, a robust capital market and a cultural heritage of professional management, seem to raise concerns for the Chinese researchers. While bolstering the agency model against the family governance in the POE-PCs, these concerns should not be ignored. In this sense, the mere shift in corporate governance model, as contended by the Chinese scholars,
from the family governance to the agency model would not suffice. It would not be adequate and justifiable to simply transplant the Anglo-American model to the POE-PCs, and hope they will be prosperous in the future. In other words, there is a breakdown between the corporate governance models that may impede the development of the POE-PCs.
4. Theoretical analyses on the breakdown of the corporate governance model

In Section 3, the thesis has identified four potential mismatches between the agency model and the POE-PCs in China, ranging from the dispersed ownership implication, the uniqueness of the family governance, the underdevelopment of Chinese security market to the Chinese cultural heritage. These mismatches may yield to practical difficulties for successfully applying or transplanting the agency model, constituting a breakdown in corporate governance models.

Remember that challenges of applying the western corporate governance model have been made by some Chinese scholars (Wei, 2003; Leng, 2005). Similarly, one may also wonder whether the transplantation of the agency model would be problematic, in particular, given the distinctive characteristics of the POE-PCs in China. Despite certain plausibilities addressed in last section and welcomes from some Chinese scholars, one may reasonably question which shall be the optimal model for the Chinese corporations?

4.1 Choosing between the corporate governance models

4.1.1 The strengths of the agency model

Following with earlier arguments, the establishment of “modern enterprise system” is a must in China. Also, it is necessary to reform, “modernize” and “corporatize” the POE-PCs due to the limits and weaknesses of this type of enterprises. When it comes to
the selection of appropriate models, the limitations as well as practical obstacles of the agency model seem to hinder people’s steps. Should the Chinese authorities abandon this agency model and hence seek other alternatives, or should they remain the model yet make necessary changes accordingly? The answer shall be the latter.

In the first place, according to the analyses in Section 1, it is obvious that the agency model contains strengths – the disparity between shareholders and the management, the fiduciary duties of the management and other characteristics and implications that come along. The disparity between shareholders and the management allows a relatively new conception towards shareholders: instead of viewing them, in particular the minority shareholders in the POE-PCs who are introduced post IPO, the disparity conception views shareholders “collectively” as the “owners” of the corporation. Such a transformation in vision can be a sound ground for the protection of shareholders. In addition, this conception would remind the controlling group of the POE-PCs, normally the founders and their relatives, that the corporation is no longer their private property and should stand on its own right. Such a reminder would then correlate with the fiduciary duties in terms that the management is employed by the corporation, and should be responsible for the corporation. These are all the advantages of the agency model that would help to reshape the corporate governance structure of the POE-PCs.
For these sakes, the agency model should not be abandoned completely and replaced by other alternatives.

4.1.2 To challenge the challenges

An immediate challenge would then be how to properly position the management of the POE-PCs under the agency model, since the management is both the owner of the corporation and the employees that owe fiduciary duties to the corporation at the same time. The introduction of professional managers can be one solution, as illustrated by various Chinese researchers in their studies.

4.1.2.1 The convergence of the agency model and monitoring concern of the POE-PCs

Another solution would come from the modification of the agency model in the application, namely using monitoring power to control the management. The concern of having the controlling group as both owners and agent lies in the potential expropriation of the corporation by them. In other words, those in control of the POE-PCs may behave opportunistically in the name of bad investment, poor long-term strategies or general

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business risks. Prior to the IPO, the ownership of the enterprises used to function as incentives for the controlling group to industrially develop and strengthen their company, as suggested by Berle and Means. They have argued that “…self-interest has long been regarded as the best guarantee of economic efficiency. It has been assumed that, if the individual is protected in the right both to use his own property as he sees fit and to receive the full fruits of its use, his desire for personal gain, for profits, can be relied upon as an effective incentive to his efficient use of any industrial property he may possess.” See supra note 9 at 9. Nevertheless, after the IPO, the ownership structure has been diversified and even diluted by other shareholders (the outside shareholders), the ownership could not maintain its function. Instead, the family governance would in turn result in the expropriation of minority shareholders or risky investment while abusing the legal personality of the corporation as merely a shield for their limited liabilities. In other words, they are abusing the outside shareholders with their investments.

Likewise, as argued by Berle and Means and other corporate governance scholars, the separation of ownership from control as well as the agency theory also runs a risk of expropriation. To clarify, the management may abuse the shareholders with similar excuses like bad investments or business risks. Therefore, regardless of the governing group of the POE-PCs or the agency model, the problems seem to converge in terms of the possibility of expropriating those that are not in control.
4.1.2.2 Empirical responses from the US and China

A natural response to prevent the expropriation would hence be to monitor those in control. In the context of the Anglo-American agency model, there are traditionally boards of directors that perform the monitoring function. However, the staggered boards in the US as well as a strong connection between the board members and the managers seem to weaken their effects. An alternative in China is a design of the two-tier board system. Apart from the managerial board, which is in charge of the day-to-day management of the corporation, the Company law of the People’s Republic of China (hereinafter: the Chinese company law) requires a supervisory board to function as the monitors. Unfortunately, due to the underperformance and ineffectiveness of the Chinese supervisory boards, they are unlikely to fulfill their duties and to successfully control or monitor the managers. It would be worth mentioning an attempt of introducing the independent directors to the boards by Chinese authorities. Although this attempt has been coded in Chinese Company Law 2005, its outcome is still quite uncertain.

4.1.2.3 The internal versus external debate

Theoretically speaking, the approaches to monitor those in power can be categorized

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32 See Company Law of the People’s Republic of China, P.R.C. 2005, c. 2, s. 52-55, c. 3, s. 71, c. 4, s. 82, 84, 91, 97 & 101, online: <http://www.saic.gov.cn/wzj/zcfg/fl/200610/t20061026_51872.html>

33 Ibid. c. 5, s. 123.
into two sources – the internal source and the external source. The internal approach of monitoring intends to set certain standards or disciplines for those in control, and to let them consciously and voluntarily follow rather than exceed the standards of disciplines. This approach can be translated into the corporate governance regulations, rules, best practices and other similar standards. In contrast to the internal approach, the external approach aims at controlling or monitoring those in control with specialized entities, such as certain departments of the Securities and Exchange Commission (the SEC) in the US and China Securities Regulatory Commission. By having these entities to supervise or monitor those in control, their behaviors can be advised, directed and restricted. The external approach hence functions through outside corporate-related commissions or investigating authorities.

It is debating to have a separate body to reshape, control and monitor the existing corporate governance structure, however. It would be desirable, on the one hand, since the corporate governance is a complex subject, which often involves the relationship between the corporation and the capital market, the disparity between the shareholders and the management and even the intervention of the government. For instance, under the agency model, the management needs to pay attention to the stock prices of the corporations in the securities market, especially if their compensation is tied up with the stock options. The alliance of the corporate securities and executive compensation may
lead to scandals like the manipulation of the stock prices, which might be seen from Enron and WorldCom. Meanwhile, this scheme can induce the executives to pursue better performances of the corporation. Therefore, it seems to be reasonable to introduce an independent entity in order to transcend these internal conflicts of interests.

At the same time, the involvement of a separate entity to control or monitor the management of the corporation might lack efficiency and effectiveness. As mentioned before, “…self-interest...been regarded as the best guarantee of economic efficiency.” Likewise, the control or monitoring of the management would be problematic for the same reason. After all, such kind of control or monitoring is external, which shall be considered as preventive rather than inductive. In other words, the non-self-incentivized management can follow this suit and consequently be directed or disciplined; however, they might be non-cooperative, or at least involuntary, resulting in inefficiency in their performances and impairing the entire corporation. A related concern would arise from the ex ante effect of the regulations. To establish such an entity to supervise or monitor the management is correlated with the supply of respective regulations or laws, which is ex ante. Although the ex ante effect of external supervision might be justified from its deterrence, it is none the less costly and inefficient.

34 Supra note 9 at 9.
It is true that transaction cost is hardly to neglect, and every movement contains cost and benefit. It is hardly to deny that, in any case, either to employ internal approach to control those in control or to employ it externally, any resolution involves advantages and disadvantages. Nevertheless, whatever these advantages or disadvantages are, our discussion would only be meaningful when falling down to the context of the POE-PCs in China. It would be important to recall the memory of rise of the POE-PCs, which embraces merely a history of less than thirty years. Compared with their counterparts in the US or the UK, the POE-PCs remain junior and need long-term development. The external approach and its separate supervisory entity, hence, would not be the optimal choice for the POE-PCs.

4.1.2.4 The concern from legal transplantation

Studies on legal transplant have generated fruitful and thoughtful accounts for the studies of laws, which have also had an echo in the law and finance literature. It would not be difficult to conceive that the corporate reform in China and the need of western experiences would equally fall into this regime. There seem to be few concerns with legal transplantation per se, as opposed to with its applicability, feasibility and viability and so on. In other words, the Anglo-American corporate governance model, the agency model, when considering from the perspective of legal transplantation, seem to shed more light on the “transplantable” issue and the “transferrable” issue. Historical
experiences on legal transplantation, in this sense, may become a challenge for the “transferee” countries. That is to say, a country should be informed that the agency model, despite its success in the US and the UK, is open to doubt for the Chinese context, and may be subject to changes. Such a conception though may somehow be pessimistic for transitional countries like China when they turn to look for “advanced” experiences, is, paradoxically, able to justify the agency model. It is due to the concern of legal transplantation that one can explain the mismatches between the agency model and Chinese context. As a result, one should not focus only on the limitations and weaknesses of this model; instead, one should try to find the matches between them in order to apply it in the legal reform.

4.1.2.5 Lessons from Russia

Being one of the transitional economies, the Russian story has long been the center of academic discussions. Almost every study on corporate governance of the transitional economies would leave space for this country. The reason is that it has experienced massive transitions from the planned economy to the market one, and the governance of its corporations is far more severe than one could expect. As Fox and Heller have stated, “if they [the stock price] could sink any further, shares would literally have a value of zero. As it is, the entire market is made up of penny stocks.” Such a bad reflection of

35 Supra note 27 at 18.
the stock prices is not because the corporations are bad in their performance; rather, it could all be attributed to their bad corporate governance. Indeed, a variety of factors would be accountable for the poor corporate governance in Russia. Yet, among all the reasons, the most significant might be the ignorance or little attention paid to the difference between the western origins of the models and their application context in Russia. It has been argued that “in the absence of institutional constraints on insider opportunism, what has been induced is wealth destruction. Given the poor corporate governance of Russian privatized firms, it is not surprising that short-term activities and asset stripping have become common practices for managers.”36 According to her arguments, although there are mismatches between the western models and its Russian environment, the key reason that has resulted in the failure of privatization and corporatization in Russia lies in the lack of local adaptation. It is just the mismatches between the two that has triggered the collapse of scheme. With this regard, when we turn to those Chinese scholars who seem to show little interests in the differences between the agency model and the Chinese context, it is worth noting that both the mismatches and the local modification accordingly.

4.2 From the perspective of path-dependency theory

36 Supra note 2 at 8.
The perspective of path-dependency theory, though it varies according to the contexts, provides an important account for our discussions here. As already stated, there are characteristics embedded in the agency model that could be beneficial to the Chinese corporations as well. Equally valuable to the Chinese context are demonstrated by those challenges mentioned above. However, there seems to still be one dimension that, the path-dependency dimension, would contribute to our thinking.

Our concerns of the path-dependency perspective to whether adopt the agency model arise from the institutional, regulatory, world customs and other designs alike. After more than two decades of open and reform, China has established two capital markets (one in Shanghai and the other in Shenzhen), a variety of institutions and a relatively complete system of laws and regulations. Although it would be excessive to assert that the entire system is “copying” or “mirroring” the Anglo-American corporate system, there are similarities between them, which could be a common ground for the agency model. Studies on the US corporate governance in China have also shown a tendency that the American corporate governance, the agency model in particular, is quite familiar to the Chinese scholars. Therefore, not only the corporate practitioners but also the academies have been putting a lot of efforts to this model.
In addition, consider the sunk cost of this model. An argument that would support to follow the suit of the agency model may rest upon the sunk cost that China has already spent on. The lack of experience in building markets and corporations implies that China needs to be invoked by certain models. Even though it would be equally possible for China to establish the entire system on her own, it is more quickly and convenient for this country to western models to follow. In the meantime, models like the agency model which seem to share little in common for the POE-PCs, in terms of dispersed ownership, managerial tradition and the disparity between the shareholders and the management, could supply the most to this country. Particularly, having seen the tendency and practices of following the agency model, there could be enormous sunk cost coming out of the institutional design, the regulatory modes, the capital market devise and even officials and employees that are familiar to this model, if China gave it up.

It is true that the agency model is not perfect and contains a number of insufficiencies and mismatches when applied to the Chinese context. However, it would also become highly path dependent after its application. The path-dependency theory as well as the sunk cost of the application, though sometimes undesirable, may turn into a persuasive argument for a society to continue this model.

4.3 Summary
Although there are obvious mismatches between the agency model and the Chinese context in terms of the underdevelopment of the market and cultural heritage, the breakdown in corporate governance theory is not detrimental. This is not to deny those mismatches or obstacles; rather, compared with the aforementioned fundamental problems of controlling those in control, these obstacles can be overcome in certain ways. Namely, as argued before, there are advantages and plausibility for the agency model, if it could transcend the limitations in controlling the governing group in the POE-PCs. In this sense, the introduction of the agency model to the POE-PCs can be justified, which correctly corresponds to the problems lying in the control of those in control, just as some Chinese researchers have pointed out.
5. **The proposed changes to the agency model for the governance of the POE-PCs**

The agency model implies both a disparity between the shareholders and the management and a separation of ownership from control in theory. Based on the previous analyses, this model does not necessarily match the requirements of the POE-PCs in terms of controlling the management because of the family governance in the POE-PCs, the underdevelopment of the Chinese markets and respective cultural heritage. Nevertheless, this model manages to converge and even be compatible with the POE-PCs with respect to the monitoring desire, path-dependency perspective and so on. The contrast between the assumptions and implications of the agency model and its possibilities of application in the Chinese context seems to indicate some compatibilities of this model. In other words, there are possibilities for the Anglo-American corporate governance model to be applied to the Chinese corporations. Those Chinese researchers seem to be right in the sense that the POE-PCs could shift their governance models to the western one, if only it can be modified in line with the Chinese circumstances, namely, to add changes to the agency model. In this section, the thesis will address the modification of the agency model, with respect to the dispersed ownership, the family governance, the underdevelopment of the Chinese market and its cultural heritage.

First, consider the dispersion of ownership. The greatest challenge of applying the agency model evolves from the dispersed ownership structure prevailing in corporations...
in the US and the UK. It is presumed that shareholders are scattered, numerous and non-influential, for each shareholder possesses only a small proportion of shares, and is out of control of the corporation.

Whereas the Anglo-American corporations involve large number of “small” shareholders, the POE-PCs in China are not the same. Instead, there are controlling shareholders who used to be the founders or founders’ relatives and non-controlling shareholders who are outside shareholders and have joined the corporation since the IPO. An empirical study conducted in suggested that the shareholding of one Chinese POE-PC have centered almost exclusively on the founders and their family members, with 67.19% ownership of the corporation. Instead of being controlled and expropriated by the management, the outside shareholders of the POE-PCs have been controlled and expropriated by the controlling shareholders within the shareholder collective.

However, as analyzed in Section 2 and 3, the controlling shareholders in the POE-PCs happen to be the management at the same time, which seems to indicate that the technique used for control the management in dispersed corporations should be used for

37 See Kang Li, Xingjun Yang & Jiangyi, “Zhongguo minying shangshi gongsi de gongsi zhili moshi falv zhengce yanjiu” (Research on laws and policies of the corporate governance models of POE-PCs in China) (2008) <http://www.360doc.com/content/081217/14/85140_2143693.html> [translated by author].
the controlling shareholders as well. The control or monitoring the management, according to the analyses in Section 3, would emerge internally rather than externally from boards of directors (one-tier boards), independent directors, various committees and even the supervisory boards. Techniques used to control the majority shareholders, none the less, are fewer and uncommon (e.g. the Tag-Along rights, a minority shareholder protection measure, enabling the minority shareholders to participate in the transaction if the majority shareholder would like sell their shares).

Therefore, it would be interesting to envision how these techniques could be used in the POE-PCs without compromising. In general, corporations could align the interests of the management with their stock options in order to induce the management to pay more attention to the performance of the corporations in the stock market and their long-term development. Unfortunately, the controlling group of the POE-PCs happens to be the shareholders in the corporations as well, which makes it difficult to adopt the same strategy. Some Chinese scholars have suggested that “separation of ownership from control” can be a therapy to the majority control (since they are the management as well).  

\[38\] However, it would be unlikely for those in control to give up their power or to

38 See e.g. supra note 19; 24 at 65; Xiaolei Wu, “Woguo jiazu shangshil gongsi zhili de zhuyao wenti” (Major problems with the corporate governance of Chinese family controlled public corporation), (2008) 136 China Opening Herald 102 at 102[translated by author].
forego their fortunes, for they used to be the entrepreneurs or have strong ties of governing the corporations.

Second, the mismatch that followed closely with the dispersion of ownership is the family governance. The family governance concerns the founders (entrepreneurs), their relatives or even their friends to be involved in the management of the corporations. It is often the case that those relatives or friends of the entrepreneurs do not possess the necessary knowledge, skills or intelligence to direct the corporations. Also, the management tends to be authoritative when it comes to the decision-making of the corporations. Simply put, the entire governance of the corporation is a reflection of that of a large family in ancient China.

In contrast to the assumption of the agency model, the family governance does not differentiate the management from the shareholders as a relationship between the principals and agent, which, in essence, is a relationship of purely employment. The family ties existing among those managers have complicated their relationships: potential mechanisms that can be used by the board of director, the independent director or the supervisory board to control the managers may yield to kinship or friendship. That may cause undisciplined, ineffective control of the management. To the extreme, outside investors could be frustrated by the corporation, leaving it fail in the end.
The advantage of the agency model reveals partly as the disparity between the shareholders and the management, which has grounded fiduciary duties and other disciplines for the management. Such an advantage is valuable for the POE-PCs. In other words, the second proposal for modifying the agency model should be how to reconcile this advantage with the family governance.

The disparity required by the model does not exist in the POE-PCs, which can be beneficial. In this sense, there should not be any intention to modify the agency model; rather, the management itself shall be adapted to changes. The changes may come from introducing professional managers externally, as contended by a number of Chinese researchers. Or it can come from disciplining and controlling the relatives or friends directly and without exceptions. The core problem with the family governance lies in blurring kinship and friendship with economic relationship. Although this thesis is not denying the existence and importance of those relationships, they have to be confined within certain boundaries.

Third, the underdevelopment of the Chinese markets makes it uneasy to examine the outcomes of agency model. It is assumed that the consequence of corporate governance can be illustrated by the capital markets, as discussed in the last two sections. This
consequence is normally demonstrated by the share prices in the stock market and the availability to raise new capitals. As a result, on the one hand, shareholders would be able to be aware of how the corporations are going on in order to decide their investments; on the other, the corporations could benefit from external finance and be allowed to make short-term, mid-term and long-term strategies. Such a relationship between the capital market and the corporate governance is established through the agency model, and becomes a way to examine and evaluate the entire corporations. The importance of the capital markets is hence obvious.

From our earlier analyses, it is a fact that the stock markets in China are relatively new and underdeveloped. Besides, studies on the correlation of the corporate governance with respective performance in the stock markets in China are quite unclear. Investors, in particular the retail investors, seem to be irrational. The inadequate reflection, or to some extent inability of reflection, has also led to lack of confidence in the markets.

With these regards, the intention to apply the agency model to the POE-PCs can be fairly difficult. As a proposal to change the situation, the thesis is then considered to reform the stock market and restore the market confidence. The reform can be conducted from mandatory disclosure on material information, imposing heavy penalty to corporations that disclose false or misleading information and so on. Due to the interest of the thesis,
it would not address more problems with the capital markets here; yet, it have to be mentioned that, in order to launch a good corporate governance in the POE-PCs, a robust capital market is among the most essentials.

Fourth, consider the mismatch from the perspective of cultural heritage. Cultures are engrained in people’s minds and lives. Cultures are influential. One may behave unconsciously to follow certain rules underlying in his/her culture. A culture may function in favor of or in opposition to a foreign trend, which is known as the influence of the culture.

Compared in Section 3, the protestant history and an individualist inclination have partly been the attributes of the rise of corporations in the US and the UK. Likewise, the Confucius theory, the emperor history and an ordered tradition have been accountable for the evolvement of ancient China. Although China has been abandoned the royal families for almost a century, the tendency of abeyance in terms of the order, the social structure and political arrangement is deeply embedded in its culture. Such a cultural heritage, as shown in Section 3, can be an explanation for the existence of the family governance in the POE-PCs, and could remain its influences in the future.
The contrast between the Individualism and the Confucius and that between the agency model and the family governance give rise to the mismatch of the model. One could, for that reason, easily infer that the proposed change shall come from the change of Chinese culture. Obviously, such a change is not easy. Also, one may wonder whether it is necessary, since it has shifted the focus from the dimension of economies to culture, and there seem to be no guarantees for the success of the agency model.

Therefore, it would be reasonable to seek to change the sub-culture in the POE-PCs per se, without further referring to the culture of the society. In this course, it would be desirable to find out that the employees are incentivized and energized by the conception of individualism. As a result, they can contribute more to the corporations in terms of inventions, improvements in methods and so on.
Conclusion

Corporations in the US and the UK have been developing for more than a hundred years, and have evolved a unique model for their corporate governance, the agency model. Although this agency model is not a conventional description in conform to the corporate governance history, and is used intentionally in this thesis to refer to two distinctive corporate governance theories of Anglo-American corporations, it is justifiable to link them together under the same heading.

In this thesis, the agency model embraces both the agency theory and the separation of ownership from control thesis. As analyzed in Section 1, the agency theory differentiates the shareholders from the management, regarding the shareholders as the principals of the corporation and the management as the agent of it. Similarly, the separation of ownership from control thesis is addressing the relationship between the shareholders and the management as well, and has further explored the disparity through discussions on which takes the real control. Though on different levels, both theories seek to, and to some extent successfully, uncover and solve the basic problem of corporate governance, and should be regarded as a whole.

The success of the agency model in corporate governance and related corporations have gone beyond the boundaries of countries, shedding a lot of light on countries around the
world. Since the transition of the former planned economies to the market-oriented ones, the agency model has turned out to be a model that could help to “modernize” and “corporatize” their enterprises. Being one of those transitional economies, China has been experiencing more two decades of open and reform. Its desire to build a “modern enterprise system” has become particularly urgent and deserving. In this course, the POE-PCs, enterprises transformed from “mingying qiye” to public corporations, have managed to take an important part in the economy.

Although the development of the POE-PCs is significant and promising, this type of enterprises is not out of concern. Rather, there are a number of concerns with the POE-PCs. As argued by some Chinese corporate law scholars, the family governance, kinship problems and authoritative governance are the most significant ones. Therefore, there has arisen a tendency to “learn” from the agency model in order to reform, reconstruct and reshape the governance structure in the POE-PCs. However, the intention of modernizing and corporatizing the POE-PCs with the agency model is confronted to challenges, and can be problematic.

Inspired by the agency model and the Chinese demand for economic development and prosperity, the thesis has focused on the same issue. The initial proposition of the thesis is that whether there is any correlation between the insufficiency of the agency model in
explaining and influencing the Chinese corporate governance and the ineffectiveness of control the management in Chinese public companies, which have been transformed from privately-owned enterprises? In other words, if we could link the agency model, the problems with the POE-PCs and potential challenges confronted by the Chinese researchers, whether there would be a possibility for one to uncover certain mismatches among them.

Followed with the intention, the thesis has examined the potential mismatches between the agency model and the corporate governance in the POE-PCs. It has been presumed that the assumptions and the implication of the agency model as well as the Chinese features may be the causes of the mismatches. As of the assumptions and implications, they can be the dispersed ownership assumption, the robust capital market assumption, the managerial tradition of modern corporations; whereas for the Chinese features, the causes might be the family governance, the underdevelopment of the Chinese market and its Confucian cultural heritage. The combination of these causes has led to a breakdown in corporate governance theory.

The exploration and examination of those reasons, which would attribute to the breakdown of corporate governance theory, and consequently worsen the problems with the governance of the POE-PCs, in Section 3 are important. The thesis is then able to
tentatively propose changes to the agency model, making it more suitable for the POE-PCs and for the corporate reform in China.
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