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## INSTITUTIONAL INVESTORS IN CHINA: PROBLEMS AND PROSPECTS

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*Institutional investors play a crucial role in promoting good corporate governance and the efficient allocation of capital. As such, regulators have urged institutional investors to act as responsible stewards by actively engaging with their investee corporations in order to deliver long-term value to their ultimate beneficiaries and to promote the long-term success of corporations. While there is significant literature on US and UK institutional investors, far less has been written about institutional investors in China.*

*This paper corrects this deficiency by exploring the critical question of whether, and if so, why, institutional investors in listed corporations in China are generally passive. I distinguish three categories of corporations—state-owned enterprises (SOEs), private-owned enterprises (POEs), and strategic investor enterprises. And I distinguish two main types of investors—state-backed institutional investors (SII) and privately-backed institutional investors (PII).*

*I make three key arguments. First, in SOEs where the state is the controlling shareholder, minority SIIs and minority PIIs are generally passive. This is because minority SIIs are subject to regulatory requirements, face inadequate incentives, and encounter conflicts of interest. As for minority PIIs, they may be subject to influence or pressure from the state, may face state retaliation for their activism, and may rely on an investor protection agency. Second, in a POE where a private investor is in the majority, while some minority SIIs that are set up to advance the state's interest are activist in nature, others are passive. Furthermore, most of the domestic minority PIIs are not active. As for the large foreign minority PIIs, there is inconclusive evidence that they improve monitoring and firm performance. Finally, in a strategic investor enterprise where there are majority strategic PIIs, they may face obstacles when pursuing an activist approach. This is because the*

*management of the company may be controlled or influenced by the state, and minority investors can rely on an investor protection agency to challenge or constrain the actions of the majority strategic PII.*

*To conclude, it suggests three principal mechanisms to increase engagement by minority SIIs, minority PIIs, and the majority strategic PII. The first is to reduce the influence of the state in SOEs. The second is to increase the incentives for the professional managers of passive minority SIIs to engage. Finally, the conflicts of interest surrounding the investor protection agency should be addressed.*

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## I. INTRODUCTION

Institutional investors play a crucial role in promoting good corporate governance and the efficient allocation of

capital.<sup>1</sup> Conversely, passive institutional investors have been blamed for the global financial crisis of 2008 and other corporate ailments.<sup>2</sup> Therefore, policymakers and scholars have urged institutional investors to act as responsible stewards by actively engaging with their investee corporations in order to deliver long-term value to their ultimate beneficiaries and to promote the long-term success of corporations.<sup>3</sup> Accordingly, there is significant literature<sup>4</sup> on whether, why and which types of US and UK institutional investors are generally passive (or active) and what measures should be taken to incentivize stewardship (or to address value-decreasing activism).

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\*National University of Singapore. I would like to thank Ernest Lim, Eilis Ferran, Lin Lin, Dan Puchniak and the *CBLR* editors. All errors remain my own.

<sup>1</sup> See, e.g., Amil Dasgupta, Vyacheslav Fos & Zacharias Sautner, *Institutional Investors and Corporate Governance* (European Corporate Governance Institute, Finance Working Paper 700/2020), [https://ecgi.global/sites/default/files/working\\_papers/documents/dasguptafo\\_ssautnerfinal.pdf](https://ecgi.global/sites/default/files/working_papers/documents/dasguptafo_ssautnerfinal.pdf) [<https://perma.cc/CJZ2-JN94>]; Serdar Çelik & Mats Isaksson, *Institutional Investors and Ownership Engagement*, 2013/2 OECD J.: FIN. MKT. TRENDS 93 (2014); OECD, *OECD INSTITUTIONAL INVESTORS STATISTICS 2020* (2020).

<sup>2</sup> See, e.g., Eur. Comm'n, *Green Paper – Corporate Governance in Financial Institutions and Remuneration Policies* at 8, COM (2010) 285 final (June 6, 2010); Eur. Comm'n, *Green Paper – the EU Corporate Governance Framework* at 11, COM (2011) 164 final (Apr. 5, 2011).

<sup>3</sup> For a comprehensive analysis of shareholder stewardship, see *GLOBAL SHAREHOLDER STEWARDSHIP* (Dionysia Katelouzou & Dan W. Puchniak eds., 2022).

<sup>4</sup> See, e.g., Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019); Dorothy Shapiro Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2018); John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harv. Pub. L., Working Paper No. 19–07, 2019); Jill E. Fisch, Asaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17 (2019); *INSTITUTIONAL INVESTOR ACTIVISM: HEDGE FUNDS AND PRIVATE EQUITY, ECONOMICS AND REGULATION* (William W. Bratton & Joseph A. McCahery eds., 2015).

However, there is little legal and policy analysis of institutional investors in China,<sup>5</sup> *despite the fact that* China's stock exchanges are among the world's top seven largest by market capitalization,<sup>6</sup> and even though the China Securities Regulatory Commission (CSRC) regarded the continuous promotion of the development of institutional investors as a key strategy for the development of China's capital markets from 2008–2020.<sup>7</sup> Moreover, China's asset management industry has been estimated to be worth at least US\$16 trillion,<sup>8</sup> and institutional shareholder ownership has increased from 1.4% in 2003 to 18.8% in 2018.<sup>9</sup> The portion of publicly-traded shares held by institutional investors has risen from 4.6% in 2003 to 47.5% in 2018.<sup>10</sup> Much more has been written about state-owned enterprises (SOEs) and their controlling shareholder (the state)—or, more precisely, about

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<sup>5</sup> *But see* Lin Lin & Dan W. Puchniak, *Institutional Investors in China: Corporate Governance and Policy Channeling in the Market Within the State*, 35 COLUM. J. ASIAN L. 74 (2022); Chao Xi, *Institutional Shareholder Activism in China: Law and Practice (Part 1)*, 17 INT'L CO. & COMMERCIAL L. REV. 251 (2006); Chao Xi, *Institutional Shareholder Activism in China: Law and Practice (Part 2)*, 17 INT'L CO. & COMMERCIAL L. REV. 287 (2006).

<sup>6</sup> Kanan Arora, *10 Largest Stock Exchanges in the World*, ANALYTIC STEPS (Apr. 23, 2021), <https://www.analyticssteps.com/blogs/10-largest-stock-exchanges-world> [<https://perma.cc/8342-XN4S>]; Ben Winck, *Here Are the 10 Biggest Stock Exchanges in the World, Ranked by Market Cap*, BUS. INSIDER (June 19, 2020), <https://markets.businessinsider.com/news/stocks/biggest-stock-exchanges-world-ranked-market-cap-nyse-nasdaq-trading-2020-6> [<https://perma.cc/NU85-X93V>].

<sup>7</sup> CHINA SEC. REG. COMM'N, CHINA CAPITAL MARKETS DEVELOPMENT REPORT (2008).

<sup>8</sup> WORLD ECONOMIC FORUM, CHINA ASSET MANAGEMENT AT AN INFLECTION POINT 5 (July 2020), [http://www3.weforum.org/docs/WEF\\_IR\\_China\\_Asset\\_Management\\_2020.pdf](http://www3.weforum.org/docs/WEF_IR_China_Asset_Management_2020.pdf) [<https://perma.cc/4NRM-C6Y9>].

<sup>9</sup> Zhongjin Gongsi: A Gu “Sanhuhua” Yijing Mingxian Xiajiang (中金公司：A股“散户化”已经明显下降) [CICC: *Retail Investors in the A-share market Have Declined Significantly*], ZHONGJIN GONGSI YANJIUBU (中金公司研究部) [CICC RESEARCH DEPARTMENT] (July 2, 2019), <https://m.21jingji.com/article/20190702/herald/b39f0f661609f2353cdfafbb8d88b974.html> [<https://perma.cc/K4KD-ZRC3>].

<sup>10</sup> *Id.*

the Chinese Communist Party (CCP) and its organs.<sup>11</sup> This is understandable in light of the critical importance of the controlling shareholder, especially the CCP, and the associated problems of corruption and expropriation in SOEs.<sup>12</sup>

However, there has been little critical analysis of whether institutional investors in SOEs are active or passive, particularly in China, the world's second largest (and projected to be the largest) economy,<sup>13</sup> where the state's influence is ubiquitous. Although the analysis here is confined to China, I suggest that it is relevant to the study of minority institutional investors in other concentrated ownership jurisdictions with SOEs.<sup>14</sup> In addition to SOEs, another related issue is whether minority investors in non-SOEs in China, known as private-owned enterprises (POEs), are active or passive. Finally, this article also investigates the role of

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<sup>11</sup> See, e.g., Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 GEO. L. J. 665 (2015); Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013); Nicholas C. Howson, *Protecting the State from Itself? Regulatory Interventions in Corporate Governance and the Financing of China's 'State Capitalism'*, in REGULATING THE INVISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM (Benjamin L. Liebman & Curtis J. Milhaupt eds., 2015).

<sup>12</sup> See, e.g., OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2015 ed. 2015), <http://dx.doi.org/10.1787/9789264244160-en>.

<sup>13</sup> Jin Wu & Tom Hancock, *China's Covid Rebound Edges it Closer to Overtaking U.S. Economy*, BLOOMBERG (Mar. 30, 2021), <https://www.bloomberg.com/graphics/2021-china-accelerated-growth/> [<https://perma.cc/9JCT-LAUD>]; Evelyn Cheng & Yen Nee Lee, *New Chart Shows China Could Overtake the U.S. as the World's Largest Economy Earlier Than Expected*, CNBC (Jan. 31, 2021), <https://www.cnbc.com/2021/02/01/new-chart-shows-china-gdp-could-overtake-us-sooner-as-covid-took-its-toll.html> [<https://perma.cc/9G89-8QXG>].

<sup>14</sup> These jurisdictions include some of the world's top twenty largest economies: India, Brazil, Russia, Indonesia and Saudi Arabia. See OECD, OWNERS OF THE WORLD'S LISTED COMPANIES 27 (2019), <https://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm> [<https://perma.cc/D4A7-B3KD>].

institutional investors in a third type of corporation in China, namely, the strategic investor enterprise.

This article thus shines a spotlight on several understudied aspects of comparative corporate governance scholarship by critically examining whether and why institutional investors in listed corporations in China are generally passive or active. It distinguishes between three main types of corporations—SOEs, POEs, and strategic investor enterprises—and two main types of institutional investors—state-backed institutional investors (SIIs) and privately-backed institutional investors (PIIs).<sup>15</sup> The category of PII consists of both *minority* (domestic<sup>16</sup> and foreign) investors, and *majority* strategic investors, that is, those who

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<sup>15</sup> A “minority SII” refers to an investor in which the state holds a majority of shares, and the state is able to control the appointment and dismissal of the key directors and managers. But it does not follow that the state always or necessarily exercises its power over the investor. A “minority PII” refers to an investor in which the state does not directly hold shares, nor does the state have the power to appoint and dismiss the board and managers of that investor. That said, the state can be a minority shareholder of a private entity, which in turn can be the controlling shareholder of the minority PII. For example, Tianhong Innovation Assets Management Co., Ltd. is a minority PII. [*National Enterprise Credit System Information for Tianhong Innovation Assets Management Co., Ltd.*, QICHACHA, <https://www.qcc.com/firm/e1d8f4dde60d8112c77e3f66cb776dc0.html>] Its majority shareholder is Ant Group, a non-SOE. [*National Enterprise Credit System Information for Ant Group Co., Ltd.*, QICHACHA, <https://www.qcc.com/firm/ff3aac2898ef5e5f12f3d31032898c7c.html>]. However, some minority investors of Ant Group are SIIs, such as China Life Insurance Company. [*National Enterprise Credit System Information for Zhongguo Life Insurance (Group) Company*, QICHACHA, <https://www.qcc.com/firm/7d2ff2d16325bdc9e1a4e93b6f2f3132.html>]; National Social Security Fund. [*National Enterprise Credit System Information for National Social Security Fund*, QICHACHA, <https://www.qcc.com/firm/g599bafb4da74aa069cc9b67a39992e0.html>].

<sup>16</sup> There are six types of domestic investors: securities investment funds (also known as mutual funds), insurance companies, pension funds, securities institutions (also known as investment banks), trust companies, and private investment funds. None of the above holds more 4% of the total capitalization of the A-share market. A-share, also known as RMB ordinary shares, are shares issued by listed companies in mainland China that are subscribed and traded in RMB. See Lin & Puchniak, *supra* note 5.

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hold majority shares in the listed company for the long term and bring significant resources to boost the company's performance.

This article makes three key arguments. First, in SOEs where the state is the controlling shareholder, minority SIIs and minority PIIs are generally passive. This is because minority SIIs are subject to regulatory restrictions, lack adequate incentives to engage in management, and encounter conflicts of interest. As for minority PIIs, they may be subject to influence or pressure from the state to remain passive, face state retaliation for their activism, and rely on the investor protection agency (the China Securities Investor Services Centre) to protect minority shareholders' interests.

Second, in POEs, some activist minority state-backed institutional investors are state-created institutions which advance the state's interest. The rest of the minority investors are passive. Furthermore, most of the minority domestic PIIs are passive. It is unclear whether minority foreign PIIs improve monitoring and firm performance.

The final argument is that, in strategic investor enterprises, a majority strategic PII may face obstacles when pursuing an activist approach, because the management of the company may still be controlled or influenced by the state, and also because the actions of the majority strategic PII may be constrained or challenged by the China Securities Investor Services Centre.

This article has two lessons for future studies concerning institutional investor activism in concentrated ownership jurisdictions with SOEs beyond the case of China. The first lesson is that one cannot assume that the reasons for minority institutional investor passivity in SOEs are all the same.<sup>17</sup> After all, this paper demonstrates that there are subtle differences in the reasons for passivity, depending on whether

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<sup>17</sup> Wenge Wang, *The Mechanisms of Institutional Activism: Qualified Foreign Institutional Investors in China*, 14 CAP. MKT. L. J. 78, 96 (2019); ERNEST LIM, A CASE FOR SHAREHOLDERS' FIDUCIARY DUTIES IN COMMON LAW ASIA 292 (2019). Cf. Lili Fu et al., *Does Passive Investment Have a Positive Governance Effect? Evidence from Index Funds Ownership and Corporate Innovation*, 75 INT'L REV. ECON. & FIN. 524, 534 (2021).

the minority investors are SIIs or PIIs. The second lesson is that, in investigating whether minority institutional investors are passive or active in concentrated ownership jurisdictions, it is necessary to analyze SOEs, but insufficient; POEs and strategic investor enterprises should also be examined. Within POEs, one must distinguish between minority SIIs and minority PIIs, as well as between each of their different subtypes. After all, different types of investors have different functions and strategies, which in turn affect whether and the extent to which they are active or passive.

The structure of the paper is as follows. Part III, which concerns SOEs, is comprised of three major sections. Section A provides a historical overview of the relationship between the CCP, the SOEs and institutional investors. Section B analyses the role of *minority SIIs* in SOEs. Section C examines the role of *minority PIIs* in SOEs. Part IV concerns POEs. Section IV.A reviews the role of three different types of minority *SIIs*. Section IV.B examines the role of two different types of minority *PIIs*: domestic and foreign. Part V concerns strategic investor enterprises, and is comprised of two sections. Although the strategic PII owns the majority of shares, it may not be incentivized to actively engage and monitor the corporation because the management of the corporation may still be controlled by the state (Section A) and the strategic investor's actions may be constrained by the Securities Investor Services Centre (Section B). In Part VI, I propose three main solutions to address institutional investor passivity: reduce state influence (Section A), increase incentives for professional managers to engage (Section B), and address conflicts of interest in the Securities Investor Services Centre (Section C). Part VII concludes.

## II. INSTITUTIONAL INVESTORS IN CHINA: STATE-OWNED ENTERPRISES (SOES)

In order to understand the nature and role of institutional investors in China, we need to first understand the ubiquitous and critical role played by the state, specifically the CCP, through its different agencies in setting the strategic direction for, and overseeing the management and operations of,

corporations. The state (through its agencies) is the controlling shareholder of the majority of the publicly listed corporations in China,<sup>18</sup> also known as SOEs.<sup>19</sup> Xi Jinping, the Chair of the CCP and President of the People's Republic of China (PRC), said that "party leadership and building the role of the party is the root and soul" of PRC SOEs.<sup>20</sup> Further, he reminded the SOE executives that "their number one role and responsibility is to work for the party."<sup>21</sup> Thus, the directors and senior management of the SOEs are CCP members whose appointment and dismissal are subject to state control.<sup>22</sup>

As a result, because the state effectively calls the shots by being both the controlling shareholder and the regulator of a

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<sup>18</sup> Technically, the CCP has assigned its shares to the State-Owned Asset Supervision and Administration Commission (SASAC), a central state asset management agency established in 2003 to act on behalf of the CCP. Lin & Milhaupt, *supra* note 11, at 700. There are ninety-six corporate groups owned by SASAC. Lauren Yu-Hsin Lin & Curtis J. Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance* 7 (ECGI, Law Working Paper No. 493/2020, 2020).

<sup>19</sup> Curtis J. Milhaupt, *Chinese Corporate Capitalism in Comparative Context*, in *THE BEIJING CONSENSUS?: HOW CHINA HAS CHANGED WESTERN IDEAS OF LAW AND ECONOMIC DEVELOPMENT* 275 (Weitseng Chen ed., 2017).

<sup>20</sup> Emily Feng, *Xi Jinping Reminds China's State Companies of Who's the Boss*, *N.Y. TIMES* (Oct. 13, 2016), <https://www.nytimes.com/2016/10/14/world/asia/china-soe-state-owned-enterprises.html> [<https://perma.cc/3RE5-FF3Q>].

<sup>21</sup> Yusho Cho & Kenji Kawase, *How China's State-Backed Companies Fell Behind*, *NIKKEI ASIAN REV.* (May 23, 2018), <https://asia.nikkei.com/Spotlight/The-Big-Story/How-China-s-state-backed-companies-fell-behind> [<https://perma.cc/VD92-4BXA>].

<sup>22</sup> *Zhonggong Zhongyang Guanyu Yangge Anzhao Dangde Yuanze Xuanba Renyong Ganbu De Tongzhi* (中共中央关于严格按照党的原则选拔任用干部的通知) [Notice of the Central Committee of the Communist Party of China on Selecting and Appointing Cadres in Accordance with Party Principles] (promulgated by the CCP Cent. Comm., Jan. 1, 1986); *Zhongguo Gongchandang Jilv Chufen Tiaoli* (中国共产党纪律处分条例) [Regulations of The Communist Party of China on Disciplinary Measures] (promulgated by the CPC Cent. Comm., effective Oct. 1, 2018), <http://www.12371.cn/2018/08/27/ARTI1535321642505383.shtml> [<https://perma.cc/SU3X-JGSQ>].

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company, and through the formal and informal power it exercises in those capacities,<sup>23</sup> minority institutional investors in SOEs are generally passive in nature. Further, even if the state is not the controlling shareholder—such as when the state is a minority investor and a private investor is the majority investor, as is the case in POEs—the governmental minority investor can be an activist, as will be examined in Part III(A). As one scholar puts it,

the PRC Party-state can therefore promote its interests [not only] via its controlling shareholder position in its subsidiary listed firms, and via state regulatory agencies and the legal system, but also through its controlling ownership position in most of China’s fund managers, insurance companies and other public investment vehicles, securities companies and banks.<sup>24</sup>

The next section provides a short history of how the CCP has impacted the development of institutional investors in China. Subsequently, this article critically analyses the role of institutional investors by distinguishing between two different types of institutional investors (SIIs and PIIs) and by placing them within the context of SOEs and POEs.

#### A. The Chinese Communist Party and China’s Economic Reforms

The state plays an active role in the management of SOEs as their controller,<sup>25</sup> whereas institutional investors are generally minority investors in SOEs. In order to understand the ownership structure of institutional investors in SOEs and

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<sup>23</sup> Milhaupt & Zheng, *supra* note 11, at 670. While the authors point out that state ownership is not always equated with state control, they recognize that the state exerts “nearly unbridled control over SOEs and has free reign to use these firms as tools of government policy, both domestically and abroad.” *Id.*

<sup>24</sup> Tamar Groswald Ozery, *Minority Public Shareholders in China’s Concentrated Capital Markets – A New Paradigm?*, 30 COLUM. J. ASIAN L. 1, 31–32 (2016).

<sup>25</sup> More details on the active role played by the state are provided in Section III(B)(1).

their relationship with the state, we must review the role played by the CCP in this context. Specifically, the development of institutional investors is linked to China's political and economic system led by the CCP—a macro-controller of the national economy. The key point this section makes is that, despite the reforms taken to privatize and liberalize the Chinese economy through the establishment of the stock exchange and mixed ownership corporations, and the implementation of the Qualified Foreign Institutional Investors (QFIIs) and strategic investor enterprises, the state still exercises significant formal or informal control over the corporations. Thus, measures to promote the development of institutional investors should be evaluated through the lens of the CCP's operations.

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Around 1978, the focus of the CCP shifted from class conflict to economic growth.<sup>26</sup> In 1980, the CCP advanced the idea that public ownership (a state-owned economy) was to be the central pillar of China's economic development.<sup>27</sup> In 1982, the nationalized economic system was enshrined in the Constitution of the PRC for the first time, which stipulated

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<sup>26</sup> "Class conflict" is a term used in political science, which refers to the conflict primarily between the bourgeoisie and the proletariat. In December 1978, the Third Plenary Session of the Eleventh Central Committee of the CCP proposed to shift the focus of the CCP's work to socialist modernization. See *The Third Plenary Session of the 11<sup>th</sup> Central Committee of the CPC announces that China is shifting its focus to economic development and adopting the policy of reform and opening-up*, CPPCC NATIONAL COMMITTEE (June 30, 2021), [http://en.cppcc.gov.cn/2021-06/30/c\\_638045.htm](http://en.cppcc.gov.cn/2021-06/30/c_638045.htm) [<https://perma.cc/J2K6-3TBP>].

<sup>27</sup> *Shehui Zhuyi Jiben Jingjizhidu Shi Danghe Renmin De Weida Chuangzao* (社会主义基本经济制度是党和人民的伟大创造) [*The Basic Socialist Economic System is a Great Creation of the Party and the People*], SASAC (Jan. 2, 2020), <http://www.sasac.gov.cn/n2588025/n2588134/c13373820/content.html> [<https://perma.cc/7VM7-NBDL>].

that the economy of China was state-owned.<sup>28</sup> The CCP also held that private ownership could be a necessary and beneficial supplement to a state-owned economy.<sup>29</sup> In 1988, the Constitutional Amendment further refined China's socialist economic system by allowing for a limited private economy to exist and develop, and to play a complementary role to the state-owned economy.<sup>30</sup> The state was required to guide, supervise and control the development of the private economy.<sup>31</sup> Despite these pronouncements, in the late 1980s, the state remained the exclusive controller of the national economy, the stock market was not yet established, and private investors did not yet have the opportunity to invest in SOEs.

The situation changed in 1990, when the Shanghai Stock Exchange and Shenzhen Stock Exchange were established in succession.<sup>32</sup> The rise of the Chinese securities market was accompanied by the development of institutional investors in

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<sup>28</sup> China (People's Republic of)'s Const. of 1982 with Amendments through 2004, CONSTITUTE PROJECT, [https://www.constituteproject.org/constitution/China\\_2004.pdf](https://www.constituteproject.org/constitution/China_2004.pdf). .lang=en [https://perma.cc/EWN8-ZZAA]. According to Article 6, "the basis of the socialist economic system of the PRC is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people." *Id.* Article 7 establishes the status of the state-owned economy: "the socialist economy under ownership by the whole people is the leading force in the national economy. And the state ensures the consolidation and growth of the state-owned economy." *Id.*

<sup>29</sup> *Id.* art. 6.

<sup>30</sup> 1988 Amendment to the Constitution of the People's Republic of China (Chinese and English Text), CONGRESSIONAL-EXECUTIVE COMMISSION ON CHINA, <https://www.cecc.gov/resources/legal-provisions/1988-amendment-to-the-constitution-of-the-peoples-republic-of-china> [https://perma.cc/HQX9-7TSD] (last accessed Jan. 31, 2023).

<sup>31</sup> China (People's Republic of)'s Const. of 1982 with Amendments through 2004, CONSTITUTE PROJECT, [https://www.constituteproject.org/constitution/China\\_2004.pdf](https://www.constituteproject.org/constitution/China_2004.pdf). .lang=en [https://perma.cc/EWN8-ZZAA].

<sup>32</sup> *Overview*, SHANGHAI STOCK EXCH., <http://english.sse.com.cn/aboutsse/overview/> [https://perma.cc/S8X7-A33A]; *Overview*, SHENZHEN STOCK EXCH., [www.szse.cn/English/about/overview/index.html](http://www.szse.cn/English/about/overview/index.html).

China.<sup>33</sup> The chairman of the CCP at the time, Deng Xiaopeng, said in 1992 that the securities market should be liberalized, tried, and tested, and any mistakes could be corrected by the state.<sup>34</sup> In the same year, thirty-seven investment funds were established for the purposes of investing in listed corporations.<sup>35</sup>

Importantly, in 1997, the then-chairman of the CCP, Jiang Zemin, proposed the concept of “mixed ownership,”<sup>36</sup> arguing that private ownership is not only complementary to, but also an important component of, China’s socialist market economy. He also argued that reducing the proportion of the economy that was state-owned, as opposed to privately-held, would not affect China’s socialist nature.<sup>37</sup> In the same year, the CCP began to experiment with a new economic development strategy,<sup>38</sup> requiring SOEs to relinquish their monopolistic

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<sup>33</sup> Wu Xiaoqiu (吴晓求) & Fang Minghao (方明浩), *Zhongguo Ziben Shichang Sanshi Nian: Tansuo Yu Biange* (中国资本市场30年: 探索与变革) [*30 Years of Chinese Capital Markets: Exploration and Reform*], 42 *CAIMAO JINGJI* (财贸经济) [FIN. & TRADE ECON.] 20, 20, 24, 33–34 (2021).

<sup>34</sup> *Deng Xiaoping Ban Gaige Kaifang Cidian: You Zhexiehua Caiyou Jintian de Zhongguo* (邓小平版改革开放词典: 有这些话才有今天的中国) [*Deng Xiaoping’s Reform and Opening Up Dictionary: Only with These Phrases Came Today’s China*], CCTV.COM (Feb. 8, 2007), [http://news.cctv.com/special/C17399/20070208/106943\\_4.shtml](http://news.cctv.com/special/C17399/20070208/106943_4.shtml) [https://perma.cc/4ME2-YLBZ].

<sup>35</sup> *Zhongguo Jijinye Fazhan Lishi* (中国基金业发展历史) [*History of China’s Fund Industry*], SINA FIN. (June 7, 2007), <http://finance.sina.com.cn/money/fund/20070607/16373671032.shtml> [https://perma.cc/LMN4-JYRK].

<sup>36</sup> For a history of mixed ownership in China, see Jiangyu Wang & Tan Cheng-Han, *Mixed Ownership Reform and Corporate Governance in China’s State-Owned Enterprises*, 53 *VAND. J. TRANSNAT’L L.* 1062–64 (2021).

<sup>37</sup> See 江泽民在中国共产党第十五次全国代表大会上的报告 [*Jiang Zemin’s Report at the 15th National Congress of the Communist Party of China*], 央视网 [CCTV.COM] (Oct. 19, 2011), <http://news.cntv.cn/china/20111019/106606.shtml> [https://perma.cc/8BS5-W2YF].

<sup>38</sup> *Id.* However, this policy was criticized because the correct approach ought to be that SOEs should actively remedy their deficiencies and promote the rapid development of the national economy rather than transferring state-owned assets to private sector without proper compensation. See 朱镕基: 国企改革“国退民进”做法是错误的 [*Zhu Rongji: SOE Reform of the*

status in numerous competitive industries, so that SOEs focus primarily on industries related to the national economy and national security.<sup>39</sup> Moreover, the CCP encouraged domestic institutional and retail investors to purchase shares, increasing private sector ownership. This was the beginning of the CCP's mixed-ownership reform, which entailed a combination of state and private ownership in SOEs.

Thus, from 1998 to 2003, the number of state-owned and state-controlled enterprises decreased by 40%.<sup>40</sup> The number of fund management corporations which were institutional investors increased from five in 1998 to forty-seven at the end of 2003, of which thirty-five were mixed-ownership domestic corporations and twelve were Sino-foreign joint venture corporations.<sup>41</sup> At the end of 2003, the investment assets of these fund management corporations reached RMB 171.56 billion, an increase of more than fifteen times compared to 1998 (RMB 10.741 billion), of which about 85.5% were invested in listed corporations in the form of equity investments.<sup>42</sup>

Moreover, China also sought to attract investments from overseas by coming up with a scheme to attract foreign institutional investors to Chinese securities markets. The rationale was that these investors could not only bring in

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*"Retreat of the State and Advance of the Private Sector" Approach is Wrong*,  
江苏财经信息网 [JSCJ.COM]  
<http://www.jscj.com/jscj/economic/data/20010821120800.php>  
[<https://perma.cc/2LB5-J44K>].

<sup>39</sup> The privatization of SOEs emerged on a large scale in 1998. The state-owned capital was pulled out from 164 industries, while the state retained its monopoly position in various industries, including steel, energy, automobile, aviation, telecommunications, electric power, machinery, military, etc. See 回首66年国企改革路 [Looking Back at 66 years of SOE Reform], 中证网 [CHINA SEC. J.] (Sept. 14, 2015), [http://cs.com.cn/xwzx/hg/201509/t20150914\\_4797422.html](http://cs.com.cn/xwzx/hg/201509/t20150914_4797422.html) (on file with Columbia Business Law Review).

<sup>40</sup> WU, *supra* note 26, at 613–14.

<sup>41</sup> 王连洲 [Lianzhou Wang], ZHONGGUO ZHENGQUAN TOUZIJIN NIANJIAN (中国证券投资基金年鉴) [ALMANAC OF CHINA'S SECURITIES INVESTMENT FUNDS] 35–37 (2005).

<sup>42</sup> *Id.* at 36.

additional capital, but also monitor the corporation in order to improve firm efficiency and to cause the corporation to adopt good governance practices.<sup>43</sup> Thus, in 2002, the state allowed large foreign investors, called QFIIs,<sup>44</sup> to buy shares—known as A-shares—in domestic corporations on a quota scheme.

Despite the increase in the percentage of privately-owned corporations (including domestic and foreign PIIs), the SOEs did not diminish in importance. This is because, due to the mismanagement of SOEs by the central government, 38% of state-owned industrial enterprises were in dire financial straits in 1996, increasing to 52% in 1997, and continuing to expand in 1998.<sup>45</sup> Since the central government could no longer prop up these SOEs, the CCP had to intervene to sustain them. Unlike the government's financial support to SOEs, the CCP adopted the strategy of selecting a few key SOEs for preferential treatment to let them grow into sizeable international enterprises, while other smaller SOEs were left unattended.<sup>46</sup> Many of the selected SOEs were listed on the stock exchange as part of the CCP's strategy of providing financing to the SOEs and to subject them to market discipline.<sup>47</sup>

Thus, notwithstanding the policies encouraging minority domestic and foreign private investments, concentrated

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<sup>43</sup> 吴卫华等 [Weihua Wu et al.], *合格境外机构投资者: 投资者还是投机者?* [*Qualified Foreign Institutional Investors: Investors or Speculators?*], 12 证券市场导报 [SEC. MKT. HERALD] 17 (2011).

<sup>44</sup> 中国证券监督管理委员会 [CHINA SEC. REG. COMM'N], *合格境外机构投资者境内证券投资管理暂行办法(已废止)* [*Interim Provisions on the Administration of Foreign Exchange in Domestic Securities Investments of Qualified Foreign Institutional Investors (expired)*], <http://www.csrc.gov.cn/csrc/c101797/c1003536/content.shtml> [<https://perma.cc/G76H-JA8P>].

<sup>45</sup> 许经勇 [Jingyong Xu], *我国国有企业改革的深层思考* [*Profound Thoughts on the Reform of State-Owned Enterprises in China*], 5 云南财贸学院学报 [J. YUNNAN FIN. & ECON. U.] 6 (1999).

<sup>46</sup> Yingyi Qian, *The Process of China's Market Transition (1978-1998): The Evolutionary, Historical, and Comparative Perspectives*, 156 J. INST. & THEORETICAL ECON. 151, 163 (2000).

<sup>47</sup> Karen Jingrong Lin et al., *State-Owned Enterprises in China: A Review of 40 Years of Research and Practice*, 13 CHINA J. ACCOUNTING RES. 8 (2020).

ownership in China persisted. This means that minority institutional investors were less likely to have an incentive to engage with the corporation, as confirmed in subsequent studies. A 2013 study of all Chinese listed companies found that 21.4% of listed corporations had a shareholder who held an absolute majority of shares, and 37.9% of listed corporations had investors which held controlling stakes in the corporation, while institutional investors owned 7.3% of tradable shares in listed corporations.<sup>48</sup> In a 2014 questionnaire conducted by the Shanghai Asset Management Association, 67.65% of listed corporations and 90.90% of institutional investors believed that “corporate shareholding structure and governance structure” had the greatest adverse impact on institutional investors’ participation in corporate governance.<sup>49</sup> More than 71% of institutional investors indicated a reluctance to engage in corporate governance.<sup>50</sup>

At the CCP National Congress in 2015, the CCP reiterated the overriding primacy of the party in spearheading and managing China’s economy.<sup>51</sup> Nevertheless, it also

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<sup>48</sup> 吴新春 [XINCHUN WU], 上海证券交易所 [SHANGHAI STOCK EXCHANGE] 大力推进机构投资者参与上市公司治理 [VIGOROUSLY PROMOTE THE PARTICIPATION OF INSTITUTIONAL INVESTORS IN THE GOVERNANCE OF LISTED CORPORATIONS] 15–16 (Jan. 2015), <http://www.sse.com.cn/aboutus/research/research/c/3986593.pdf> [<https://perma.cc/PKW2-XBA7>].

<sup>49</sup> 上海辖区机构投资者参与上市公司治理现状、存在问题及改进建议 [*Current Situation, Problems and Suggestions for Improvement of Institutional Investors’ Participation in Governance of Listed Corporations in Shanghai*], 上海市基金同业协会 [SHANGHAI ASSET MANAGEMENT ASSOCIATION] (Feb. 24, 2014), [http://samacn.org.cn/d\\_4001\\_78720.html](http://samacn.org.cn/d_4001_78720.html) (on file with Columbia Business Law Review)

<sup>50</sup> *Id.* In another survey in 2017, despite 46% of foreign institutional investors attempting to engage with Chinese listed corporations, 98% of these investors found it difficult to do so. See ASIAN CORPORATE GOVERNANCE ASS’N, AWAKING GOVERNANCE: THE EVOLUTION OF CORPORATE GOVERNANCE IN CHINA 6–7 fig.s 1.4, 1.5 (July 2018), [https://www.acga-asia.org/advocacy-detail.php...id=158&sk=&sa=](https://www.acga-asia.org/advocacy-detail.php?...id=158&sk=&sa=) [<https://perma.cc/CM29-C5BP>].

<sup>51</sup> 中国共产党第十八届中央委员会第五次全体会议公报 [*Communiqué of The Fifth Plenary Session of the 18th Central Committee of the CCP*], 新华网 [XINHUANET] (Oct. 29, 2015), [http://www.xinhuanet.com/politics/2015-10/29/c\\_1116983078.htm](http://www.xinhuanet.com/politics/2015-10/29/c_1116983078.htm) [<https://perma.cc/ZKW8-UFHD>].

emphasized the importance of the involvement of private investments.<sup>52</sup> Among the measures taken to promote mixed ownership was facilitating the transferability of shares through the listing of SOEs on the stock exchanges to enable private investors to invest in them.<sup>53</sup> These measures were consistent with, and a reinforcement of, those taken from 1997 to 2003, which sought to increase investments from the private sector.

To be clear, the mixed ownership reforms do not imply that the CCP has relinquished its control over the mixed ownership corporations. Despite the state's reduced shareholdings in such corporations, the CCP continues to maintain its control by requiring SOEs to clearly define in their corporate constitutions the party's decision-making powers over appointments, dismissals and operations.<sup>54</sup> The purpose of the corporate constitution requirements was to strengthen the role of the CCP in mixed-ownership corporations.

While the percentage of listed mixed ownership corporations has increased,<sup>55</sup> inadequate minority shareholder protection laws, unsound information disclosure

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<sup>52</sup> *Id.*

<sup>53</sup> Curtis J. Milhaupt, *The State as Owner—China's Experience*, 36 OXFORD R. ECON. POL'Y 376 (2020).

<sup>54</sup> 贯彻落实全国国有企业党的建设工作会议精神重点任务 [Implementing the Key Tasks and Spirit of the Party-Building Working Conference of SOEs], 共产党员网:党务问答 [WENDA.12371.CN] (Nov. 2, 2017), <http://wenda.12371.cn/liebiao.php?mod=viewthread&tid=576719> [<https://perma.cc/US9V-DJY8>].

<sup>55</sup> The number of China's listed domestic corporations rapidly increased from 323 in 1995 to 4,154 in 2020. See WORLD BANK DATA, <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=CN> [<https://perma.cc/XC39-V7XB>] (last visited July 13, 2021). According to a 2014 study by the China Development Research Foundation, the number of mixed ownership corporations increased 2.38 times from 2000 to 2014. Xiao Qingwen (肖庆文) [Qingwen Xiao], *Hunhe Suoyouzhi Qiye Shuliang, Leixing he Hangye Fenbu* (混合所有制企业数量、类型和行业分布) [The number, type and industry distribution of mixed ownership enterprises], ZHONGGUO FAZHAN YANJIU JIJINHUI (中国发展研究基金会) [CHINA DEV. RES. FOUND.] (Dec. 18, 2015), <https://www.cdrf.org.cn/xqw/3973.htm> [<https://perma.cc/5RAY-A899>].

systems, and insufficient regulatory oversight have undermined the long-term stability and effective functioning of Chinese capital markets.<sup>56</sup> This has led to a proliferation of financial fraud, goodwill impairment, and financial losses among listed corporations in recent years.<sup>57</sup> To address these problems, the CCP took several actions, including, but not limited to, transferring part of the state's shareholdings to private institutional investors and creating a new category of strategic PIIs.<sup>58</sup>

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<sup>56</sup> See Zhongguo Zhengjianhui Xinwen Fayanren Jiu (*Guowuyuan Guanyu Jinyibu Cujin Ziben Shichang Jiankang Fahzha De Ruogan Yijian*) Da Wen Jizhe Wen (中国证监会新闻发言人就《国务院关于进一步促进资本市场健康发展的若干意见》答记者问) [*CSRC Spokesman Answers Reporters' Questions on "Several Opinions of the State Council on Further Promoting the Healthy Development of the Capital Market"*], CHINA SEC. REG. COMM'N (2014), <http://www.csrc.gov.cn/csrc/c100039/c1362119/content.shtml>. [<https://perma.cc/8UZ3-VA3F>].

<sup>57</sup> A Gu Baolei Qishilu: Zhaiwu Weiyue Shi Shangshi Gongsi Baolei De Zhuyao Tixian (*A股暴雷启示录：债务违约是上市公司爆雷的主要体现*) [*A-share Crash: Debt Default is the Main Problem of Listed Corporations*], SINA FIN. (Dec. 16, 2019), <http://finance.sina.com.cn/stock/stocktalk/2019-12-16/doc-iihnzhfz6283778.shtml> [<https://perma.cc/5CGG-6AYS>]. More recently, in its 2021 annual report, the Shanghai Stock Exchange issued forty-three public reprimands to listed corporations in 2020, which was an increase of 7.5% as compared to the previous year. In addition, forty-seven persons were barred from serving as directors, supervisors, and senior managers of listed corporations (which was an increase of 88% on a year-over-year basis). See *Shangjiaosuo Tongbao 2020 Nian Hushi Shangshi Gongsi Xinxi Pilu Weigui Chachu Qingkuang* (*上交所通报2020年沪市上市公司信息披露违规查处情况*) [*SSE Announces Investigations of Information Disclosure Violations of Listed Corporations in Shanghai in 2020*], SSE (Jan. 18, 2021), <http://jrj.sh.gov.cn/SC212/20210118/0141c9c3bc8f4ed49ce48fd63d92cc6.html> (on file with Columbia Business Law Review).

<sup>58</sup> CSRC, 中国证券监督管理委员会 [China Sec. Reg. Comm'n], *发行监管问答——关于上市公司非公开发行股票引入战略投资者有关事项的监管要求* [*Issue Supervision Q&A - Supervisory Requirements on Matters Relating to the Introduction of Strategic Investors in Non-Public Offering Shares by Listed Companies*] (Mar. 20, 2020). The question of whether these majority strategic PIIs in these strategic investor enterprises are active and effective in promoting good corporate governance will be discussed in Part V.

The above short description of the role of the CCP in reforming China's economic system demonstrates the significant and persistent function of the state as a controller and investor. It also raises three principal questions. First, in an SOE where the state is the controlling shareholder, how likely is it that *minority* SII and *minority* PII will be active? Parts II(B) and II(C) examine this question, respectively. Examples of such SOEs include, but are not limited to: Sinopec Group, SAIC Motor, China Life Insurance, and Bank of China.

Second, in a POE with a majority PII, what role do the *minority* SII and *minority* PII play? Parts III(A) and (B) examine this question, respectively. An SII has one of two attributes: either the state exercises control over it (because the state is a controlling shareholder of that institutional investor), or the state is the ultimate beneficiary of that institutional investor. Examples of SII include China Life Insurance, Central Huijin, and China Securities Finance Corporation. A PII does not have either of these two attributes (but the state can be a minority investor of that PII). Examples of PII include E Fund Management, Gf Securities, Hillhouse Capital and Taikang Life Insurance.

The final question is: in a strategic investor enterprise, how likely is it that the majority strategic PII will actively promote good corporate governance? Part IV examines this question. A prominent example of a strategic investor enterprise is Gree Electric. Its majority shareholder is the private equity investor, Hillhouse Capital. The previous majority shareholder of Gree Electric was a government agency.<sup>59</sup> It transferred 15% of its shares to Hillhouse Capital<sup>60</sup> on the basis that Hillhouse Capital, already an

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<sup>59</sup> The government agency is the Zhuhai branch of the State-owned Assets Supervision and Administration Commission (Zhuhai SASAC), an ad-hoc agency under the Zhuhai Municipal Government. On SASAC, see *supra* note 18.

<sup>60</sup> 珠海格力电器股份有限公司关于公司控股股东签署《股份转让协议》暨公司控制权拟发生变更的提示性公告 [ZHUHAI GREE ELECTRIC CO., *Announcement on the Signing of the Share Transfer Agreement by the*

institutional investor in China's top technology corporations including Tencent, would be able to provide strategic leadership and technological know-how to Gree Electric.<sup>61</sup> Gree Electric's public announcement of the share transfer stated that Hillhouse Capital contractually agreed to improve the corporate governance and to promote the long-term success of the corporation.<sup>62</sup>

## B. SOEs: State-Backed Institutional Investors (SIIs)

### 1. The State is the Controlling Shareholder of Both the SOEs and State-Backed Institutional Investment Funds

Because the state is the controlling shareholder and the ultimate beneficiary of both the listed SOEs and the minority SIIs of those listed SOEs, it is likely that the private minority shareholder will remain passive and defer to the controller of the SOEs and the management appointed by the controller.

The state exercises its power over SOEs and SIIs through a variety of agencies. The state delegates its functions and executive powers to the State Council, which in turn delegates them to different government agencies, such as the State-Owned Asset Supervision and Administration Commission (SASAC), the Ministry of Finance, and the State Administration of Foreign Exchange.<sup>63</sup> These government

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*Controlling Shareholder and the proposed change of company's control*] 12–13 (2019), [https://pdf.dcfw.com/pdf/H2\\_AN201912021371467379\\_1.PDF](https://pdf.dcfw.com/pdf/H2_AN201912021371467379_1.PDF).

<sup>61</sup> Fan Feifei, *Gree Electric Steps on Reform Pedal*, CHINA DAILY (Dec. 4, 2019), <https://www.chinadaily.com.cn/a/201912/04/WS5de7228da310cf3e3557beb6.html> [<https://perma.cc/3V5Q-5LGV>].

<sup>62</sup> 珠海格力电器股份有限公司关于公司控股股东签署《股份转让协议》暨公司控制权拟发生变更的提示性公告 [ZHUHAI GREE ELECTRIC Co., *Announcement on the Signing of the Share Transfer Agreement by the Controlling Shareholder and the proposed change of company's control*] 12–13 (2019), [https://pdf.dcfw.com/pdf/H2\\_AN201912021371467379\\_1.PDF](https://pdf.dcfw.com/pdf/H2_AN201912021371467379_1.PDF).

<sup>63</sup> A national bureau administered by the People's Bank of China, responsible for foreign exchange management. See *Major Functions*, SAFE,

agencies are the direct controlling investors of the parent corporations of different listed SOEs such as Sinopec, SAIC Motor, China Life Insurance Company and Bank of China. The top ten minority institutional investors of these listed SOEs are mostly state-backed. This is because these minority institutional investors are either listed SOEs, such as China Life Insurance (controlled by the state), or they are state-backed sovereign institutions not listed on the stock market, such as Central Huijin. China's state-backed sovereign institutions are those engaged in managing and investing foreign exchange capital, with 100% of their shares controlled by the government and invested for the benefit of the state. In China, the sovereign institutions are the China Investment Corporation and its three wholly-owned subsidiaries, namely CIC International Company, CIC Overseas Direct Investment Company, and Central Huijin.<sup>64</sup>

To give an example of the state as the ultimate controller and beneficiary, consider Sinopec Group, one of the world's largest oil and gas conglomerates.<sup>65</sup> It is the parent corporation of China Petroleum and Chemical Corporation, an SOE listed on the Shanghai Stock Exchange and Hong Kong Stock Exchange.<sup>66</sup> The direct controlling shareholder of Sinopec Group is the SASAC and the latter is managed by the State Council,<sup>67</sup> an executive organ of the state. The minority

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<https://www.safe.gov.cn/en/MajorFunctions/index.html> (last visited Jan. 31, 2023).

<sup>64</sup> 中国投资有限责任公司2020年度报告 [CHINA INVESTMENT CORPORATION Co., *Annual Report 2020*] 8 (2020), [http://www.china-inv.cn/china\\_inv/xhtml/Media/2020CN.pdf](http://www.china-inv.cn/china_inv/xhtml/Media/2020CN.pdf).

<sup>65</sup> *Sinopec Group*, FORTUNE, <https://fortune.com/company/sinopec-group/global500/> [<https://perma.cc/CRC7-T3YD>] (last visited Oct. 6, 2022). See also Sinopec, QCC, <https://www.qcc.com/firm/ab603b8e94724170604c95f2bd3bcc9d.html> [<https://perma.cc/R37A-HC25>].

<sup>66</sup> *China Petroleum & Chemical Corp.*, NIKKEI ASIA, <https://asia.nikkei.com/Companies/China-Petroleum-Chemical-Corp> [<https://perma.cc/KWM6-UJ6F>] (last visited Oct. 6, 2022).

<sup>67</sup> SASAC is a government agency directly under the State Council. SASAC is authorized by the State Council to perform the duties of capital contributor on behalf of the State and to supervise the management of the

institutional investors of China Petroleum and Chemical Corporation include China Life Insurance Company (a listed SOE whose controller is the state<sup>68</sup>); Central Huijin, a wholly-owned subsidiary of China Investment Corporation<sup>69</sup> (the latter being a sovereign wealth fund,<sup>70</sup> whose direct controlling shareholder is the Ministry of Finance, and the latter is in turn managed by the State Council); and China Securities Finance Corporation (a non-profit fund controlled by stock exchanges<sup>71</sup>).

Consider another example. Bank of China is an SOE listed on the Shanghai Stock Exchange and Hong Kong Stock Exchange.<sup>72</sup> The direct controlling shareholder of Bank of China is Central Huijin, and the latter is ultimately controlled by the State Council. The minority institutional investors of Bank of China include China Life Insurance Company and China Pacific Life Insurance (both of which are listed SOEs whose controller is the state), China Securities Finance Corporation (mentioned above), and Wutongshu Investment

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state-owned assets of the enterprises. *What We Do*, SASAC, [http://en.sasac.gov.cn/2018/07/17/c\\_9258.htm](http://en.sasac.gov.cn/2018/07/17/c_9258.htm) [<https://perma.cc/E5XY-QYN9>].

<sup>68</sup> *Lifelong Promise, Lifelong Partner*, CHINA LIFE INSURANCE COMPANY, <https://www.chinalife.com.hk/about-us/clio> [<https://perma.cc/PE7P-48WG>]. See also *China Life Insurance Company*, QCC, <https://www.qcc.com/firm/11eddf8966bbd38f36e3357161c14182.html> (on file with Columbia Business Law Review).

<sup>69</sup> *About Us*, CENTRAL HUIJIN INVESTMENT CO., LTD., [http://www.huijin-inv.cn/huijin-inv/About\\_Us/index.shtml](http://www.huijin-inv.cn/huijin-inv/About_Us/index.shtml) [<https://perma.cc/TNZ9-ZEG6>] (last visited July 2, 2021).

<sup>70</sup> *About CIC*, CHINA INVESTMENT CORP., [http://www.china-inv.cn/chinainven/About\\_CIC/Who\\_We\\_Are.shtml](http://www.china-inv.cn/chinainven/About_CIC/Who_We_Are.shtml) [<https://perma.cc/R8SD-8HLD>] (last visited June 16, 2022).

<sup>71</sup> *About CSF*, CHINA SEC. FINANCE CORP. LTD., <http://www.csf.com.cn/publish/english/1071/1076/index.html> [<https://perma.cc/6SMT-SMCD>] (last visited Jan. 12, 2023).

<sup>72</sup> *Bank of China Was Successfully Listed in Hong Kong and Opened a New Chapter in Its One-Hundred-Year History*, BANK OF CHINA (2006), [https://www.boc.cn/en/aboutboc/ab7/200809/t20080926\\_1601843.html](https://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601843.html) [<https://perma.cc/X2DL-BAL4>]. See also *Bank of China*, QCC, <https://www.qcc.com/firm/837e8c3db3440424d29a579e27bd4b95.html> (on file with Columbia Business Law Review).

Platform Corporation (whose sole controlling shareholder is the State Administration of Foreign Exchange which is an agency of the State Council).<sup>73</sup> Table 1 below provides further illustrations. Note that the ultimate controller of all of the below companies is the State Council of the People's Republic of China.

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<sup>73</sup> Bank of China, QCC, <https://www.qcc.com/firm/837e8c3db3440424d29a579e27bd4b95.html> (on file with Columbia Business Law Review); *Wutongshu Touzi Pingtai Youxianzeren Gongsi* (梧桐树投资平台有限责任公司) [*Wutongshu Investment Platform Co. Ltd.*], WIKIPEDIA (维基百科), <https://zh.wikipedia.org/zh-hans/%E6%A2%A7%E6%A1%90%E6%A0%91%E6%8A%95%E8%B5%84%E5%B9%B3%E5%8F%B0%E6%9C%89%E9%99%90%E8%B4%A3%E4%B%BB%E5%85%AC%E5%8F%B8> [<https://perma.cc/QP55-C4VW>].

Table 1: Ownership structure of sample listed SOEs<sup>74</sup>

Controlling shareholder of the parent corporation	Parent corporation of listed SOEs	Listed SOEs	Minority SIIs of listed SOEs
State-owned Assets Supervision and Administration Commission (SASAC)	Sinopec Group SAIC Group	China Petroleum and Chemical Corporation SAIC Motor Corporation Limited	China Life Insurance Company Central Huijin China Securities Finance Corporation China Securities Investor Services Centre National Social Security Fund*
Ministry of Finance	China Life Insurance (Group) Central Huijin	China Life Insurance Company Bank of China	Central Huijin China Securities Finance Corporation China Securities Investor Services Centre Industrial and Commercial Bank of China China Life Insurance Company

<sup>74</sup> *Sinopec*, QCC, <https://www.qcc.com/firm/ab603b8e94724170604c95f2bd3bcc9d.html> [https://perma.cc/R37A-HC25]; *SAIC Motor*, QCC, <https://www.qcc.com/firm/36b18225f91d3e3f1069f50f8e3f97d7.html> (on file with Columbia Business Law Review); *China Life Insurance Company*, QCC, <https://www.qcc.com/firm/11eddf8966bbd38f36e3357161c14182.html> (on file with Columbia Business Law Review); *Bank of China*, QCC, <https://www.qcc.com/firm/837e8c3db3440424d29a579e27bd4b95.html> (on file with Columbia Business Law Review); *Zhongguo Touzi Youxianzeren Gongsi* (中国投资有限责任公司) [*China Investment Corporation*], WIKIPEDIA (维基百科), <https://zh.wikipedia.org/wiki/%E4%B8%AD%E5%9B%BD%E6%8A%95%E8%B5%84%E6%9C%89%E9%99%90%E8%B4%A3%E4%BB%BB%E5%85%AC%E5%8F%B8> [https://perma.cc/66NW-N76R]; Guowuyuan Zuzhi Jigou (国务院组织机构) [*Organization of the State Council*], GOV.CN (中国政府网), <http://www.gov.cn/guowuyuan/zuzhi.htm> [https://perma.cc/9NL5-PUSC]; *Wutongshu Touzi Pingtai Youxianzeren Gongsi* (梧桐树投资平台有限责任公司) [*Wutongshu Investment Platform Co. Ltd.*], WIKIPEDIA (维基百科), <https://zh.wikipedia.org/hans/%E6%A2%A7%E6%A1%90%E6%A0%91%E6%8A%95%E8%B5%84%E5%B9%B3%E5%8F%B0%E6%9C%89%E9%99%90%E8%B4%A3%E4%B%BB%E5%85%AC%E5%8F%B8> [https://perma.cc/QP55-C4VW].

			China Pacific Life Insurance China Securities Finance Corporation China Securities Investor Services Centre Wutongshu Investment Platform Co Ltd
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\*Only an institutional investor in China Petroleum and Chemical Corporation, and not SAIC Motor

Given that the ultimate controller of both the listed SOE and its minority SIIs is the State Council and its organs, it is unlikely that these minority investors will challenge or actively engage with the controller of the listed SOE or its management for two reasons.

First, given that the State Council would have likely issued its commands to the controlling shareholder of the parent corporation of the listed SOEs, the State Council is unlikely to direct the minority SIIs to interfere with its wishes. That said, because the controlling shareholder of (the parent corporation of) the listed SOE may be different from that of the minority SIIs, there could be differences in opinion as to how the listed SOE should be run. In other words, the controller of the listed SOE and the controller of the minority SIIs could disagree over the management of the SOE. For example, the controlling shareholder (of the parent) of China Petroleum and Chemical Corporation is SASAC. But the controlling shareholder (of the parent) of one of its minority institutional investors, China Life Insurance Company, is the Ministry of Finance. The SASAC and the Ministry of Finance may take different views on the strategies and business operations of China Petroleum and Chemical Corporation. Even then, it is doubtful whether this will result in the minority SII actively monitoring or even interfering with the actions of the state controller and the management of the listed SOE, because the minority SII may not have sufficient voting power to effect meaningful changes.

Second, the CCP holds appointment and dismissal powers over the board and senior management of both the SOEs and

the minority SIIs.<sup>75</sup> A corporation's chairman of the board of directors (usually the same person as the Secretary of the Party Committee of the corporation<sup>76</sup>) and its general manager are ultimately appointed and removed by the organizational department of the CCP.<sup>77</sup> This ensures that the directors and managers are generally members of the CCP who will strengthen the CCP's leadership and follow its commands. By controlling the appointment and dismissal of the board and management, the behavior of the listed SOE and its minority SIIs are strongly influenced, if not dictated, by the CCP. In addition, even if the board and senior management are not the CCP members, the management is required to consult with the CCP committee of SOEs before they make decisions on "important matters," defined as those related to appointments, investments in important projects, and "important issues" (which are not defined).<sup>78</sup>

A major risk arising from this structure is that the directors and managers of the listed SOE and those of the minority SIIs are more interested in their own political promotion—gained by obeying the CCP—than in acting in the long-term financial interests of the SOE. In other words, as the directors and managers of the minority SIIs are appointed and rewarded mainly on the basis of political connections and loyalty, it is unlikely that they will incur additional costs to monitor and engage with the investee corporations in order to promote the latter's long-term financial success.

## 2. Regulations Require State-Backed Sovereign

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<sup>75</sup> See Regulations on the Work of Selection and Appointing Leading Party and Government Cadres, *supra* note 22.

<sup>76</sup> "Secretary of the Party Committee of the corporation" refers to the leader of the CCP in SOEs.

<sup>77</sup> See Regulations on the Work of Selection and Appointing Leading Party and Government Cadres, *supra* note 22.

<sup>78</sup> Guanyu Jinyibu Tuijin Guoyu Qiye Guanchi Luoshi "Sanzhongyida" (关于进一步推进国有企业贯彻落实"三重一大"决策制度的意见) [*Opinions on the Further Promotion of SOEs to Implement the Decision-Making System of "Three Important and One Large"*], CEN. PEOPLE'S GOV. (2010).

### Institutional Investors to Be Passive

Central Huijin is a minority state-backed sovereign institutional investor in numerous listed SOEs, including but not limited to Sinopec,<sup>79</sup> SAIC Motor,<sup>80</sup> and China Life.<sup>81</sup> Central Huijin is a wholly-owned subsidiary of China Investment Corporation, China's sovereign wealth fund.<sup>82</sup> Under the State Council's regulations, Central Huijin was established for the purposes of making equity investments in key SOEs, and it exercises the rights and fulfills the obligations as a capital contributor on behalf of the state, so as to achieve preservation and appreciation of state-owned financial assets.<sup>83</sup> Under the controlling regulations, Central Huijin is not allowed to carry out any other commercial business activities, and is not permitted to interfere with the day-to-day business activities of the SOEs in which it holds shares.<sup>84</sup> Importantly, the regulations provide that if a sovereign institutional investor who invests government funds in SOEs interferes with their operations, and thereby cause them to incur losses, the state will take disciplinary actions against the persons responsible.<sup>85</sup>

### 3. State-Backed Non-Sovereign Institutional Investors have Little Incentive to Engage

Unlike the minority state-backed *sovereign* institutional investor Central Huijin, minority state-backed *non-*

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<sup>79</sup> See *Sinopec*, *supra* note 65.

<sup>80</sup> SAIC Motor, QCC, <https://www.qcc.com/firm/36b18225f91d3e3f1069f50f8e3f97d7.html> (on file with Columbia Business Law Review)

<sup>81</sup> See *China Life Insurance Company*, *supra* note 68.

<sup>82</sup> CHINA INVESTMENT CORP., *supra* note 70.

<sup>83</sup> CENTRAL HUIJIN INVESTMENT CO., LTD., *supra* note 69.

<sup>84</sup> *Id.*

<sup>85</sup> Gen. Off. St. Council, *Notice by the General Office of the State Council on Issuing the Interim Provisions on the Duties of State-owned Financial Capital Contributors*, LAWINFOCHINA (Nov. 7, 2019), <http://lawinfochina.com/display.aspx?.id=32420&lib=law&EncodingName=big5>.

*sovereign*<sup>86</sup> institutional investors<sup>87</sup> are not precluded from engaging with the SOEs. Nevertheless, these minority state-backed non-sovereign institutional investors are unlikely to actively engage with their investee corporations for at least two reasons.

First, because the primary managers of minority state-backed *non-sovereign* institutional investors are ultimately appointed by the CCP, they are motivated more to advance their career development and political positions than to promote the financial interests of the SOEs.<sup>88</sup> Minority state-backed non-sovereign institutions are required to have an Investment Decision Committee, which is tasked with making broad, strategic decisions (as opposed to day-to-day operational decisions).<sup>89</sup> The Investment Decision Committee members generally consist of the chairman of the corporation, the secretary of the corporation's branch of the CCP, and the managers of each department, all of whom are usually members of the CCP.<sup>90</sup> Moreover, the Investment Decision

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<sup>86</sup> Minority state-backed non-sovereign institutions refer to those organizations that are not directly owned or controlled by China Investment Corporation, China's sovereign wealth fund.

<sup>87</sup> Examples of minority state-backed non-sovereign institutional investors include mutual funds, insurance corporations, pension funds, and securities institutions (investment banks). See Lin & Puchniak, *supra* note 5.

<sup>88</sup> Wang Qi (王琦) & Shao Xingzhong (邵兴忠), *Dui Guoyou Yinhang "Suoyouzhe Daibiao Queshi" Zhilide Sikao* (对国有商业银行"所有者代表缺失"治理的思考) [Research on the Governance of "Lack of Ownership Representatives" in State-owned Commercial Banks], 12 SHANGHAI JINRONG (上海金融) [J. SHANGHAI FIN. UNIV.] 70–71 (2005).

<sup>89</sup> Zhengquan Touzi Jijin Guanli Gongsi Gongping Jiaoyi Zhidao Yijian (2011 Nian Xiuding) (证券投资基金管理公司公平交易制度指导(2011年修订)), translated in *Guiding Opinions on Fair Trading Rules of Securities Investment Fund Management Corporations (2011 Version)* art. 10, LAWINFOCHINA (Aug. 3, 2011), <http://www.lawinfochina.com/Display.aspx?.lib=law&Cgid=157092> [<https://perma.cc/Y3SX-63H7>].

<sup>90</sup> See, e.g., *Quanguo Shebao Jijin Lishihui Touzi Juece Weiyuanhui* (全国社保基金理事会投资决策委员会) [Investment Decision Committee of the National Social Security Fund Council], SSF (Sept. 19, 2018), <http://www.ssf.gov.cn/portal/jgjs/jgsz/fcsjg/webinfo/2021/09/1633144867444>

Committee is subject to the supervision of the CSRC, in that the CSRC can take regulatory measures against the Investment Decision Committee, such as issuing letters of warning and suspending the members from performing their duties if they engage in misconduct.<sup>91</sup> Although CSRC cannot dictate the qualifications of the directors and managers of these minority state-backed non-sovereign institutions, the latter are required to make filings with the CSRC concerning the appointments of directors and managers,<sup>92</sup> and it is possible for the CSRC to reject these filings.<sup>93</sup> Thus, because of the control wielded by the state over the minority state-backed non-sovereign institutional investors, the latter will not defy the state who is also the controller of the SOEs, let alone to incur time and resources in monitoring them.

Second, minority state-backed non-sovereign institutional investors focus on both the state's interests and the financial returns of their investee corporations. For example, some state-backed investors are more interested in stabilizing the stock market and reducing systemic risks.<sup>94</sup> In contrast,

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225.htm, [<https://perma.cc/N6WQ-59YQ>]; Zhonggong Zhongyang Yinfu Zhongguo Gongchandang Guoyou Qiye Jiceng Zuzhi Gongzuo Tiaoli (Shixing) (中共中央印发《中国共产党国有企业基层组织工作条例(试行)》)[*The Central Committee of the Communist Party of China (CPC) issued the 'Regulations on the Work of Grassroots Organizations of State-owned Enterprises of the Communist Party of China (for Trial Implementation)*], CEN. PEOPLE'S GOV'T (2019), [http://www.gov.cn/zhengce/2020-01/05/content\\_5466687.htm](http://www.gov.cn/zhengce/2020-01/05/content_5466687.htm) [<https://perma.cc/R3DA-MQEH>]. See also *Agency Introduction*, NATIONAL COUNCIL FOR SSF, [http://www.ssf.gov.cn/portal/jgjs/hld/A000101index\\_1.htm](http://www.ssf.gov.cn/portal/jgjs/hld/A000101index_1.htm) [<https://perma.cc/3T2Z-XUNF>].

<sup>91</sup> China Sec. Reg. Comm'n, *Notice of the CSRC on Requesting Public Comment on the Draft Revisions of the Measures for the Administration of Securities Investment Fund Management Corporations and the Related Rules* art. 74–75, LAWINFOCHINA (June 20, 2012), <http://lawinfochina.com/display.aspx? . .id=32420&lib=law&EncodingName=big5>.

<sup>92</sup> Lin & Puchniak, *supra* note 5, at 30.

<sup>93</sup> *Id.*

<sup>94</sup> See Zhang Jingwei (张敬伟) [Jingwei Zhang], *Sanhu Liuchu A Gu Huanjiele Guojia Wending Gushi De Yali* (散户流出A股缓解了国家稳定股市的压力) [*Retailers' Outflow from A-shares Eases Pressure on the State to*

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competitive, profit-driven minority foreign PIIs, such as BlackRock or State Street, have more time and resources to improve the corporate governance of their investee corporations to generate higher financial returns.

#### 4. Conflicts of Interest Involving State-Backed Non-Sovereign Institutional Investors May Render Them Reluctant to Challenge the Controller or Management

It has been found that securities corporations (the equivalent of investment banks), a prominent type of institutional investor, have close business relationships with the listed SOEs, as they provide underwriting services, in addition to other financial and advisory services.<sup>95</sup> To maintain their existing business ties and to attract more work from the listed SOEs, these securities corporations may be unwilling to challenge the decisions made by the controller and management. Consequently, they are more likely to vote in line with the management of the listed SOEs and are less likely to monitor.<sup>96</sup>

Another type of conflict of interest is this: the controlling shareholder of the listed SOE—in which the minority state-backed non-sovereign institutional investor holds shares—may also be a shareholder of that minority investor. Thus, it is possible that the minority institutional investor will think twice before voting against the controlling shareholder of the SOE, out of concern that the controller may retaliate by voting against proposals favored by the management of the minority institutional investor. For example, as mentioned earlier, Central Huijin is the direct controlling shareholder (i.e.

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*Stabilize Stock Market*], MEIJINGWANG (每经网)[NAT'L BUS. DAILY] (Aug. 7, 2015),

<http://finance.sina.com.cn/stock/stocktalk/20150807/021422899472.shtml>  
[<https://perma.cc/XJ73-7Z2A>].

<sup>95</sup> See Securities Law of the People's Republic of China (2019) art. 120.

<sup>96</sup> Rongli Yuan et al., *The Role of Financial Institutions in the Corporate Governance of Listed Chinese Corporations*, 20 BRIT. J. MGMT. 562, 562–63 (2009).

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parent corporation) of Bank of China.<sup>97</sup> Central Huijin also holds shares in China Life Insurance Company, which is one of the minority institutional investors in Bank of China.<sup>98</sup> Thus, China Life Insurance Company may hesitate before voting against the interests of the controller.

### C. SOEs: Privately-Backed Institutional Investors (PIIs)

This section argues that in SOEs with a mixed ownership model, minority PIIs are likely to be passive for four reasons. First, the state puts pressure on PIIs to conform. Second, the state may retaliate against minority PIIs if they oppose the state. Third, foreign PIIs' engagement with SOEs is unlikely to be effective. Finally, rather than incurring costs in monitoring their investee corporations, minority PIIs will likely rely on the Securities Investor Services Centre to do so.

#### 1. The State as the Controller Can Pressure or Influence Minority PIIs

To begin with, as established in Section III(B)(1) above, the state is the ultimate controlling shareholder of SOEs, and the CCP exercises the ultimate appointment and dismissal rights over their directors and managers. Under the regulation issued by the State Council, SOEs are required to adhere to and strengthen CCP leadership.<sup>99</sup> Importantly, the regulations require the CCP to control, supervise and manage the SOEs with respect to leadership matters, strategies and key operational decisions.<sup>100</sup> Thus, the preferences and decisions of the minority PIIs will necessarily be subordinated to those of the state. There is little incentive for the minority

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<sup>97</sup> BANK OF CHINA, *supra* note 72.

<sup>98</sup> *Id.*; see also CHINA LIFE INSURANCE COMPANY, *supra* note 68.

<sup>99</sup> Regulations on the Work of Selection and Appointing Leading Party and Government Cadres, *supra* note 22, art. 1.

<sup>100</sup> The Central Committee of the Communist Party of China (CPC) issued the "Regulations on the Work of Grassroots Organizations of State-owned Enterprises of the Communist Party of China (for Trial Implementation)."

PIIs to incur additional costs to monitor and engage with the management of the SOEs, who will only take instructions from the controller. After all, minority investors may regard it as pointless at best—or counterproductive at worst—to engage, as they will always be outvoted.<sup>101</sup>

Given the critical, ubiquitous and extensive role played by the state in an SOE in which the state is both the direct and indirect controller, the state can easily apply pressure on minority PIIs to accede to its demands. Three case studies are considered below:

First, the split share reform of 2005. Prior to 2005, the shares of SOEs were divided into tradeable and non-tradeable categories, the latter of which comprised two-thirds of all outstanding shares.<sup>102</sup> To attract institutional investors and to improve the corporate governance of the listed corporations, the CSRC implemented measures to convert non-tradeable shares into tradeable shares.<sup>103</sup> The measures required non-tradeable investors to compensate the tradeable investors whose shares had been diluted. The compensation proposal had to be approved by two-thirds of the investors in a given

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<sup>101</sup> For example, minority PIIs have observed that, “in SOEs, small and medium sized investors are hopeless. We cannot claim compensation from SOEs when the share price is falling continuously.” *Yiqi Gudong Dahui Linjin Jigou Chuixiang Weiquan “Jijiehao”* (一汽股东大会临近 机构吹响维权“集结号”) [*Approaching Yiqi’s Shareholders Meeting, Institutional Investors Acting Collectively*], MEIJINGWANG (每经网) [NAT’L BUS. DAILY] (June 14, 2016), <http://www.nbd.com.cn/articles/2016-06-14/1012640.html> [<https://perma.cc/9C62-84G6>]. The context was that the controlling shareholder of an SOE refused to include a proposed resolution from a minority PII which was critical of the actions taken by the controller.

<sup>102</sup> Weishenme “Guquanfenzhi Gaige” Shi Zhongguo Ziben Shichangshang De Yizuo Fengbei (为什么“股权分置改革”是中国资本市场史上的一座丰碑) [*Why the “Equity Reform” is a Monument in the History of China’s Capital Market*], ZHENGQUAN SHIBAO (证券时报) [SEC. TIMES] (Nov. 25, 2020), [https://news.stcn.com/sd/202011/t20201125\\_2567455.html](https://news.stcn.com/sd/202011/t20201125_2567455.html) [<https://perma.cc/Q6Q3-7YYE>].

<sup>103</sup> Wei Huang & Tao Zhu, *Foreign Institutional Investors and Corporate Governance in Emerging Markets: Evidence of a Split-Share Structure Reform in China*, 32 J. CORP. FIN. 312, 313–15 (2015).

company.<sup>104</sup> If rejected, there was a moratorium of three months before a new proposal could be considered. As the government officials' pecuniary and non-pecuniary benefits (including promotion prospects) depended on the initial proposal being approved, these officials put pressure on the mutual funds, who were the main institutional investors in tradeable shares, to vote quickly and in favor of the proposal, although the proposal did not benefit the mutual funds' beneficiaries as the compensation was not high.<sup>105</sup> The government officials were able to pressure the mutual funds because the government was not only a controlling shareholder in, but was also the regulator of, the mutual funds.<sup>106</sup> Moreover, the CSRC transferred the right to vote on the compensation proposal from the individual mutual fund managers to the funds' investment decision committee, whose members were not only appointed by the CSRC, but who were also CCP members.<sup>107</sup>

Next, consider the case of Gree Electric, which was an SOE (prior to 2019<sup>108</sup>). In 2016, its state-appointed management proposed a financing transaction in which a state agency, as the ultimate controlling shareholder of Gree Electric, stood to benefit.<sup>109</sup> The transactions were approved by a slim

<sup>104</sup> *Id.* at 313.

<sup>105</sup> Michael Firth, Chen Lin & Hong Zou, *Friend or Foe? The Role of State and Mutual Fund Ownership in the Split Share Structure Reform in China*, 45 J. FIN. & QUANTITATIVE ANALYSIS 685, 687 (2010); Huang & Zhu, *supra* note 104, at 314.

<sup>106</sup> Firth et al., *supra* note 106, at 692–93.

<sup>107</sup> *Id.*

<sup>108</sup> From 2019, Gree Electric became a POE because the state became the minority shareholder. But Gree Electric is still subject to state influence because the minority state shareholder retains the right to appoint directors and the rights of the majority privately-backed shareholder were contractually curbed. See Shen Hongbo et al. (沈红波等), *Guoqi Hungai Ruhe Cong Guanqiye Guodudao Guanziben — Jiyu Geli Dianqi De Anliyanjiu* (国企混改如何从管企业过渡到管资本——基于格力电器的案例研究) [*Mixed Ownership Reform: A Case Study of Gree Inc.*], ZHONGGUO GUANLI KUAJJI (中国管理会计) [CHINA MGMT. ACCOUNTING REV.] 89 (2021).

<sup>109</sup> See Jane Ho, *Where Would Thwarted Power Woman Dong Mingzhu Lead China's Appliance Giant Gree?*, FORBES (Dec. 1, 2016), <https://www.forbes.com/sites/janeho/2016/12/01/where-would-thwarted->

margin.<sup>110</sup> But it drew the wrath of Gree Chairman, Mingzhu Dong, who lashed out at shareholders for not actively supporting her proposal. The state-appointed management subsequently proposed a resolution at a general meeting to withhold any cash dividends and bonus shares. This resolution was passed, despite resistance from the minority PIIs.<sup>111</sup> The decision to withhold dividends and bonus shares was effectively a means of pressuring the minority PIIs to succumb to future demands of the controlling shareholder and its management.

Finally, consider the corporate constitutional amendments imposed by the state. In 2015, the state set out a policy requiring corporations to amend their charters to incorporate CCP-friendly provisions.<sup>112</sup> From 2016–17, the state required SOEs to amend their constitutions to include provisions related to the role of the CCP and the CCP Constitution, the CCP's decision-making powers over the SOE, and appointments and dismissals of key personnel.<sup>113</sup> Even

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power-woman-dong-mingzhu-lead-chinas-appliance-giant-gree/. . .sh=36a576021a51.

<sup>110</sup> *Zhongxiao Gudong Toupiao Fandui, Dong Mingzhu Fabiao Gudonghui Biaoju Jieguo* (中小股东投票反对, 董明珠发飙格力股东会表决结果) (*Small and Medium Investors Voted Against, Mingzhu Dong Fumed at Gree's Investors Meeting*), XINHUANET (Oct. 31, 2016), [https://www.sohu.com/a/117670837\\_115402](https://www.sohu.com/a/117670837_115402) [https://perma.cc/HS6C-NYPK].

<sup>111</sup> Geli Electric, Zhuhai Geli Dianqi Gufen Youxiangongsi 2017 Nian Niandu Baogao (珠海格力电器股份有限公司2017年年度报告) [ZHUHAI GREE ELECTRIC CO., LTD., 2017 ANNUAL REPORT] (Apr. 2018), [https://pdf.dfcfw.com/pdf/H2\\_AN201804251130340862\\_1.pdf](https://pdf.dfcfw.com/pdf/H2_AN201804251130340862_1.pdf) [https://perma.cc/6DCZ-5JBM].

<sup>112</sup> Chinese Communist Party Cent. Comm. & St. Council, Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises (Aug. 24, 2015).

<sup>113</sup> Xi Jinping Zai Quanguo Guoyou Qiye Dang de Jianshe Gongzuo Huiyishang Qiangdiao: Jianchi Dang Dui Guoqi de Lingdao Budongyao (习近平在全国国有企业党的建设工作会议上强调: 坚持党对国企的领导不动摇) [*Xi Stresses CCP Leadership of State-Owned Enterprises*], XINHUA NEWS AGENCY (Oct. 11, 2016), [http://www.xinhuanet.com/politics/2016-10/11/c\\_1119697415.htm](http://www.xinhuanet.com/politics/2016-10/11/c_1119697415.htm) [https://perma.cc/JZW3-EETP]; Ke-jun Guo & Dong-yang Hu, *Incorporating State-Owned Enterprise Party-Building into Articles of Association: Analysis of Paths and Mechanisms* (国企党建工作进

foreign minority PIIs have been pressured to vote in favor of amending the constitution to officially recognize the CCP.<sup>114</sup> For example, in the case of Tianjin Realty Development, the amendment to the constitution to establish the role of CCP in the corporation received only 62.5% of the votes initially, and as a result failed to meet the two-thirds threshold needed to pass. But as a result of a pressure campaign conducted by the state against foreign minority PIIs, a subsequent amendment was passed, with 99.87 voting in favor.<sup>115</sup> There are also cases in which the senior management of SOEs have pressured foreign minority PIIs to support an amendment. For instance, the Bank of Shanghai lobbied every institutional investor that holds more than 2 million shares (including BlackRock and Fidelity) prior to a shareholder meeting to amend a corporate constitution, which resulted in them voting in favor of the

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章程——路径及机制分析), ZHONG LUN (Aug. 1, 2017), <https://www.zhonglun.com/Content/2017/08-01/1843041618.html> [<https://perma.cc/P849-EJTB>].

<sup>114</sup> Chen Qingqing, *Foreign Firms Concerned over Party Building*, GLOBAL TIMES (Nov. 29, 2017, 9:33 PM), <https://www.globaltimes.cn/page/201711/1077866.shtml> [<https://perma.cc/5PDB-KUJ5>]; Simon Denyer, *Command and Control: China's Communist Party Extends Reach into Foreign Corporations*, WASH. POST (Jan. 28, 2018, 6:30 PM), [https://www.washingtonpost.com/world/asia\\_pacific/command-and-control-chinas-communist-party-extends-reach-into-foreign-companies/2018/01/28/cd49ffa6-fc57-11e7-9b5d-bbf0da31214d\\_story.html](https://www.washingtonpost.com/world/asia_pacific/command-and-control-chinas-communist-party-extends-reach-into-foreign-companies/2018/01/28/cd49ffa6-fc57-11e7-9b5d-bbf0da31214d_story.html) [<https://perma.cc/UFU4-UBXA>] (noting that the function of corporate party leaders has changed).

<sup>115</sup> Tianjinshi Fangdichan Fazhan (Jituan) Gufen Youxiangongsi 2017 Nian Dierci Linshi Gudong Dahui Jueyi Gonggao (天津市房地产发展(集团)股份有限公司2017年第二次临时股东大会决议公告)[*Notice of Tianjin Realty Development (Group) Co., Ltd on Poll Results of the Second Extraordinary General Meeting of 2017*, CNINFO] (May 5, 2017), <http://www.cninfo.com.cn/new/disclosure/detail...stockCode=600322&announcementId=1203482992&orgId=gssh0600322&announcementTime=2017-05-06> [<https://perma.cc/963D-PEVM>]; see also Lauren Yu-Hsin Lin, *Institutionalizing political influence in business: Party-building and insider control in Chinese state-owned enterprises*, 45 VT. L. REV. 441, 461(2020).

amendment.<sup>116</sup> Finally, there is a concern that such pressure and interference by the CCP will not be confined to corporations in which foreign investors are in the minority, but could be extended to those in which they are in the majority.<sup>117</sup>

## 2. Activist PIIs May Face Retaliation from the State

Institutional investors are subject to supervision from different regulatory departments—the Ministry of Finance, the CSRC, the State Administration of Foreign Exchange, and the China Banking and Insurance Regulatory Commission.<sup>118</sup> The China Banking and Insurance Regulatory Commission and the CSRC regulate PIIs such as BlackRock and Vanguard, which are minority investors in SOEs such as the Bank of China and China Life Insurance. The China Banking and Insurance Regulatory Commission and the CSRC also regulate listed SOEs. Should these minority PIIs oppose the proposed resolutions or decisions of an SOE's controlling shareholder or the directors appointed by it, the PIIs may run the risk of a regulator revoking a PII's existing regulatory approvals, or taking selective enforcement actions against them for alleged or trumped-up violations of the law. After all, the CSRC has the authority to approve and revoke the qualification of these minority foreign institutional investors.<sup>119</sup>

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<sup>116</sup> Jennifer Hughes, *BlackRock and Fidelity Put China's Communists into Company Laws*, FIN. TIMES (Sept. 7, 2017) <https://www.ft.com/content/e91270a8-9364-11e7-bdfa-eda243196c2c> (on file with Columbia Business Law Review). See also Lauren, *Id.*, 466–67.

<sup>117</sup> Xinhe Fan, *Chamber Stance on the Governance of Joint Ventures and the Role of Party Organisations*, EUR. CHAMBER (Nov. 3, 2017), [https://www.europeanchamber.com.cn/en/press-releases/2583/chamber\\_stance\\_on\\_the\\_governance\\_of\\_joint\\_ventures\\_and\\_the\\_role\\_of\\_party\\_organisations](https://www.europeanchamber.com.cn/en/press-releases/2583/chamber_stance_on_the_governance_of_joint_ventures_and_the_role_of_party_organisations) [<https://perma.cc/F9XA-5SDF>].

<sup>118</sup> An executive agency of the State Council, responsible for supervising the business activities of banking and insurance institutions.

<sup>119</sup> Provisions on Issues concerning the Implementation of the Administrative Measures for Securities and Futures Investment Made in

### 3. Foreign PIIs' Engagement with SOEs Is Unlikely to be Effective

Foreign PIIs can invest in China in three ways. First, they can invest as QFIIs approved by the CSRC and the State Administration of Foreign Exchange to invest in the Chinese securities market through onshore RMB converted from foreign currency.<sup>120</sup> Second, as Renminbi QFII, investing directly through offshore RMB with the approval of the CSRC and the State Administration of Foreign Exchange.<sup>121</sup> Finally, as institutional investors in Chinese domestic listed corporations through the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, without the approval of CSRC and the State Administration of Foreign Exchange.<sup>122</sup>

In 2018, as the MSCI Emerging Markets Index and the FTSE Global Equity Index Series began to include A-shares in their indices, an increasing number of foreign institutions started to turn their attention to the Chinese A-share market.<sup>123</sup> However, most foreign PIIs invest a tiny fraction of the assets that they manage in Chinese listed

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China by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (promulgated by the China Sec. Regul. Comm'n, People's Bank China, St. Admin. Foreign Exch., Sept. 25, 2020, effective Nov. 1, 2020), art. 2, CLI.4.346337(EN) (Lawinfochina).

<sup>120</sup> *Id.*, art. 6.

<sup>121</sup> *Id.*

<sup>122</sup> Joint Announcement of the CSRC and the Securities and Futures Commission of Hong Kong—Announcement on Matters concerning Shenzhen-Hong Kong Stock Connect (promulgated by the CSRC, Aug. 16, 2016, effective Aug. 16, 2016), §§2–3, CLI.4.278206(EN) (Lawinfochina).

<sup>123</sup> Wei Zhen, *Emerging Markets Since China A Shares' Inclusion*, MSCI (Dec. 5, 2019), <https://www.msci.com/www/blog-posts/emerging-markets-since-china-a/01662775315> [<https://perma.cc/MC3M-AKXF>]; Sandrine Soubeyran, *China A Shares Inclusion: The End of the Beginning (Not the Beginning of the End)*, FTSE RUSSEL (June 20, 2019), <https://www.ftserussell.com/blogs/china-shares-inclusion-end-beginning-not-beginning-end> (on file with Columbia Business Law Review).

corporations.<sup>124</sup> Furthermore, a 2018 survey of foreign PIIs revealed that 54% of them have never attempted to communicate with Chinese A-share corporations, and more than 80% admitted that private communication has had no substantial impact on corporate governance.<sup>125</sup> It has also been observed that the foreign PIIs had allowed controlling shareholder-appointed (i.e., state-appointed) directors to vote on their behalf,<sup>126</sup> rather than take action that would maximize the value of the assets in their portfolio.<sup>127</sup>

The largest and most influential foreign PIIs in China are BlackRock, Vanguard, and State Street, also collectively known as the “Big Three.”<sup>128</sup> Considering the controlling position of China’s state-owned shareholders, despite the fact that the Big Three are the world’s largest institutional investors, their relatively small holdings in Chinese listed corporations make them minority investors with limited influence. Although they have issued stewardship reports and general guidelines for proxy voting, it is doubtful that they have been effective in their limited engagement.<sup>129</sup>

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<sup>124</sup> JAMIE ALLEN & LI RUI, ASIAN CORPORATE GOVERNANCE ASSOCIATION, AWAKENING GOVERNANCE: THE EVOLUTION OF CORPORATE GOVERNANCE IN CHINA 15 (Jaime Allen et al. eds., 2018).

<sup>125</sup> See *id.* at 6–7.

<sup>126</sup> OECD, CORPORATE GOVERNANCE OF LISTED CORPORATIONS IN CHINA SELF-ASSESSMENT BY THE CHINA SECURITIES REGULATORY COMMISSION, at 29 (2011), <http://www.oecd.org/daf/ca/48444985.pdf> [<https://perma.cc/7D76-WSZ3>].

<sup>127</sup> See Curtis J. Milhaupt, *Nonprofit Organizations as Investor Protection: Economic Theory and Evidence from East Asia*, 29 YALE J. INT’L L. 160, 190 (2004).

<sup>128</sup> See, e.g., Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298, 298 (2017).

<sup>129</sup> One exception is that in 2012, Yale University Endowment Fund, a minority foreign institutional investor in Gree Electric (which was at that time an SOE), jointly voted with a minority state-backed institutional investor (Penghua Fund Management Company) against a board candidate nominated by SASAC which is the controlling shareholder of Gree Electric. See Lu Tong (鲁桐), Yu Baoliang (于宝亮), *Geli Dianqi Zhongxiao Gudong Heyi Shengchu—Jiaqiang Jigou Touzizhe Canyu Gongsizhili De Yiyuan He*

BlackRock is involved in the corporate governance of Chinese listed corporations in two main ways: private communications and voting at investors' meeting. BlackRock disclosed that its approach to communication is "still at the stage of educating issuers."<sup>130</sup> With regards to voting, BlackRock's general stewardship voting guidelines are based on a policy of comply-or-explain, whereby Chinese corporations are expected to comply with BlackRock's recommended corporate governance policies, and if not, to explain the deviations.<sup>131</sup> However, SOEs are controlled by state-appointed management, and the controlling shareholder has control of listed corporations. Thus, the SOE is incentivized to listen to the controller and management, rather than to BlackRock. Indeed, one survey revealed that some listed corporations "refuse to give detailed answers beyond the party line."<sup>132</sup> Further, because BlackRock typically holds a minority stake in listed SOEs, although it has (on rare occasion) voted against management or shareholder proposals, it did not change the final outcome. For example, in China Coal Energy Company, an SOE, BlackRock voted against a proposal for a connected transaction between the corporation and its controlling shareholder, as it was not in the best interest of investors,<sup>133</sup> but the proposal was passed with over 84% approval.<sup>134</sup>

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Nengli (格力电器中小股东何以胜出——加强机构投资者参与公司治理的意愿和能力) [*What Makes Gree Electric's Small and Medium Investors Win - Strengthening Institutional Investors' Willingness and Ability to Participate in Corporate Governance*], 07 ZIBEN SHICHANG (资本市场) [CAP. MKT.] 116, 117 (2012).

<sup>130</sup> BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: 2018 ANNUAL REPORT, at 6 (Aug. 30, 2018),

<https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2018.pdf> [<https://perma.cc/AJG9-RB5N>].

<sup>131</sup> See *id.* at 3.

<sup>132</sup> Allen et al., *supra* note 124, at 8.

<sup>133</sup> See *BlackRock Proxy Voting Results: BlackRock, Inc. Vote Disclosure*, ISS PROXY, <http://vds.issproxy.com/VoteDetail.php>. (last visited July 7, 2021).

<sup>134</sup> China Coal Energy, *Zhongguo Zhongmei Nengyuan Gufen Youxian Gongsi 2020 Nian 6 Yue 16 Ri Juxingde 2019 Niandu Gudong Zhounian*

BlackRock has also cooperated with domestic SIIs to establish Sino-foreign joint ventures to invest in the Chinese securities market. In 2004, BlackRock and the Bank of China established a mutual fund corporation named Bank of China Investment Management, in which BlackRock held 16.5% of the shares and Bank of China 83.5%.<sup>135</sup> However, the Bank of China Investment Management's published fund investment strategy clearly states that the portfolio manager of the institutional investor is not involved in the corporate governance of the investee listed corporations.<sup>136</sup> Moreover, in 2021, although BlackRock entered into a joint venture agreement with China Construction Bank (an SOE) to conduct wealth management business in China, the joint venture did not disclose any stewardship policies. Thus, it is not clear whether BlackRock's new joint venture engages in the corporate governance of its investee companies in China.

As for Vanguard, it states that in China, the lack of emphasis on criteria for improvement in government regulations "has led to inconsistencies in how companies approach governance."<sup>137</sup> Vanguard's investment stewardship

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*Dahui Toupiao Biaojue Jiegou (中国中煤能源股份有限公司2020年6月16日举行的2019年度股东周年大会投票表决结果)* [Poll Results of the 2019 Annual General Meeting of China Coal Energy Corporation Limited held on June 16, 2020] CHINA COAL ENERGY CO. LTD. (June 16, 2020), <https://www.chinacoalenergy.com/attach/0/c6effd335e724408ab44fc290618427c.pdf> [<https://perma.cc/R4V3-KFUT>].

<sup>135</sup> *Zhongyin Hangye Youxuan Linghuo Peizhi Hunhexing Zhengquan Touzi jijin Zhaogu Shuomingshu (中银行业优选灵活配置混合型证券投资基金招募说明书 [BOCIM Industry Preferred Flexible Allocation Fund Prospectus])* 7 (Feb. 2009) (on file with Columbia Business Law Review).

<sup>136</sup> BOCIM, *Zhongyin Shouyi Hunhexing Zhengquan Touzi Jijin Gengxin Zhaomu Shuomingshu Zhaiyao (中银收益混合型证券投资基金更新招募说明书摘要)* [Summary of the Updated Prospectus of BOCIM Income Hybrid Securities Investment Fund] §12 (Jan. 17, 2020), [http://pg.jrj.com.cn/acc/CN\\_DISC/FUND\\_NT/2020/01/17/163803\\_ls\\_1207260331.PDF](http://pg.jrj.com.cn/acc/CN_DISC/FUND_NT/2020/01/17/163803_ls_1207260331.PDF) [<https://perma.cc/95UC-KE47>].

<sup>137</sup> VANGUARD, *VANGUARD: INVESTMENT STEWARDSHIP 2020 ANNUAL REPORT*, at 12 (Dec. 31, 2020), <https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and->

team has disclosed its engagement policies in its annual report, and it claims that it has discussed corporate governance issues with listed corporations in private meetings.<sup>138</sup> However, Vanguard has played a limited role in governance. In 2019, Vanguard's stewardship team had only engaged with three listed SOEs (China Petroleum & Chemical, PetroChina, and Sinopec Oilfield Service),<sup>139</sup> despite being a shareholder in more than 1,800 listed Chinese corporations.<sup>140</sup> Moreover, given that these three SOEs are controlled by the SASAC, and the percentage of shares Vanguard holds is less than that of minority SIIs,<sup>141</sup> Vanguard's engagement efforts are likely to be futile.

State Street does not disclose specific stewardship guidelines for China's listed corporations, but it has collaborated with E Fund Management Company (a domestic institutional investor) to develop an environmental A-share strategy to enable investors to effectively incorporate environmental scores into their equity portfolios.<sup>142</sup> But it is

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reports/2020\_investment\_stewardship\_annual\_report.pdf  
[<https://perma.cc/AUW5-YXUP>].

<sup>138</sup> *Id.* at 52.

<sup>139</sup> VANGUARD, INVESTMENT STEWARDSHIP — 2019 IN FOCUS: ASIA-PACIFIC REGION (2019), WACHTELL, LIPTON, ROSEN & KATZ, [https://www.wlrk.com/files/2019/Vanguard\\_2019\\_Annual\\_Report\\_Investment\\_Stewardship.pdf](https://www.wlrk.com/files/2019/Vanguard_2019_Annual_Report_Investment_Stewardship.pdf) [<https://perma.cc/3WNT-3SKR>].

<sup>140</sup> Vanguard Yazhouqu Zongcai Lin Xiaodong: Weilai Xiwang Yi Duzi Xingshi Jinru Zhongguo Gongmu Shichang (Vanguard 亚洲区总裁林晓东: 未来希望以独资形式进入中国公募市场) [Vanguard Asia President Xiaodong Lin: Future Hopes to Enter the Chinese Public Offering Market as a Sole Proprietorship], FIN. SINA (Aug. 15, 2019), <https://finance.sina.com.cn/roll/2019-08-15/doc-ihytcitm9353740.shtml> [<https://perma.cc/42N2-CASN>].

<sup>141</sup> The percentage of shares held by Vanguard in China Petroleum & Chemical, PetroChina, and Sinopec Oilfield Service is 0.015%, 0.006% and 0.17%, respectively. See *Vanguard Immerging Markets Stock Index Fund*, VANGUARD, <https://personal.vanguard.com/us/FundsAllHoldings...FundId=1354&FundIntExt=INT&APP=PE&WL=PE&tableName=Equity&tableIndex=21> (on file with Columbia Business Law Review).

<sup>142</sup> Shannen Wong, *SSGA, E Fund Co-Develop Environmental A-Share Strategy*, CITYWIRE ASIA (June 28, 2018),

not clear whether State Street would participate in the corporate governance of its investee corporations on the basis of its environmental A-share strategy. Furthermore, even if State Street exercises its voting rights, its vote is unlikely to be outcome-determinative. For example, State Street voted against CITIC Bank's proposal to issue bonds in October 2020,<sup>143</sup> probably because issuing bonds would lead to a fall in the share price, increase the corporation's financial burden and harm its long-term growth. Yet the proposal was approved, with 99% of votes in favor.<sup>144</sup>

To conclude, foreign minority PIIs are unlikely to make a material difference in the outcome of SOE shareholder elections when the state holds the controlling vote. One study found that, from 2010 to 2013, the average rate of votes in favor of resolutions proposed by the management of SOEs was 99.3%, the highest among the jurisdictions studied.<sup>145</sup> Moreover, only 55.3% of the shares in SOEs were voted during the same period, which was the lowest among the listed corporations in the US, UK, Hong Kong and France.<sup>146</sup> A key implication of the findings is that voting rate among the foreign minority PIIs is low. After all, the state already wields the majority of shares in order to approve the resolutions.<sup>147</sup>

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<https://citywireasia.com/news/ssga-e-fund-co-develop-environmental-a-share-strategy/a1133028> [<https://perma.cc/XGD8-SEZP>].

<sup>143</sup> SSGA, *Proxy Voting Records*, Ticker No. 998 (Oct. 30, 2020), <https://vds.issgovernance.com/vds#/MTA1/> (on file with the Columbia Business Law Review).

<sup>144</sup> *Zhongxin Yinhang Gufen Youxian Gongsi 2020 Nian Dierci Linshi Gudong Dahui Jueyi Gonggao* (中信银行股份有限公司2020年第二次临时股东大会决议公告) [*Announcement of Resolutions of the Second Extraordinary General Meeting of 2020 of CITIC Bank*], CITIC BANK (Oct. 30, 2020), <https://www.citicbank.com/about/investor/notice/ashare/202010/P020201030705626331626.pdf> [<https://perma.cc/7DJH-WMFN>].

<sup>145</sup> Institutional Shareholder Services, *China Investor Stewardship: An Examination of Voting and Engagement Activities in China* 13, ISS (Nov. 3, 2014), <https://www.issgovernance.com/file/publications/china-investor-stewardship.pdf> [<https://perma.cc/59Q4-SR3B>].

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 8. This finding was recently corroborated in another study, which found that foreign minority PIIs, even when they exercise their voting rights, failed to block amendments to the corporate constitution initiated

#### 4. PIIs Rely on the Securities Investor Services Centre

The CSRC is responsible for managing the China Securities Investor Services Centre, a SII, which was established to promote and protect the interests of minority investors.<sup>148</sup> As of March 2021, the Securities Investor Services Centre had bought 100 shares in over 4,225 corporations listed on the Shanghai and Shenzhen Stock Exchanges<sup>149</sup> in order to become the smallest shareholder in each of these corporations, to exercise shareholder rights, and to engage with the corporation.<sup>150</sup> Thus, the Securities Investor Services Centre acts as another lever which the state uses to exert power over SOEs and deters PIIs from incurring costs to monitor the corporation.

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and favoured by the controlling shareholder. See Lauren, *supra* note 117, at 441, 479.

<sup>148</sup> Chen Jie (陈洁)[Jie Chen], *Toufu Zhongxin Gongyi Gudongquan De Peizhi ji Zhidu Jiangou: Yi “Chigu Xingquan” Wei Yanjiu Kuangjia* (投服中心公益股东权的配置及制度建构: 以“持股行权”为研究框架) [*The Configuration and Institutional Construction of the Rights of Investment Services Centre as a Public Interest Shareholder: A Study on “Exercising Shareholder Rights”*], 1 TOUZIZHE (投资者)[INV.] 77 (2018).

<sup>149</sup> Guo Wenyong Dongshizhang Zai “Disanqi Gongsì Zhili Zhuanti Peixunban” Shangde Zhici (郭文英董事长在“第三期公司治理专题培训班”上的致辞) [*Chairman Guo Wenyong’s Speech at the “Third Corporate Governance Training Course”*], CHINA SECURITIES INVESTOR SERVICES CENTER (Apr. 29, 2021), <http://www.isc.com.cn/html/zxxw/20210429/3780.html> [<https://perma.cc/RU36-GGVU>].

<sup>150</sup> Guo Li (郭雳) [Li Guo], *Zuwei Jiji Gudong De Touzizhe Baohu Jigou — Yi Toufu Zhongxin Wei Li De Fenxi* (作为积极股东的投资者保护机构——以投服中心为例的分析) [*Shareholder Protection Institution as Active Shareholder—an Analysis of the Securities Investor Service Center*], 8 FAXUE YANJIU (法学研究) [L. SCI.] 148-159 (2019). For example, the Securities Investor Services Centre has participated in the corporate governance of SOEs by making inquiries concerning their financial performance. See *Toufu Zhongxin Canjia Zhejiang Guoyou Shangshi Gongsì Shouchang Jiti Yeji Shuominghui* (投服中心参加浙江国有上市公司首场集体业绩说明会) [*Investment Service Center Participates in the First Collective Performance Presentation of Zhejiang State-owned Listed Corporations*], SINA (Apr. 16, 2021), <https://finance.sina.com.cn/roll/2021-04-16/doc-ikmyaawc0078776.shtml> [<https://perma.cc/YBF2-NZ4W>].

Further and importantly, in 2019, China's new securities law established an investor protection institutional mechanism which requires the Securities Investor Services Centre to actively exercise shareholding rights.<sup>151</sup> Under the law, the investor protection agency may act as: (1) a proxy for investors, by publicly requesting investors to authorize it to collectively exercise their rights;<sup>152</sup> (2) a mediator, by mediating disputes between investors and the listed corporations;<sup>153</sup> (3) a supporter, by backing investors bringing lawsuits related to acts that damage their interests;<sup>154</sup> (4) a shareholder, by bringing derivative action for the benefit of the corporation;<sup>155</sup> and (5) a representative, by bringing class actions when authorized by more than 50 investors.<sup>156</sup>

In addition, the Supreme People's Court and the Shanghai People's Court have proposed the establishment of a separate civil litigation system for securities claims, with the Securities Investor Services Centre providing professional legal services and other litigation support to protect the interests of minority investors of listed corporations.<sup>157</sup> It is thus likely

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<sup>151</sup> Zhengquan Fa (证券法) [Securities Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2019, effective Mar. 1, 2020), CLI.1.338305(EN), NPC.GOV.CN (Dec. 28, 2019), <http://www.npc.gov.cn/englishnpc/c23934/202109/9886ca6f805e4663a9a725d6f72066dd.shtml> [<https://perma.cc/D9DP-J5Q5>].

<sup>152</sup> *Id.* art. 90(1).

<sup>153</sup> *Id.* art. 94(1).

<sup>154</sup> *Id.* art. 94(2).

<sup>155</sup> *Id.* art. 94(3). Notably, the conditions for bringing the derivative action under the PRC Company Law (i.e. the restrictions on the percentage of shares held and how long the shares have been held) will not apply.

<sup>156</sup> *Id.* art. 95(3).

<sup>157</sup> Zuigao Renmin Fayuan Yinfa <Guanyu wei Sheli Kechuangban Bing Shidian Zhuhezhi Gaige Tigong Sifa Baozhang De Ruogan Yijian> De Tongzhi, Fashi [2019] Shiqi Hao (最高人民法院印发《关于为设立科创板并试点注册制改革提供司法保障的若干意见》的通知), 法发【2019】17号[Notice by the Supreme People's Court on the Issuance of Several Opinions on Providing Judicial Guarantees for the Establishment of the STAR Market and the Pilot Program of the Registration System Reform No.17 [2019]] (promulgated by the Sup. People's Ct., June 20, 2019, effective June 20, 2019), §13, CLI.3.333390(EN), SIPF (Mar. 24, 2020),

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that the Securities Investor Services Centre can play a leading role in protecting minority investors' interests<sup>158</sup>— further reducing the likelihood that minority PIIs will actively and voluntarily initiate actions to monitor and engage with the listed corporation.

Having analyzed the roles played by minority SIIs and PIIs in SOEs, the next section examines the roles played by minority investors in POEs.

### III. INSTITUTIONAL INVESTORS IN CHINA: PRIVATELY-OWNED ENTERPRISES (POES)

Minority SIIs play three different kinds of roles in listed POEs. First, they are actively involved in the governance of private enterprises in order to fulfill strategic national development objectives. Second, they actively participate in corporate governance to protect state assets. Finally, the other minority SIIs are passive financial investors who only seek to increase the value of state assets through short-term investments.

#### A. POEs: Three Sub-categories of SIIs

##### 1. Government-Established Funds: Active Participation to Pursue National Strategic

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<http://www.sipf.com.cn/tbfg/2020/03/12883.shtml> [<https://perma.cc/JHJ8-W3CE>].

<sup>158</sup> But there is a risk that the Securities Investor Services Centre may not actively or effectively exercise its litigation rights under securities law in SOEs (with a mixed ownership model). This is because, given that the state is the controlling shareholder of the SOE, the Securities Investor Services Centre—which is also managed and controlled by another state organ (the CSRC)—will think twice before challenging the actions of another state organ (the controller of the SOE). This is especially so if the actions of the controller or its board are sanctioned by the CCP. Needless to say, the Securities Investor Services Centre will not and cannot contradict the CCP. So far, it has not been involved in any litigation matters in SOEs.

## Objectives

The government-established funds mainly focus on the state's strategic investment in POEs—in other words, the state wields influence in newly established POEs through strategic investments managed by minority state-backed institutions. The state sets up government funds to promote the development of private enterprises and accelerate the implementation of the national development strategy. As of 2020, the state has established 2,156 government funds with a value of over RMB 11.6 trillion, which focus on outstanding small and medium enterprises in emerging industries in order to rapidly develop innovative corporations.<sup>159</sup> Those government funds are required by the central government to be actively involved in the corporate governance of POEs through actions including active monitoring, private communications and voting.<sup>160</sup> For example, the China State Development and Investment Group Company, a government established fund, invested in the artificial intelligence chip POE, Cambricon Technologies Corporation, during a period in which Cambricon was suffering from liquidity problems, and became the largest minority institutional investor. In addition to attending the corporation's shareholder meetings and exercising its voting rights, the China State Development and Investment Group Company has nominated a director to

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<sup>159</sup> *Gelei Zhengfu Chanye Yindao Jijin Guimo Yu Lii Wanyi Yuan, Zhuli Mingying Qiye Zhuanxing Shengji (各类政府产业引导基金规模逾6万亿元, 助力民营企业转型升级)[The Size of Various Government Industrial Guidance Funds Exceeds RMB 6 Trillion: Assisting the Transformation and Upgrade of Private Enterprises]*, XINHUANET (Oct. 27, 2020), [https://www.cs.com.cn/xwzx/hg/202010/t20201027\\_6105370.html](https://www.cs.com.cn/xwzx/hg/202010/t20201027_6105370.html) [<https://perma.cc/LSR5-CBRV>].

<sup>160</sup> Implementation Opinions of the National Development and Reform Commission, the Ministry of Science and Technology, and the Ministry of Industry and Information Technology on Supporting Private Enterprises in Accelerating Reform, Development, Transformation and Upgrading (promulgated by the St. Dev. & Reform Comm., Ministry Sci. & Tech., Ministry Indus. & Info. Tech., Ministry Fin., Ministry Hum. Resources & Soc. Sec., People's Bank China, Oct. 14, 2020, effective Oct. 14, 2020), ¶ 35, CLI.4.347166(EN) (Lawinfochina).

Cambricon's board and is otherwise actively involved in the governance of the corporation.

Further, the China State Development and Investment Group Company has launched a large number of investment funds to meet national strategic goals.<sup>161</sup> It established an investment fund, the "Advanced Manufacturing Industry Investment," in partnership with other SIIs, such as the Industrial and Commercial Bank of China, in order to invest in a large number of POEs in the advanced manufacturing sector.<sup>162</sup>

## 2. SOE Funds: Active Participation to Protect State Assets

SOEs are authorized by the State Council to set up funds to invest in POEs and become minority institutional investors in them.<sup>163</sup> In order to align the investments of these SOE funds with national interests, the SASAC has set up a Fund Coordination Leading Group to guide and coordinate these institutional investors through regular meetings.<sup>164</sup> However, the

Fund Coordination Leading Group does not interfere with the specific investment decisions and engagement actions of those minority SIIs, which generally rest on market-based considerations that do not require approval from the state.<sup>165</sup>

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<sup>161</sup> "Jijin Guojiadui" Jinhuaishi ("基金国家队"进化史) [*The evolution of the "Fund National Team*], SDIC (Jan. 7, 2020), <https://www.sdic.com.cn/cn/rmtzx/xwzx/jtfc/webinfo/2020/01/1579939662955354.htm>. [<https://perma.cc/EQQ8-LVBR>]

<sup>162</sup> *Id.*

<sup>163</sup> Chuangtou "Gujiaodui" Dajun Jihe: Jijinhua Yunzuo, Shijia Shidian Yangqi Zhizhang Jiuqian Wubai Yiyuan! (创投"国家队"大军集结: 基金化运作, 10家试点央企执掌9500亿元!) [*Venture Capital of "National Team" was Assembled: 10 Pilot Central SOEs have RMB 950 Billion for Fund-based Investment!*], PEDAILY (July 31, 2018), <https://news.pedaily.cn/201807/434188.shtml>. [<https://perma.cc/K7PX-CSW4>].

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

SOE funds are required to protect and augment state assets. The State Council requires these funds to monitor the POEs and to actively exercise their shareholder voting rights by appointing directors and supervisors in order to minimize expropriation by controlling investors of the POEs.<sup>166</sup> Furthermore, should these SOE funds fail to protect the state assets, the fund managers may be personally liable for the losses, and their managers may be stripped of their managerial powers and voting rights.<sup>167</sup>

Finally, to increase the incentive for these SOE funds to engage with the POEs, the performance and remuneration of their executives are tied to the extent to which the SOE funds participate in the corporate governance of POEs.<sup>168</sup> The risk, however, is that these managers will actively engage with the POEs not so much to protect and augment the state assets, but rather to further their own personal interests.

### 3. Other SIIs: Generally Passive

Apart from government-established funds and SOE funds, it is unlikely for other types of minority SIIs to actively engage

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<sup>166</sup> Implementation Opinions of the State Council on Advancing the Pilot Program of the Reform of State Capital Investment and Operation Corporations (promulgated by the St. Council, July 14, 2018, effective July 14, 2018), §1(5)(2), CLI.2.318382(EN) (Lawinfochina), (on file with Columbia Business Law Review); *see also* Guanyu Yinfa <Zhangcheng Shifan Tiaokuan (Guoyou Cangu Gudong Quanyi Baohu)> De Tongzhi (关于印发《章程示范条款(国有参股股东权益保护)》的通知) [Notice on the Issuance of Model Articles of Association (Protection of Rights and Interests of State-owned Participating Shareholders)] (promulgated by the Shanghai SASAC, Dec. 19, 2018, effective Dec. 19, 2018), [https://www.gzw.sh.gov.cn/shgzw\\_ffg\\_zcfg\\_gfxwj/20181218/0054-89734.html](https://www.gzw.sh.gov.cn/shgzw_ffg_zcfg_gfxwj/20181218/0054-89734.html) [<https://perma.cc/KKE8-ULQH>].

<sup>167</sup> *Id.*

<sup>168</sup> Yunnan Sheng Shengshu Cangu Qiye Guquan Guanli Zanzing Banfa (云南省省属参股企业股权管理暂行办法) [Interim Measures for the Management of Equity Participation in Provincial Enterprises in Yunnan Province] (promulgated by the People's Gov. Yunnan Province, July 31, 2020, effective Aug. 7, 2020), art. 5, art. 6, [http://www.yn.gov.cn/zwgk/zcwj/zxwj/202008/t20200807\\_208577.html](http://www.yn.gov.cn/zwgk/zcwj/zxwj/202008/t20200807_208577.html) [<https://perma.cc/MWL2-NUWD>] (China).

with the POEs for two main reasons. First, they are not required to participate in the corporate governance of the POEs, unlike the SOE funds and government-established funds. Second, they have little incentive to do so.

Regarding the first reason, a survey of the top ten listed POEs, as measured by market capitalization, demonstrates that 75% of minority SIIs who invest in them hold less than 1% of a given company's shares.<sup>169</sup> Due to the small percentage of shares they hold, and in view of the free rider problem and coordination costs, they would have a greater incentive to sell the shares if the POE is not performing than to incur time and expense in engaging with the POE in order to effect meaningful changes to its business strategy. For example, in March 2021, after a POE, Yihai Kerry Arawana Holdings Company, disclosed in its 2020 annual report that its net profit was lower than what its institutional investors had expected,<sup>170</sup> one of its investors, ICBC, sold off its shares.<sup>171</sup> As for the minority investors with individual holdings of more than 1%, which add up to 25% ownership of the company, none of them holds at least 3%—the minimum requirement for proposing shareholder resolutions.<sup>172</sup> It is reasonable to conclude that, in view of the insignificant shareholdings of these minority investors, they are unlikely to incur cost to promote the long-term success of the POEs.

<sup>169</sup> See Appendix A.

<sup>170</sup> *Jinlongyu Nianbao Luodi: Zhongjin Liting Yibai Yishiyuan Mubiaoja, Liushi Yi Jingli Zhicheng Siqian Yibai Yi Shizhi Zhengyi* (金龙鱼年报落地：中金力挺110元目标价，60亿净利支撑4100亿市值争议) [Yihai Kerry Arawana Holdings Co. Ltd Annual Report Disclosure: Target price of RMB 110, Net profit of 6 Billion and Market value of 410 Billion Sparked Controversy], 21<sup>ST</sup> CENTURY BUS. HERALD (Mar. 24, 2021), [https://m.21jingji.com/article/20210324/herald/7f3036bdc9c9a1aac875aabd9f2370bc\\_zaker.html](https://m.21jingji.com/article/20210324/herald/7f3036bdc9c9a1aac875aabd9f2370bc_zaker.html) [https://perma.cc/4XM2-DNJA]

<sup>171</sup> 益海嘉里金龙鱼粮油食品股份有限公司2020年年度报告 [Yihai Kerry Arawana Holdings Co. Ltd 2020 Annual Report] 1, 100 (Mar. 2021); see also 益海嘉里金龙鱼粮油食品股份有限公司2021年年度报告 [Yihai Kerry Arawana Holdings Co. Ltd 2021 Annual Report] 1, 135–37 (Mar. 2022).

<sup>172</sup> Rules for the Shareholders' Meetings of Listed Companies (promulgated by the CSRC, Jan. 5, 2022, effective Jan. 5, 2022), art. 14, CLI.4.5113284(EN) (Lawinfochina).

## B. POEs: Two Sub-Categories of PIIs

### 1. Domestic

In view of the insignificant percentage of shares held by domestic minority SIIs in POEs, they generally play a passive role in corporate governance.<sup>173</sup> Nevertheless, with the emergence of a number of listed POEs without dominant investors in the A-share market, it is possible for domestic PIIs to actively engage with the POEs—although such activism is rare in China, as there are only nine reported cases observed in the last decade, as shown in Table 2 below.

**Table 2: Cases of activism in POEs by minority PIIs<sup>174</sup>**

Case no., year	Listed POE	Shareholding of the largest investor	Goal	Minority PII	Types of activism	S/F?
1, 2011	Amoi Technology Co. Ltd.	32.49%	Suing for the false statement of securities	Hongshan Fund Management (1%)	Derivative action	S
2, 2012	Zhejiang Huahai Pharmaceutical Co. Ltd.	26.92%	Veto the proposal for the dismissal of the general manager	E Fund Management (3.44%)	Exercise of voting rights	S
3, 2013	Shanghai Jahwa United Co. Ltd.	26.78%	Selection and recommendation of candidates for the	E Fund Management (3.27%)	Shareholder proposal and exercise of voting rights	S

<sup>173</sup> See Cai Yi (蔡奕) & Yu Zhongbo (于忠泊), *Guanyu Tuijin Jigou Touzizhe Canyu Shangshi Gongsi Zhili De Ruogan Fazhi Jianyi* (关于推进机构投资者参与上市公司治理的若干法制建议) [Certain Legal Suggestions on Promoting Institutional Investors to Participate in the Governance of Listed Corporations], *Jinrong Fayuan* (金融法苑) [FIN. L. F.] 74, 87, 91 (2015); Liming Wang, et al., *Growth and Challenges in the Development of Institutional Investors in China*, in *DEVELOPING CHINA'S CAPITAL MARKET: EXPERIENCES AND CHALLENGES* (Douglas Cumming et al. ed., 2013).

<sup>174</sup> S/F in the last column means “succeed/fail.” Table adapted from Lin & Puchniak, *supra* note 5, app. 2 at 143–59; Wu, *supra* note 48, at 25–26.

			board of director			
4, 2014	Ningbo United Group Co. Ltd.	29.08%	Issue of bonus shares	Shanghai Zexi Investment Management (5%)	Shareholder proposal	F
5, 2014	HIT. Shouchuang Technology Co. Ltd.	15.8%	Re-election of the board of directors	Shanghai Zexi Investment Management (15.59%)	Shareholder proposal	S
6, 2014	Tongwei Co. Ltd.	57.35%	Sign a Strategic Consulting and M&A Integration Agreement with the corporation to actively participate in corporate governance	Haven-sent Capital Management Group co., Ltd. (4.83%)	be a strategic investor, exercise shareholder rights in the daily corporate governance	S
7, 2016	Yinchuan Xinhua Commercial (group) Co. Ltd.	32.94%	Proposal to convert the corporation's capital reserve into share capital	Shanghai Bao Yin Chuang Ying Investment Management Co., Ltd (32.45%)	Shareholder proposal	F
8, 2017	Zhenxing Biopharmaceutical & Chemical Co. Ltd.	29.11%	Hostile takeover	Zhejiang United Investment Group (2.51%)	General offer to investors	S
9, 2019	Shenzhen Sunrise New Energy Co. Ltd.	26.26%	Selection and recommendation of candidates for the board of directors and removal of some of the directors	Shenzhen Huitong Zhengyuan Private Equity Investment Fund Partnership Enterprise L.P. (6.45%)	Shareholder proposal	F

Minority institutional investors with a larger shareholding (such as those who wield 5% or more shares) are more active in corporations with no dominant shareholder. As shown in

Table 2 above, with the exception of the 2014 case involving Tongwei Co., Ltd., most institutional activism has occurred in listed POEs with relatively diffuse shareholdings (as compared to SOEs) — the largest shareholder in such cases holding approximately 30% of a given company's shares. At the same time, most of the proactive institutional investors held more than 3%, and in two cases, 10%,<sup>175</sup> which is higher than the third category of state-backed institutional investors discussed in Section A3.

Four points can be drawn from the nine cases shown in Table 2 above. First, four of the cases concerned the appointment or dismissal of directors, which seems to suggest that reforming corporate governance is a priority among the investors. Second, five of the cases dealt with investor-proposed resolutions, that is, only investors who hold at least 3% of the company's stock can propose resolutions. This indicates that investors with a larger shareholding preferred to change the company's operations through shareholder proposals. Third, six of the cases pertained to exercising voting rights or proposing shareholder resolutions, which are relatively low-cost approaches to participating in governance, as compared to derivative lawsuits or hostile takeovers. This is consistent with the intuition that minority investors prefer more cost-efficient approach to engagement. Finally, the one derivative action and one takeover case, both of which were successful, are exceptions that prove the rule: both types of actions are generally rare in listed corporations in China.<sup>176</sup>

As the nine cases above show, there are two main types of activism, the first of which may be said to promote the long-term success of the corporation, and the second of which may

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<sup>175</sup> The shareholding threshold for shareholders to convene a general meeting. Rules for the Shareholders' Meetings of Listed Companies, art. 9, art. 10, *supra* note 175.

<sup>176</sup> See Robin Hui Huang & Juan Chen, *Takeover Regulation in China: Striking a Balance between Takeover Contestability and Shareholder Protection*, in *COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES* 209-210 (Umakanth Varottil & Wai Yee Wan eds., 2017); Donald C. Clarke & Nicholas C. Howson, *Pathway to Minority Shareholder Protection*, in *THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH* 243-295 (Dan W. Puchniak et al. eds., 2012).

benefit specific minority investors but not necessarily the corporation or the investors as a group. The first type consists of actions pertaining to governance such as nominating, appointing and dismissing directors.<sup>177</sup> Similarly, contractual agreements between the minority investors and the corporation, under which the former agree to participate actively in governance to promote the corporation's long-term development, also fall into this category<sup>178</sup>; so does bringing derivative action to remedy the wrongs committed against the corporation.<sup>179</sup> The second type consists of hostile takeovers<sup>180</sup> and the issuance of bonus shares.<sup>181</sup> China does not have a robust mechanism to protect investors from being squeezed out in a hostile takeover situation.<sup>182</sup> However, a potential conflict of interest may exist between a hostile acquirer and minority investors of the target company: the acquirer will transfer the target company's assets and business opportunities to the acquirer's parent company or other affiliates without compensation after gaining control.<sup>183</sup> As for bonus shares, their issuance does not necessarily improve the long-term financial performance of a listed corporation or promote the development of its corporate governance.<sup>184</sup> This is because, after bonus shares are issued,

<sup>177</sup> See case numbers 2, 3, 5 and 9 on Table 2 above.

<sup>178</sup> *Id.* See case number 6.

<sup>179</sup> *Id.* See case number 1.

<sup>180</sup> *Id.* See case number 8.

<sup>181</sup> *Id.* See case number 4.

<sup>182</sup> Fu Qiong (傅穹)[Qiong Fu], *Diyi Shougou De Falü Lichang (敌意收购的法律立场)* [The Legal Standpoint of Hostile Takeover], 3 ZHONGGUO FAXUE (中国法学)[CHINA LEGAL SCI.] 226, 227 (2017); Robin Hui Huang & Jun Chen, *Takeover Regulation in China: Striking a Balance between Takeover Contestability and Shareholder Protection*, in COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVE ch. 7 (Umakanth Varottil & Wai Yee Wan eds., 2017).

<sup>183</sup> Junhai Liu (刘俊海), *Lun Gongsi bingou Zhongde Xiaogudong Quanli Baohu (论公司并购中的小股东权利保护)* [On the Protection of Minority Shareholders' Rights in Corporate Mergers and Acquisitions], 5 FALÜ SHIYONG (法律适用) [J. L. APPLICATION] 38 (2012).

<sup>184</sup> *Gaosongzhuan Xianxiang Yanjiu (高送转现象研究)* [The Research on Issuing Bonus Shares], SSE 46–47 (June 4, 2017),

many retail investors will seek to buy them, thereby resulting in a temporary spike in the share price, which will benefit the minority institutional investors who received the bonus shares, as they can sell the shares at higher price.<sup>185</sup>

## 2. Foreign

There are several quantitative studies that have shown that the presence of large foreign PIIs, i.e. QFIIs, will improve firm performance, as they actively monitor the management of their investee corporations. For example, a 2017 study of listed corporations from 2004–2014 found a significant positive correlation between large QFIIs and firm performance.<sup>186</sup> A 2018 study of listed corporations from 2002–2015 found a positive correlation between QFIIs and accounting information transparency.<sup>187</sup> This suggests that QFIIs exerted influence over the listed corporations to increase information transparency.<sup>188</sup> Another 2018 study found a positive correlation between increased QFIIs and reduced cost of capital.<sup>189</sup> A 2020 study found that the presence of QFIIs is associated with superior operating performance of the firms, and that long-term QFII involvement has a greater impact than short-term involvement.<sup>190</sup> These studies suggest that QFIIs have been actively engaging with the investee corporations.

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<http://www.sse.com.cn/aboutus/research/jointresearch/c/3990530.pdf>  
[<https://perma.cc/9YQN-HGXY>].

<sup>185</sup> *Id.* at 1.

<sup>186</sup> Yongjia Rebecca Lin & Xiaoqing Maggie Fu, *Does Institutional Ownership Influence Firm Performance? Evidence from China*, 49 INT'L REV. ECON. & FIN. 17, 17 (2017).

<sup>187</sup> Ningyue Liu et al., *Institutional Ownership and Corporate Transparency in China*, 24 FIN. RES. LETTERS 328 (2018).

<sup>188</sup> *Id.*

<sup>189</sup> Jiang Hai et al., *On Foreign Shareholdings and Agency Costs: New Evidence from China*, 54 EMERGING MARKETS FINANCE AND TRADE 2815, 2380 (2018).

<sup>190</sup> Ningyue Liu et al., *The Investment Behavior of Qualified Foreign Institutional Investors in China*, 54 J. MULTINAT'L FIN. MGMT. at 1 (March 2020).

However, the studies also recognize the problem of reverse causality: because corporations that are larger, more profitable, less risky, and have better corporate governance attract more QFIIs, it is difficult to establish whether improved firm performance is driven by QFII presence.<sup>191</sup> Moreover, the findings of positive correlation between QFIIs and improved corporate governance and firm price—which indicate effective activism by QFIIs—seem difficult to reconcile with the fact that QFIIs held an average of 1% to 3% shares in the last twenty years.<sup>192</sup> Further, based on hand collected data from 2011 to 2021, with regards to POEs, there appears to be only one case of activism involving QFII<sup>193</sup> (with the rest involving mainly minority SIIs and to a lesser extent, PIIs<sup>194</sup>).

In sum while there are empirical studies showing the positive correlation between firm performance and QFIIs, there are other pieces of evidence that call into question the activist behavior of QFIIs.

## V. THE STRATEGIC INVESTOR MODEL: A NEW INITIATIVE

This section argues that, in an SOE with a strategic investor model, the majority PII, also known as a “strategic investor,” will be hampered in its ability to actively and effectively engage with the management for two reasons. First, while the strategic investor, as majority shareholder, theoretically holds appointment and dismissal rights, the management is likely to be still under the ultimate control of

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<sup>191</sup> Liu et al., *supra* note 190, at 329; Hai et al., *supra* note 189, at 2827.

<sup>192</sup> Lin & Fu, *supra* note 186, at 17; Lin & Puchniak, *supra* note 5, at 85; Liu et al., *supra* note 190, at 14.

<sup>193</sup> Lin & Puchniak, *supra* note 5, at 149; Wu, *supra* note 48, at 25–26. *See also* Appendix I (case number 16). The POE is Beingmate Baby & Child Food Co Ltd and the QFII is J.V.R. International. The QFII proposed a shareholder resolution to divest the POE of its infant related business. The resolution was passed at the general meeting. [PDFs aren't in a free access]

<sup>194</sup> Lin & Puchniak, *supra* note 5, at 143–159; Wu, *supra* note 48, at 25–26 (*see* case numbers 11, 14, 15, 17-19, 22, 24–7, 29 and 31-3 in their Appendix I).

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the state pursuant to an agreement between the strategic investor and the state. Second, given that the actions and decisions of the strategic investor will be monitored, and may even be challenged, by the Securities Investor Services Centre, it is doubtful whether the strategic investor will take serious, active steps to promote the long-term financial success of the corporation if doing so is inconsistent with the political interests of the state.

#### A. Management is Still Under Control by the State

As alluded to in Section III(A), the mixed ownership reform launched by the CCP consists of transferring the shares of the controlling shareholder (i.e., the state) to institutional investors also known as strategic investors, such that the former becomes the minority shareholder and the latter the majority. A key purpose is for strategic investors to provide leadership and transfer technical skills to the SOEs. Given that the strategic investor would hold the majority of shares, it should also possess the key governance rights such as those related to appointments and dismissals of directors and officers. However, this is not necessarily the case.

Consider the example of Gree Electric, briefly mentioned in Section IV(A). In 2019, under the share transfer agreement, the state controlling shareholder, the Zhuhai branch of the SASAC, transferred a portion of its shares to the strategic investor Hillhouse Capital, making the latter the majority shareholder.<sup>195</sup> Importantly, the agreement also required Hillhouse Capital to let the management (appointed by the Zhuhai branch of the SASAC) to remain in power and to allow the Zhuhai branch of the SASAC to retain the rights of

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<sup>195</sup> Gree Electric, Zhuhai Geli Dianqi Gufen Youxian Gongsi Guanyu Gongsi Konggu Gudong Qianshu <Gufen Zhuanrang Xieyi> Ji Gongsi Kongzhiquan Ni Fasheng Biangeng De Tishixing Gonggao (珠海格力电器股份有限公司关于公司控股股东签署《股份转让协议》暨公司控制权拟发生变更的提示性公告)[Zhuhai Gree Electric's Announcement on the Signing of the Share Transfer Agreement by the Controlling Shareholder of the Company and the Proposed Change of Control of the Company] (Feb. 4, 2020), [https://pdf.dfcfw.com/pdf/H2\\_AN202002031374706053\\_1.PDF](https://pdf.dfcfw.com/pdf/H2_AN202002031374706053_1.PDF) [<https://perma.cc/8TQV-6N6H>].

appointment and dismissal.<sup>196</sup> The effect is that the state, although no longer the controlling shareholder, still wields the governance rights that are associated with being the controller, thereby allowing the state to continue to exert considerable influence over the SOE. Thus, should there be any conflict between the strategic investor and the state regarding the strategic direction and operations of the corporation, the management will heed the wishes of the state. This will reduce the incentive for the strategic investor to take active measures to promote the corporate governance of the SOEs, because it does not have control over management.

#### B. The Actions of Even Majority Strategic PIIs Will be Monitored and May be Challenged by the Securities Investor Services Centre

If the state still wields control over the management in the strategic investor model, despite not being the majority shareholder, the state also wields influence in its capacity as a minority institutional investor, i.e., the Securities Investor Services Centre. As examined in Section III(C)4), the Securities Investor Services Centre was set up by the state to protect and promote the interests of minority investors. The Securities Investor Services Centre has purchased a small percentage of shares in all the SOEs and hence actively engages by voting its shares.<sup>197</sup> It is also permitted to vote on behalf of the minority investors, and to bring derivative actions and class action lawsuits.<sup>198</sup> Given that both the

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<sup>196</sup> Zhang Song (张松) [Song Zhang], *Hunhe Suoyouzhizhi Gaige Gongsi Zhili Tantaoyuan — Jiyu Geli Dianqi* (混合所有制改革公司治理探讨——基于格力电器) [*Exploring Corporate Governance of Mixed Ownership Reform Based on Gree Electric*], 01 XIN KUAJI (新会计) [N. ACCOUNTING] 29, 31 (2021).

<sup>197</sup> *Securities Investor Services Centre, Introduction*, <http://www.isc.com.cn/html/zxjs/> [perma.cc/Y8M5-TLPZ] (last visited July 8, 2021).

<sup>198</sup> So far, the Securities Investor Services Center has not been involved in any litigation in SOEs (whether mixed ownership or strategic investor models), but only in POEs and even then, the Securities Investor Services

management in the strategic investor enterprise and the Securities Investor Services Centre (which owns shares in the strategic investor enterprise) are controlled by the state, the extent to which the strategic investor is able and willing to monitor and even discipline the management is called into question. After all, the Securities Investor Services Centre can challenge the strategic investor's actions. Further, the strategic investor may be disincentivized to incur costs in engaging with the management because it may take the view that the Securities Investor Services Centre will exercise its rights under the securities law as an investor protection agency.

## VI. PROPOSED SOLUTIONS TO INSTITUTIONAL SHAREHOLDER PASSIVITY IN CHINA

As Parts III–V show, the reasons for institutional investor passivity vary, depending on the type of investor and corporation.

In SOEs where the state is the controlling shareholder, it is important for minority institutional investors, particularly the PIIs, to actively engage with the controller and the management appointed by the state. Active engagement—which includes monitoring, communication and taking formal and informal actions—will help to ensure that the controller acts in the interests of the investors as a whole (and not merely in its own interests) and to minimize incidents of expropriation by the controller. While the Securities Investor

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Centre's role in supporting litigation was restricted to that of providing free legal advice to, and appointing pro bono lawyers for, individual investors who filed the lawsuits. No institutional investors have (yet) brought any lawsuits. See *Zhichi Susong* (支持诉讼) [*Supporting Litigation*], CHINA SECURITIES INVESTOR SERVICES CENTER (last visited Nov. 5, 2022), <http://www.isc.com.cn/html/zcss/> [perma.cc/7TTS-38KS]; see also *Zhongzheng Zhongxiao Touzizhe Fuwu Zhongxin Zhengquan Zhichi Susong Yewu Guize* (中证中小投资者服务中心证券支持诉讼业务规则)[Securities Supportive Litigation Business Rules of Securities Investor Services Center] (promulgated by the Securities Investor Services Center, Aug. 7, 2020, effective Aug. 7, 2020), art. 5), <http://www.isc.com.cn/u/cms/www/202008/07093840gwjb.pdf> [https://perma.cc/SRV9-EUBC].

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Services Centre plays an important role in protecting minority investors' interests, it is not advisable for minority investors to be entirely reliant on it because it is ultimately regulated and controlled by the state, which is also the controlling shareholder of the SOEs.

In POEs where the majority investor is a PII, this paper shows that, while certain types of state-backed funds do actively engage with the management, the rest are passive. Further, there is no clear evidence that the majority of the domestic and foreign minority PIIs have engaged to any significant degree. Thus, measures should be taken to incentivize passive minority investors to be more actively engaged in order to ensure that the majority investor acts in the interests of all investors.

In strategic investor enterprises, the role of the majority PII is to improve the corporate governance and to introduce technical know-how in order to increase productivity and profitability. But it has been argued that the extent to which these majority strategic investors would be actively engaged is hampered by the state's hand-on management of these enterprises. Thus, it is important to reduce these barriers to effective engagement.

Accordingly, this section proposes three solutions. First, the existing dual-track management approach in SOEs has to be reformed in order to reduce state pressure or influence. Second, new incentives have to be developed to enable passive minority SIIs in POEs to actively engage. Finally, while the Securities Investor Services Centre can and should play an active role in engagement and protecting minority investors' interests in both SOEs and POEs, conflicts of interest arising from the Securities Investor Services Centre being controlled by the state (through the CSRC) have to be addressed.

#### A. Reforming the Existing Dual-Track Management Approach to Corporate Governance

Under the existing dual-track management approach, managers of SOEs consist of those who are appointed on the basis of their professional expertise and on the basis of political considerations. I argue that a reformed dual-track

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management approach can, in the case of SOEs, increase the incentives for *minority SIIs* to engage as well as reduce state pressure on *minority PIIs*, thereby incentivizing the latter to engage. And a reformed approach can, in the case of strategic investor enterprises, reduce state control and increase the incentives for the strategic majority PIIs to actively participate in corporate governance.

### 1. The Current Dual Track Management Approach: Problems

In 2015, the CCP introduced a professional managerial system in SOEs (and state-backed institutional investors), which required the board of directors to appoint professional managers based on market considerations in order to promote the long-term financial performance of the SOEs.<sup>199</sup> However, the traditional system of appointing and dismissing core management in SOEs has remained in place: the CCP still wields ultimate control over the key managers in SOEs.<sup>200</sup> As a result, SOEs are expected to be managed on two tracks. On the one hand, professional managers are selected on the basis of their market-based expertise, and they are contractually appointed to fulfill specific obligations to manage SOEs. On the other hand, the board of directors appointed by the CCP still has the ultimate right to make decisions concerning the corporations' affairs, which include appointing and dismissing these managers.

Another problem is that the prerequisite for appointing the professional managers is loyalty to the CCP, and the corporation's CCP organization plays a leading role in selecting and appointing the candidates.<sup>201</sup> In addition, due to the lack of uniform appointment criteria, some SOEs require professional managers to have held senior positions in

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<sup>199</sup> Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State-owned Enterprises, *supra* note 112, art. 9.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

government agencies or other SOEs.<sup>202</sup> In such circumstances, these professional managers, although no longer holding political positions, remain close to the CCP.

Considering that professional managers are appointed and removed by the existing boards of SOEs, who are in turn appointed by CCP, it is unlikely that professional managers will do anything to defy these state-appointed directors. Thus, despite the contractual obligation of professional managers to pursue the long-term interests of SOEs based on market considerations, these professional managers are likely to align themselves with state-appointed directors, who are motivated by political considerations. Thus, it is likely to be difficult or futile for minority PIIs to challenge these professional managers for making decisions that harm the long-term interests of SOEs. Furthermore, these minority PIIs are likely to lack the incentives to engage with the SOEs: it is unlikely for them to incur additional resources because of the free rider problem, as other minority PIIs can simply remain passive and reap the rewards of the activism of a specific minority PII.

## 2. Clarification of the Conditions Under Which Interference or Dismissal is Permitted

To reform the two-track management approach, it is not viable to turn it into a single track, namely, one in which the CCP has no control over the appointment of the managers, or in which managers are selected only on the basis of market-based considerations. After all, because China is a socialist country, SOEs nominally belong to the people, and thus, the CCP does not transfer full control to professional managers. In other words, the governance of SOEs is for the benefit of

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<sup>202</sup> See, e.g., *Mianxiang Shehui Gongkai Xuanpin Tianjin Jinlian Touzi Konggu Youxian Gongsi (Xianggang Jinlian Jituan Youxian Gongsi) Zongjingli, Fu Zongjingli Gonggao* (面向社会公开选聘天津津联投资控股有限公司(香港津联集团有限公司)总经理、副总经理公告) [Announcement of the General Manager and Deputy General Manager of Tianjin Tsinlien Investment Holding Co Ltd. (Hong Kong Tsinlien Group Ltd.)], SINA (Feb. 22, 2019), [http://k.sina.com.cn/article\\_2810373291\\_a782e4ab020010xgz.html](http://k.sina.com.cn/article_2810373291_a782e4ab020010xgz.html). . . from =finance [https://perma.cc/X6RX-2W5D].

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the state and its people, not the interests of the specific corporation or minority investors.<sup>203</sup> Moreover, it is inevitable that state-appointed managers will ensure that the SOEs are managed in line with the interests of the state. It is therefore unrealistic to suggest that the CCP should fully delegate the power to manage SOEs to professional managers.

Instead, a viable solution is to delineate the conditions under which the CCP, or the board appointed by it, is permitted to: (a) exert influence on, or interfere with the actions taken by, the state-appointed managers in a dual-track management system; and (b) dismiss the professional managers.

I suggest that interference or dismissal by the CCP or the board can only be justified where the national development goals set out by the state specifically require such intervention, or where the professional managers have breached their contractual or statutory duties. Absent these two conditions, no interference or dismissal should be permitted, and the professional managers should be given the discretion to run the SOEs as they see fit. In this situation, minority PIIs will not find it futile to engage with the professional managers because the latter will be less susceptible to pressure or influence from the CCP or the board of directors.

Further, with these two conditions in place, the strategic majority PII in a strategic investor enterprise will be more incentivised to engage and monitor the professional managers. Even if the agreement between the strategic majority PII and the former state-controlling shareholder required the management appointed by the former state-controller to remain in power, the management would have to act in accordance with market-based considerations rather than pursuant to the dictates of the former state-controller, and the latter's powers to dismiss the management would be restricted.

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<sup>203</sup> Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State-owned Enterprises, *supra* note 112, art. 1.

## B. Incentivize Professional Managers of SIIs in POEs

In addition to SOEs, minority state-backed institutions are expected to implement the professional managerial system in their corporate governance.<sup>204</sup> As examined in Part III(A), apart from two types of minority SIIs that are active in POEs, the rest are generally passive. The question then is how these passive minority SIIs can be incentivized, through their professional managers, to engage with the POEs. We suggest that these investors can include the nature, extent and impact of the stewardship activities of these professional managers in their performance appraisal criteria. Further, the compensation metrics of these professional managers can be altered in such a way that their compensation depends not on the short-term, but rather on the long-term (such as three or five years) performance of the POEs. A revised performance appraisal criteria and compensation metric along the lines suggested here are consistent with the overarching goal of the CCP to promote the long-term performance of corporations, thereby delivering financial and economic success to China.

## C. Securities Investor Services Centre: Addressing Conflicts of Interest

As examined in Part II(C)(4), the major responsibilities of the Securities Investor Services Centre include but are not limited to exercising investors' voting rights, advising and representing investors in engaging with the corporation and in legal proceedings, monitoring the corporation on the investors' behalf, speaking to the government and regulators on the investors' behalf, and any other matters requested or sanctioned by the CSRC. Because the CRSC has control over

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<sup>204</sup> See *Dangjian Yinlingxia de Guoqi Zhiye Jingliren Zhidu Jianshe Tansuo yu Sikao — Yi Huaneng Ziben Fuwu Youxian Gongsi Weili* (党建引领下的国企职业经理人制度建设探索与思考——以华能资本服务有限公司为例) [*Exploration and Reflection on the Construction of Professional Managerial System of SOEs Under the Leadership of the CCP — the Example of Huaneng Capital Services Co, Ltd.*], SASAC (July 1, 2020), <http://www.sasac.gov.cn/n2588025/n2588119/c15000921/content.html> [perma.cc/3342-MQ4J].

the Securities Investor Services Centre, a conflict of interest arises.<sup>205</sup> On the one hand, because the CSRC, a state organ, exercises oversight and sets the directions of the Securities Investor Services Centre, the CSRC can cause the Securities Investor Services Centre to take actions that will benefit the state but not necessarily the minority investors in SOEs and POEs. On the other hand, the Securities Investor Services Centre was established to protect and promote the interests of minority investors, which may not be always aligned with, and may even conflict with, those of the state. Thus, the ability and willingness of the Securities Investor Services Centre to protect and promote the interests of minority PIIs in SOEs is questionable. For example, it does not seem likely for the Securities Investor Services Centre to sue the SOE, let alone the controlling shareholder (i.e. the state), on behalf of the minority investors.

Once again, similar to the problem of professional managers in a dual-tracked management system, it is not feasible for the state (in this situation the CSRC) to give up its powers over the Securities Investor Services Centre. In other words, it does not seem viable to eliminate conflicts of interest. Rather, the question is how we can manage the conflicts. In this regard, it is suggested that for the sake of the Securities Investor Services Centre's credibility and legitimacy, it should disclose any actual or potential conflicts of interest in any major decisions it takes, and particularly, how those decisions or actions benefit the minority investors, the investors as a whole, and the corporation itself.

## VII. CONCLUSION

The CCP celebrated its 100-year anniversary in July 2021. Chinese President Xi Jinping reaffirmed the critical and pervasive importance of the CCP in all aspects of China. He asserted that “the leadership of the Party is the defining feature of socialism with Chinese characteristics and

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<sup>205</sup> Securities Investor Services Centre, *supra* note 198.

constitutes the greatest strength of this system.”<sup>206</sup> It is thus not possible to understand and evaluate the functions and characteristics of institutional investors in China without examining the direct and indirect role played by CCP. The CCP exercises its power and influence over Chinese corporations, and this has an impact on whether, to what extent, and how three important different types of institutional investors—minority state-backed, minority privately-backed, and majority privately-backed—in the context of three different types of corporations—SOEs, POEs and strategic investor enterprises—have been passive or active. Table 3 below provides a concise summary of the analysis. The typology below may be a useful framework for analyzing whether institutional investors are passive or active not only in China, but also in other concentrated ownership jurisdictions with SOEs.<sup>207</sup>

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<sup>206</sup> Yue Wang, *China's Communist Party Vows To Rule For Another 100 Years On Its Anniversary*, FORBES (July 1, 2021), <https://www.forbes.com/sites/ywang/2021/07/01/chinas-communist-party-vows-to-rule-for-another-100-years-on-its-anniversary/. . .sh=1d7fd3601bd0> [perma.cc/K5FQ-L67Q]

<sup>207</sup> Among the Fortune Global 500, the percentage of SOEs has increased from 9% in 2005 to 23% in 2014. Further, 10.2% of the Fortune 2,000 largest corporations were majority-owned SOEs with ownership interests spread across 37 countries. See PWC, STATE-OWNED ENTERPRISES: CATALYSTS FOR PUBLIC VALUE CREATION? 9–12 (2017), <https://www.pwc.com/sg/en/government-public-services/assets/state-owned-enterprises-201504.pdf>.

**Table 3: PRC minority institutional investors' taxonomy**

	Minority Investor Type: State (SIIs)	Minority Investor Type: Private (PIIs)	
		Domestic	Foreign
<b>Ownership: State (SOEs)</b>	Passive	Passive	Passive
<b>Ownership: Private (POEs)</b>	Partially Active	Mostly Passive	Partially Active
<b>Ownership: Private (Strategic Investor Enterprises)</b>	Partially Active	Mostly Passive	NA

Finally, by providing an explanation to these puzzles and conundrums—why are *minority SIIs* generally passive in SOEs but have been active in POEs? Why are *minority PIIs* likely to be passive in SOEs but can be partially active in POEs? Why are *majority PIIs* likely to find it challenging to actively engage in strategic investor enterprises? Are there different reasons for the passivity of minority SIIs and that of minority PIIs in SOEs? What should be the solutions to institutional shareholder passivity in Chinese listed corporations?—this paper fills an important gap in the literature on institutional investors and makes a valuable contribution to the field of comparative corporate governance.

### Appendix A

#### Top 10 listed POEs by market capitalization\*

Ranking by market capitalization	Corporation	Controlling shareholder	Minority SIIs (other than government-established funds and SOE funds)
1	Contemporary Ampere Technology Co. Limited	Yuqun Zeng	China Merchants Bank (2.49%)
2	Shenzhen Mindray Bio-Medical Electronics Co., Ltd.	Xiting Li	China Life Insurance Company (0.99%) ICBC (0.86%)
3	Midea Group Co., Ltd.	Xiangjian He	Central Huijin (1.28%)
4	Foshan Haitian Flavouring and Food Company Ltd.	Kang Pang	China Securities Finance Corporation (0.94%)
5	BYD Company Ltd.	Chuanfu Wang	Central Huijin (0.73%)
6	Yihai Kerry Arawana Holdings Co., Ltd	Not disclosed	China Life Insurance Company (0.11%)
7	Jiangsu Hengrui Medicine Co.,Ltd.	Piaoyang Sun	China Securities Finance Corporation (0.92%) Central Huijin (0.92%)
8	Semiconductor Manufacturing International Corporation	Not disclosed	ICBC (0.62%)
9	WuXi AppTec Co., Ltd.	Ge Li, Ning Zhao, Xiaozhong Liu, Zhaohui Zhang	NA
10	LONGi Green Energy Technology Co.,Ltd.	Zhenguo Li	Central Huijin (1.48%) China Construction Bank (0.57%)

\* The data is based on China's "Credit Information Disclosure System for Enterprises Nationwide." 查企业 上企查查, QCC.COM, <https://www.qcc.com/> [<https://perma.cc/N7A4-8SXX>] (last visited Feb. 18, 2023).