The Evolution of Chinese Corporate Governance

Shy Lih Wong

1 Introduction

In 1978, China opened its economy to the outside world in 1978. Since then, the transformation of modern CG in China has been intimately associated the unanticipated rapid growth of its capital markets. The Chinese state-owned enterprises (SOEs) began share issuance in the 1980s, and two stock exchanges were established in Shanghai and Shenzhen in the early 1990s. In 1992, the China Securities Regulatory Commission (CSRC) launched the issuance criteria and listing procedures for SOEs. The Asian financial crisis in 1997 has intensified the major reforms of CG system in China in the late 1990s, from board independence and board structure to audit committees and quarterly reporting.

Since 2000, the Chinese CG mechanism has transformed drastically in spite of the history of its institutional and regulatory settings being relatively young compared to the United States and Germany. Chinese regulator initiated the adoption of the laws and regulation in relation to universally approved CG standard in the early twenty-first century. At that time, the leading CG mechanism was the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, based primarily on the shareholder value CG model. Since then, the international standard of Anglo-American or shareholder primacy CG code has been further extended to company and securities legislation in China.

Over the past three decades, China has remained remains one of the fastest growing economies in the world (Cumming et al., 2021). Both the Shanghai and Shenzhen Stock Exchanges eased the rules for Qualified Foreign Institutional Investors (QFII), and the inclusion of more than 200 leading A shares in the MSCI

S. L. Wong (✉)
Graduate Business School, UCSI University, Kuala Lumpur, Malaysia
e-mail: 1001955457@ucsiuniversity.edu.my

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Emerging Markets Index in June 2018 were landmark achievement of China's financial market in the past decade. Despite these accomplishments, the majority of foreign investor respondents are far from fully understanding the Chinese characteristics of China's CG regime according to a survey conducted by the Asian Corporate Governance Association in 2018 (Allen & Li, 2017).

The recent financial irregularities of TAL Education Group and Luckin Coffee, Inc. (Costa, 2021) again highlight the corporate misconduct of Chinese corporations listed in the United States. This has led to an intense concern among the investor community over the efficacy of CG reforms of Chinese firms and is likely to inhibit some investors from investing into Chinese firms. Thus, the current standard of CG system in Chinese companies is evidently not satisfactory and far from ideal.

Besides the rising consideration of Chinese CG by foreign investors and foreign corporate executives, research interest in the CG of China is also escalating due to its present status as the world's second largest economy. Furthermore, the underlying CG mechanisms of Chinese firms and the distinctive characteristics of the Chinese financial system, legal and institutional frameworks, as well as business practices provide a unique context for researchers to further investigate their efficacy even though the Anglo-American CG code is generally adopted by China. In addition, it is vital to keep pace with the latest empirical findings on Chinese CG because the establishment of new codes and regulations implies that prior empirical evidence is no longer applicable in current times.

Based on the above premises, this study reviews the Chinese CG mechanism. Its aim is to overview the current CG issues in China, synthesize empirical evidence of the effects of selected Chinese CG themes, and provide an alternative point of view to help tackle the problems arising from the Chinese CG model to enhance firms' governance performance as well as protect the interests of relevant stakeholders. Also, suggestions for future research also presented.

The method that this study utilized is narrative review approach (Baumeister & Leary, 1997; Rousseau, 2012; Rousseau et al., 2008; Wong et al., 2013) which is a more popular review technique as compared to meta-analyzes and systematic reviews (Hodgkinson & Ford, 2014). The narrative review technique is considered to be appropriate if the purpose of the review is to summarize or appraise the results of several aspects of a large area of research (Snyder, 2019). Thus, this approach is applicable to this study given the broad nature of the Chinese CG literature. In addition, the scope of this study is limited to synthesizing only empirical findings of selected themes that are directly relevant to the major concerns of foreign institutional investors and foreign corporate executives, i.e., the protection of their firms' current and future investment in China as well as the level of transparency and dependability of China's CG policy. The selected themes derived from the major concerns include board independence, state ownership, concentrated ownership, supervisory board, and institutional investors.

Firstly, the terms of each theme of Chinese CG, "Chinese Capital Market" and "China Securities Regulatory Commission," were individually searched in the online databases of Emerald Publishing, Springer, SAGE, and EBSCOhost. Then, the selection of peer-reviewed articles after the initial search was based on their

suitability, significance, and the extent of the journal's impact factor (Latapí Agudelo et al., 2019). Some of the references in this review were outside of the initial search in the online academic research database, which included reports from international organizations and business news from online news agencies. They were selected and used based on their applicability and importance to support the arguments and discussions in this review.

The literature review offered in this study will not only contribute to the expanding literature in connection with the Chinese CG but will also enhance the understanding of foreign institutional investors in relation to the current CG framework, institutional environment, and background of the Chinese capital market so as to lessen their portfolio risk before investing in China. This review also offers foreign corporate executives a contemporary overview of the unique characteristics of Chinese CG and capital market regulatory authority which allows them to gain a more detailed insight into Chinese CG and financial markets before evaluating the potential direct investment of their firms in China. Furthermore, this study sheds light on whether the present Chinese CG is converging toward the Anglo-American model or the other way around which may be useful for regulators and policymakers in determining their decision to formulate new CG codes, regulations, and policies.

This study is organized as follows: Section 1 of the study presents an overview of the Chinese capital market and CSRC. Given that China is rapidly developing, and that new rules and regulations are constantly changing China's corporate governance landscape; this study updates the latest overview. Section 2 of the study synthesizes the selected themes of the Chinese CG. The characteristics and issues of the chosen themes that are, for the most part, unique to China are then compared and contrasted with Anglo-American as well as German mechanisms. Section 3 reviews the convergence forces, convergence possibilities, and its underlying challenges. Finally, concluding remarks are presented in relation to the implications for foreign institutional investors, foreign corporate practitioners, Chinese policymakers, and regulatory authorities. The future research directions are also proposed.

1.1 Chinese Capital Market

In the early 1990s, two exchanges were established in the China's equity market. The Shanghai Stock Exchange and the Shenzhen Stock Exchange were launched in December 1990 and July 1991, respectively, and they remain the major stock exchanges as of today. China's stock market has undergone a significant expansion since its establishment in the 1990s. At the end of December 2019, China's stock market capitalization reached USD 8.5 trillion (World Bank, 2020), with a global ranking second only to the United States.

The distinctive background of the Chinese stock market was seen as closely related to state-owned enterprises (SOEs) reform. SOEs controlled China's

economy, in particular its industrial sector before the 1978 economic reform (Clarke, 2003). The Chinese government adopted several approaches to enhance SOEs' performance but mostly failed (Rajagopalan & Zhang, 2008). At the end of 1994, more than half of the SOEs operated at a loss (Kaye, 1995) with the state industry's losses reaching a record high of approximately RMB 80 billion in 1996 (Lardy, 1998). Also, China had the greatest number of nonperforming loans among Asian countries between 2000 and 2002 (The Asian Banker Journal, 2002).

During the mid-1990s, the whole Chinese banking sector was technically insolvent if the international standard accounting requirements were applied (Jiang et al., 2008; Lardy, 1998; Wang et al., 2004; Xu & Wang, 1999). Hence, the Chinese government required to recourse to another fundraising mechanism for SOEs, and the newly launched stock exchanges were employed for this enormous task.

The capital market is expected to be dominated by SOEs (directly or indirectly owned) in view of the fundamental mission of the Chinese capital market which is to finance SOEs (Jiang et al., 2008). For the purpose of maintaining the control over the listed companies, two classes of shares were created by the Chinese government, i.e., tradable and non-tradable (Jiang et al., 2008). Tradable shares are offered to public investors, while non-tradable shares are owned by either the state or legal persons representing state. About 84% of listed companies were under state control in a 2003 study (Liu & Sun, 2005). Listed SOEs comprised of more than half of the total market capitalization at the beginning of 2013.

1.2 China Securities Regulatory Commission

Previous empirical findings found that strict laws and effective enforcement are critical aspects of CG (La Porta et al., 1998, 2002). These vital features can help address firms' agency problems and safeguard the interests of minority shareholders concurrently. Their evidence reveals that countries like the United States and the United Kingdom which practice common law generally provide stronger legal protection than countries like Germany and China which practice civil law. Also, their evidence discovered that common law countries usually outperform civil law countries in terms of economic and financial outcomes at the national and firm levels.

Chinese policymakers and regulators in China were aware of the significance of legal protection which induced them to develop a contemporary regulatory mechanism for legal protection in the mid-1980s. Since then, China has introduced and implemented several reforms of laws and regulations aim at strengthening CG and increasing legal protection for minority shareholders and investors. However, the legal protection of shareholders and investors in China was poor and ranked much lower in comparison with other emerging economies during the 1990s and the early 2000s.

In empirical research conducted by Allen et al. (2005) in comparing Chinese shareholder, investor and creditor rights as well as law enforcement to other nations

were explored by La Porta et al. (1998). The overall findings demonstrated China ranked lower in all aspects as compared to other English-origin nations. Also, weak investor protection has negative impact on share price and its liquidity. La Porta et al. (1998) argue that shareholders are reluctant to invest when investor protection is weak which indicates low share liquidity. On the other hand, strong protection for investor rights can encourage investment. Johnson et al. (2002) assert that when the risk of expropriation is low, entrepreneurs are more confident and willing to begin and reinvest in their businesses which implies strong legal protection for investors and minority shareholders is an essential requirement for economic growth. This is particularly important for China which is undergoing transition from planned to market-oriented economy.

In brief, Allen et al. (2005) claim that there is a lack of appropriate regulation and adequate supervision in governing the Chinese capital market as faced by many other emerging economies. The CSRC was established in 1992 as a specialized regulatory authority to safeguard the interests of shareholders. However, it only officially attained legal status as a regulator in 1998 when the securities law was enacted (Jiang & Kim, 2015).

The CSRC is accorded to regulate listed firms and is authorized to investigate fraud and impose anti-fraud measures. Apart from in charge of monitoring the market activities of exchanges, the CSRC is allowed to intervene in the authorization of seasoned equity offerings and initial public offerings (IPO) on the stock markets to ensure market liquidity, the quality of listed companies, and other economic and financial objectives of the government. For instance, the CSRC has temporarily suspended IPO approvals nine times for extended periods, and all IPO applications were rejected in 2013 (Jiang et al., 2017). The market intervention by regulators is uncommon and not welcome in many matured capital markets such as the United States and the United Kingdom. The CSRC is granted more authority than capital market regulators in advanced nations.

The first Listed Company Governance Code was introduced in 2002 and revised recently in 2018. Some key changes under the revised code include setting up a division for representatives of the Communist Party to implement state objectives and policies; encouraging board diversity; enhancing the functions of audit committee; reducing the power and influence of majority shareholders; and establishing environmental, social, and governance requirements.

2 Themes of Chinese CG

There are several themes of CG in the context of China. However, the focus of this study is to review the importance and effectiveness of board independence, SOEs, ownership concentration, supervisory board, and the role played by institutional investors on CG in the Chinese setting.

2.1 Board Independence

CG is regarded as a system in which a board of directors is an important monitoring tool to mitigate the problems arising from the principal-agent relationship. The majority of the prior and current research on CG is based upon agency theory. However, agency theory which emphasizes the separation of ownership and management has resulted in principal-agent problems in modern firms (Berle & Means, 1932).

Agency theory argues that the board will oversee the behavior of management to safeguard the interests of owners, and hence the directors must be independent (Fama & Jensen, 1983; Jensen & Meckling, 1976). Baldenius et al. (2014) reveal that the effectiveness of a board's monitoring is significantly be affected by the balance of power between the CEO and shareholders. On the other hand, a study showed that higher board gender diversity reduces the monitoring capability of the board (Usman et al., 2018).

From another perspective, some researchers argue that over-disciplining the managers may ruin firm performance. For example, U-shaped curvilinear association between the function of board independence and firm's research and development is found which indicates excessive overseeing may demotivate the firm's intention to innovate (Guldiken & Darendeli, 2016). Additionally, Al Dah (2018) questions the validity of CEO being monitored by board.

In 2001, the CSRC (CSRC, 2001) began to emulate the US Sarbanes-Oxley Act in embracing a new CG approach to safeguard the interests of minority shareholders and investors as well as strengthen the economic reform. The very first Chinese Code of Corporate Governance for Listed Companies was drawn up in 2002 which outlined the requirement for the compulsory appointment of independent directors on the board of each listed firm. Listed firms were required to have one-third of their total directors on the board as independent directors by June 2003. The implementation of the new CG code has largely strengthened the protection of minority shareholders' and investors' interest. The legal status of the independent directors was not authorized until the company law of China was revised in 2005. However, empirical evidence is still conflicting in relation to the impacts of board independence (Hanson, 2019; Li & Naughton, 2007; Liu et al., 2015; Meng et al., 2018). The general consensus and consistent empirical results on the effectiveness of board independence remain inconclusive.

According to Liu et al. (2015), there is a positive relationship between independent directors and firm performance in China. Also, the effect of board independence on firm performance is associated with ownership concentration in China, i.e., board independence is positively related to firm performance if the concentration of ownership is reduced. However, empirical work by Bai et al. (2004) and Li and Naughton (2007) provides contradictory evidence that the independent directors have no significant influence on company performance. Jiang and Kim (2015) opine that the Chinese independent directors are generally inactive and ineffective at oversight role but merely fulfilling the requirements of the CSRC regulation even

though the number of independent directors in listed firms has grown over the years. Jiang and Kim (2015) further highlight that the nominations and appointments of independent directors in China are mainly made by majority shareholders. They further contend that the independent directors only represent the minority on boards even if they are active.

In a recent research, Meng et al. (2018) find that there is a negative impact on firm performance with the presence of independent directors, specifically firms with higher information costs. In spite of the majority of negative empirical evidence on the efficacy of the Chinese independent directors, Hanson (2019) argues that independent directors play a critical role in overseeing the actions of managers in countries where state ownership is high.

Another strand of studies exhibits how other characteristics of directors play a pivotal role in CG development in China. For example, Du et al. (2017) reveal that the probability of earnings management can be reduced by A share listed with more foreign directors. Du et al. (2018) argue that the connections of directors are very crucial for firms to acquire trade credit in China, specifically for those with financial difficulties. He and Luo (2018) also find that Chinese boards with an even number of directors are less effective with higher rate of absence in board meeting and they possess tunneling behaviors. Hu et al. (2020), on the other hand, demonstrate the importance of political connections for Chinese firm boards by employing the negative stock market reaction to the resignation of independent directors with political connections. Meanwhile, Li et al. (2020) show that innovation in Chinese firms can be enhanced by directors with technology knowledge and expertise.

2.2 *State Ownership*

The significant numbers of SOEs in China is a critical difference between China and advanced western countries. The SOEs are unique due to their distinct concentrated ownership by the central government via ministries, the provinces, and cities or local governments. The significant state ownership of listed firms possesses several considerable implications with more focus on control and cash flow rights. Although state ownership has declined substantially after the share split reform in 2006, their shareholdings are still significant, and they remain the largest shareholders in most of the strategically important industry sectors (Ng et al., 2009; Xu & Wang, 1999; Yu, 2013).

The OECD (2015a) published a report revealing that the listed entities of Chinese SOEs represent approximately 50% market capitalization in China and there is an increasing trend of SOEs in other Asian countries being listed in the stock exchanges. Empirical studies have found that there is a negative relationship between state shares and firm performance (Li et al., 2009; Shleifer & Vishny, 1997; Wei et al., 2005). Ng et al. (2009) showed that the association between state ownership and firm performance is convex.

In addition, Li et al. (2008), Menozzi et al. (2011), Wang (2015), and Wu et al. (2018) reveal that political connections play a vital role in the firm performance of SOEs. A substantial state ownership is better than a dispersed ownership structure because of the benefits of political connections and support from the state (Li et al., 2009; Yu, 2013). For example, Shao (2019) argues that the state ownership has a positive effect on firm performance given the ability of Chinese government to wield significant influence on firms.

On the other hand, Jiang and Kim (2015) found that non-SOEs are more superior than SOEs in terms of firm performance. However, Chinese SOEs which rely heavily on bank debt perform better during the financial crisis of 2008 (Liu et al., 2012). This indicates that government via Chinese state-owned banks helps distressed SOEs to alleviate financial constraints by providing them bailout loans during crisis periods.

As a whole, listed SOEs continue to underachieve compared to listed private enterprises (Jiang et al., 2017) in spite of experiencing various reforms such as partial privatization. Jiang and Kim (2015) argue that the underachievement of SOEs is not due to expropriation by state owners because they do not have the strong reason to tunnel.

Occasionally, state owners deviate from the fundamental purpose of maximizing shareholder values which may ruin the interests of minority shareholders because the objective of the state is to uphold social stability. In order to compensate for SOEs, state owners will offer them with preferential bank loans and state subsidies (Gan et al., 2018; Lin & Tan, 1999).

The conflicting relationship between the principal and the agent is the underlying problem that stems in SOEs as asserted by the shareholder theory. Managers could involve in actions for personal gain which are detrimental to the interests of both state and minority shareholders due to the separation of ownership and executive decision-making. Hence, the vertical agency problems faced by Chinese SOEs are by and large identical to those of countries that embrace the Anglo-American CG mechanism such as the United States and United Kingdom (Jiang & Kim, 2020).

OECD (2015b) issued a guideline that includes ensuring an adequate legal and regulatory framework for SOEs, fair treatment of shareholders, relationship with stakeholders, transparency and disclosure, and the responsibilities of boards of SOEs in order to address the challenges faced by the SOEs. Embracing a robust CG framework is necessary to strengthen the CG practices of SOEs (Paul, 2016), especially in the case of China.

2.3 Concentrated Ownership

Liang et al. (2020) indicate that most of the Chinese firms have concentrated ownership. Thus, the agency problem in China is considerably contributed by the deeply rooted controlling shareholders. As revealed by Jiang and Kim (2015), a large number of Chinese listed firms have large shareholders who control company

operations. Additionally, the shareholding of largest shareholder is far exceeds that of the second largest shareholder in most of these firms (Liu, 2006). Furthermore, Liu and Lu (2007) claimed that the interests of Chinese minority shareholders can be jeopardized by majority shareholders via dishonest acts such as misappropriation or embezzlement as found in Shleifer and Vishny (1997) and Cao et al. (2019).

Unfortunately, minority shareholders, investors, and boards in China are unable to dismiss managers appointed by controlling shareholders for poor performance since the controlling shareholder of a firm is either the government or the single largest owner of the equity stake. Therefore, there are limited approaches to address the agency problem in China. Conversely, large shareholders in Western countries are commonly considered a feasible answer to the vertical agency problem between internal managers and external investors due to the dispersed ownership of listed firms (Edmans, 2014; Edmans & Holderness, 2017).

On the other hand, Xu and Wang (1999) argue that the quality of direct monitoring of the managers can be improved by the existence of a controlling shareholder. In a recent study, it is found that there is a positive relationship between concentrated ownership in Chinese listed firms and firm performance even though not significant (Shao, 2019). Shao (2019) argued that larger shareholders may alleviate agency cost and enhance firm performance.

On top of that, Jiang et al. (2017) reveal that listed firms with controlling shareholders who hold more than 50% equity stake are generally found to perform better. The empirical findings of Cao et al. (2019) and Fang et al. (2018), on the other hand, claim that having a single large shareholder in a Chinese firm is less effective in improving firm performance than having several large shareholders.

2.4 Supervisory Board

A significant dissimilarity between China and other Western countries such as the United States and the United Kingdom is that China has embraced a two-tier board system which is a unique characteristic of the German model (Dahya et al., 2003). China established two-tier board mechanism comprising of the main board and supervisory board in 1992. The Chinese government plays an important role in the appointment of the supervisors on the supervisory board (Firth et al., 2010; Kato & Long, 2006). The primary responsibility of the supervisory board is to monitor and appraise the performance of senior management. The listed firm must have at least three members in a supervisory board (Firth et al., 2007). In addition, elected labor representatives should constitute at least one-third of the supervisory board membership as required by the CSRC in 2005.

According to Wang (2008), the fundamental difference between Chinese dual board system and German governance mechanism is that the German supervisory board is authorized to appoint and remove the directors on the management board. The German management board consists of only executive directors. Furthermore, there is a hierarchical relationship between the two boards in which the German

management board is required to report to the supervisory board. However, such a hierarchical relationship between supervisory and management boards does not exist in China in accordance with the Code of Corporate Governance for Listed Companies released by the CSRC in 2002, and both boards are required to report to the shareholders.

The rationale for a supervisory board is to mitigate agency conflict. Supervisory board members should therefore be elected by shareholders to provide an oversight role in monitoring the performance management board which comprises mostly executive directors. However, the Chinese supervisory boards do not have much authority to execute the oversight role (Clarke, 2006). Therefore, it is difficult for a supervisory board to exert effective supervision of the board of directors in China (Conyon & He, 2011; Wang, 2008). In a nutshell, the chairperson of the Chinese supervisory board should be given comparable authority as the chairperson of the board of directors to strengthen the effectiveness of the supervisory board.

The Chinese market has demonstrated that the supervisory boards are rubber stamp and may not be able to effectively provide monitoring (Dahya et al., 2003; Ran et al., 2015; Xi, 2006) in spite that the 2006 Chinese corporate law reform enhancing the oversight power of supervisory boards, reinforcing their right to administer directors and managers (Ding et al., 2010; Ran et al., 2015). Jiang and Kim (2020) further claim that the monitoring role of supervisory board may be negligible or purposeless since the chairperson of the supervisory board is outranked by the chairperson of the board of directors. Nonetheless, their findings are contradictory to the study of Tusek et al. (2009) in which the effectiveness of supervisory boards was found in European economies.

Furthermore, Jia et al. (2009) show that there is no positive relationship between the size and meeting frequency of Chinese supervisory boards and quality of CG. Therefore, elected labor representatives must be included in the supervisory board to further enhance the monitoring capability of directors which ultimately improves firm performance (Jiang & Kim, 2015). Notably, Farag and Mallin (2017) found that independent nonexecutive directors on the board of director could be a perfect substitute for members of the supervisory board which implies that there might be a conflict or overlap in the oversight roles and duties between the two boards.

On the other hand, Ran et al. (2015) provide evidence supporting the effectiveness of Chinese supervisory boards in which the quality of financial information can be improved by certain attributes of supervisory board members. Shao (2019) also reveals that there is a positive correlation between the Chinese supervisory board and firm performance which is contrary to much of the previous and current literature on the inefficacy of the supervisory board in China.

To recap, the Chinese CG system integrates the German model with the Anglo-Saxon model in which public companies (SOEs and non-SOEs) are required by the Chinese company law to set up a supervisory board. In spite of its two-tier board mechanism, it is much similar to the Anglo-American model given that the role of the supervisory board is evidently proven to be redundant and less effective in general.

2.5 Institutional Investors

Both domestic and foreign investor confidence play a critical role in the Chinese capital market considering the increasing importance of the Chinese economy and the growing influential role of Chinese multinational corporations in today's world. La Porta et al. (2000, 2002) reveal that traditional finance theories assert that protection of investor plays a vital role in the development of the capital market. Shleifer and Vishny (1997) acknowledge the potential expropriation of minority shareholders by the deeply rooted majority shareholders. The empirical findings of La Porta et al. (2002) demonstrate that the firm values are higher in economies with better minority shareholder protection. Jiang and Kim (2020) argue that foreign investors are willing to pay premium price for assets with better protection as investors expect more profits to be distributed to them with lesser expropriation by majority shareholders in the long run (Jiang & Kim, 2020).

Historically, China has a weak external CG mechanism due to its undeveloped legal system (Fan & Wong, 2002). The undeveloped Chinese legal system is related to the negligence of Chinese company and securities law in providing civil liability and compensation to a certain extent. Also, processes and particular clauses for enforceable civil actions are not provided. Li et al. (2010) asserted that there is no effective legal framework and governance mechanism to safeguard the interests of minority shareholders and investors in China because institutional investors are not allowed to hold more than 10% shares in a listed firm while every listed firm has a majority shareholder that holds more than 10% of listed firm's shares. Thus, institutional investors in China do not have the incentive and the authority to proactively exercise effective oversight role as compared to the institutional investors in the United States (Firth et al., 2010). A recent study (Su & Alexiou, 2020) also shows that investor protection is considerably poor in Chinese listed firms due to a weak institutional environment.

The US capital market consists of a high percentage of institutional investors that are not associated with the government which is in contrast to the high proportion of state ownership in China. The lack of state control and the high percentage of institutional investors in US firms have direct associations with the standard of US CG. Chung and Zhang (2011) investigate US firms and their empirical findings demonstrating that the proportion of a firm's shares held by institutional investors increases in tandem with the standard of its CG model. Aggarwal et al. (2011), Gillan and Starks (2003), and Pitelis and Clarke (2004) found that growing institutional ownership led to improvements in CG because institutional investors play a key role in maintaining higher standard of firm's CG. Edmans and Holderness (2017) also hold that institutional investor, such as mutual and pension funds, is effective and efficient in monitoring the board performance of listed firm in Western economies.

Empirical studies reveal the importance of institutional investors in the context of Chinese CG. For instance, political pressure is likely to affect local institutional investors and cause them to yield to the state (Huang & Zhu, 2015). Comparably,

local mutual funds capitulated on political pressure and supported SOEs during the reform of the spilt-share structure (Firth et al., 2010).

As opposed to prior research, recent studies (Aggarwal et al., 2015; Huang & Zhu, 2015; Liu, 2018) revealed that both mutual funds and foreign institutional investors can help improve the CG standard of a firm in the equity market of China. Meng et al. (2018) show that a firm is more willingly to elect outside directors to the board to enhance the monitoring capability of the board in the presence of foreign investors. In brief, foreign institutional investors have begun to play a more significant role in enhancing the Chinese CG model.

2.6 A Comparative Overview of Corporate Governance Systems

The table below summarizes the similarities and differences of each model in relation to CG attributes based on the discussion and analysis in the earlier section of this study (Table 1).

3 The Myth of Convergence in CG

There is an increasing debate among practitioners and academicians on the convergence of CG models as a result of firms and capital becoming more global. The convergence of the CG model is the progressive movement of CG policies and practices toward a common point.

Prior studies assert that the universal best CG model does not exist in the world. For instance, the Anglo-American mechanism is being advocated throughout the

Table 1 Corporate governance: similarities and differences

Attributes	Anglo-American	German	Chinese
Key stakeholder	Shareholder	Stakeholder	Government: SOEs
Board composition	Mostly nonexecutive and independent directors	Employees, founding members, and banks	Less independent directors when ownership concentration is high
Board structure	Single	Two-tier	Two-tier
Board of directors: insider/outsider	Mainly outsiders	Mainly insiders	Mainly insiders
Ownership	Widespread, noncorporate	Concentrated, high corporate, bank, family	Concentrated: high SOEs
Legal system	Common law	Civil law	Legal system is relatively weak

world, but the outcomes of the research that examined against the differences of the country's specific characteristics which include economic conditions, legal systems, ownership structures, and financial markets remain ambiguous. Such equivocal empirical findings are against the total convergence that advocates for full replication of the Western CG model. However, advocates of total divergence are required to pay attention on issues such as global stock exchange, globalization, international private equity funding, global mergers and acquisitions, international trade, and international accounting standards which are in conflict with isolated divergence systems. But the potential negative effects of deglobalization due to trade war between the United States and China as well as the recent COVID-19 pandemic may further hinder the convergence of the CG model.

Generally, there are several loopholes in the US and China's CG systems. The inefficiency of the US CG can be summarised as CEO primacy; non-vigilant directors: the director-manager agency issue; and gaps of fiduciary duties: the directors-shareholder agency issue while key problems of Chinese CG comprise of highly concentrated ownership structure (SOEs and privately owned enterprises), corporate affairs controlled by shareholders and fabrication of financial and non-financial information, inadequate protection of minority shareholders' rights and ineffective monitoring mechanism of independent directors and supervisory boards.

The separation between ownership and control remains the fundamental issue of CG. The central problem of listed companies' governance in the United States is that the current and historical practices of the US corporate laws in relation to the distribution of power between shareholders and the board of directors have granted too much freedom and authority to the management and board which in turn increases embezzlement due to widespread of ownership in the United States.

Roberts et al. (2005) opine that agency theory is influential in the development of studies, reforms, and practices in the discipline of the US CG model. Agency theory highlights the issues arising from the separation of ownership and control which centers on the protection of shareholder rights from self-serving managers (Fama, 1980; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Sarbanes-Oxley Act 2002 was established in the United States in which governance mechanisms such as board independence and accountability of directors were introduced to resolve the conflict between shareholders and management.

On the other hand, the underlying problem concerning the governance related issues in China is that the board of directors and management are easily influenced and controlled by large shareholders or shareholder groups to attain the only interests of individual shareholder or group of shareholders instead of the interests of all shareholders. Hence, the fundamental CG problem in the United States is the conflicts between shareholders and management, while the oppression of minority shareholders is the core problem that remains unresolved in the current China's CG system.

China has largely adopted the Anglo-American CG model since 1992. However, Young et al. (2008) and Yusuf et al. (2018) argue that the model of agency theory is not applicable to emerging economies in which ownership is largely concentrated.

As of today, SOEs continue to dominate the Chinese economy as a whole (Cumming et al., 2021).

Cuomo et al. (2016) show higher compliance levels with CG codes in Anglo-American countries as opposed to developing countries like China. However, there is a scarcity of data in China which explores why China has lower compliance level with CG codes as most research on CG is mainly based on quantitative methods. In addition, Cuomo et al. (2016) reveal that CG and firm performance relationships have been found to be inconsistent due to conceptual and methodological issues in which the role of a country's institutional environment on the behavior of firm has not been adequately explored.

Ironically, the bankruptcy of Lehman Brothers and the takeover of Fannie Mae and Freddie Mac in the United States were the major causes of the 2008 global financial crisis and indicating that Anglo-American CG practices might not be the model to follow. It is vital for the Chinese government to study and draw on the negative foreign lessons in which the US government employed the administrative intervention and public money to bail out the distressed firms. This course of actions may be taken as "one-off" measure, but it manifests the US CG being ineffective and may be seen as the underlying reason of the crisis.

In Anglo-American countries, insiders and outsiders of firms such as independent directors, auditors, institutional investors, security analysts, and media are considered to be an effective oversight mechanism but remain highly contestable. Dyck et al. (2010) demonstrate that the outcomes generated by some of the above intended monitoring tools in the United States are either slow or unsatisfactory; and in some cases, these monitoring mechanisms fail entirely to uncover corporate deception and scandals. In brief, the efficacy of the Anglo-American CG model remains dubious even in the context of the United States.

On the other hand, an in-depth comprehension of China's unique economic issues, CG mechanisms, institutional framework, business practices, and customs is extremely important for foreign institutional investors and foreign corporate executives. From an academic point of view, Cumming et al. (2021) assert that neither the well-established theory from the West can be directly applied in the Chinese economy nor the empirical findings from emerging economies could explain the distinctive characteristics of the Chinese capital market. Jiang and Kim (2020) further highlight that many researchers misunderstand or are unaware of the dissimilarities between the Western countries and China in the context of economic, regulatory, and cultural frameworks which led them to inaccurately interpret Chinese empirical studies based on the Western theories and perceptions. Consequently, China should establish a CG model conforming to its own reality based on its previous experiences and lessons learned.

4 Conclusion and Future Research

The objective of this study is to review the Chinese CG via the thematic lens that is directly relevant to the major considerations of foreign institutional investors and foreign corporate executives which include protection of their firms' interests in China and the extent of transparency and reliability of the second largest economy's governance policy. The selected themes are derived from the major considerations of foreign investors and foreign corporate executives which comprise of board independence, state ownership, concentrated ownership, supervisory board, and institutional investors.

Equally important, the contemporary overview of Chinese capital market and regulatory body, namely, Chinese Securities Regulatory Commission, is also provided in this review which will enhance the target audience's understanding of the distinctive characteristics of financial system and legal framework in China. At the same time, the review has implications for policymakers and regulators as well as contributes to the expansion of CG literature in China.

Agency theory argues that an increasing number of independent directors on a board promotes stronger and better CG. However, this review asserts that Chinese independent directors are short of independence and are unable to carry out their monitoring roles as stipulated in the CG guidelines and company law. The day-to-day operations are continuing dominated by the insider managers. As a result, insider control problem remains rampant in China despite studies showing that the average number of independent directors in listed firms is growing. Accordingly, this study suggests that greater power should be granted to independent directors by the regulations to effectively fulfill their oversight role.

In addition, this review holds that the agency issues concerning SOE managers such as embezzlement are generally much more destructive than the conflict of interest between the state and minority shareholders due to the separation of ownership and management. Thus, it is suggested that Chinese regulators should revisit the monitoring role of independent directors and members of supervisory boards to mitigate the agency problems caused by SOE managers and safeguard the interest of minority shareholders. It is also found that the efficacy of concentrated ownership or controlling shareholders, be it single or multiple, in mitigating agency issues and improving firm performance in China remains inconclusive. Principal-principal conflicts continues to cause high agency costs for Chinese firms. Consequently, it is recommended that Chinese policymakers revise the rules and regulations concerning the protection of minority shareholders including the foreign institutional investors to better protect their interests so as to attract more foreign investment.

With regard to supervisory board, the review shows that supervisory board is ineffective in monitoring the performance of board of directors and managers. Consequently, they are incapable of identifying and resolving expropriation by managers. Even though recent empirical evidence unveils that the supervisory board is able to improve firm performance which is in contrast with most of the prior literature on the ineffectiveness of the Chinese supervisory board, this review

suggests that Chinese policymaker and regulator should distinguish and separate the possible overlapping duties and roles of independent nonexecutive directors and members of supervisory board in listed firms.

This review signifies the critical role of institutional investors in the Chinese capital market and CG. This review found that foreign institutional investors have higher impact on state owners and are more active in overseeing SOEs because they are unsusceptible to political pressure. The degree of foreign institutional ownership and its composition are important features of the Chinese CG. Institutional investors are instrumental in causing changes within a firm in the United States, while Chinese institutional investors have limited role to play in administering SOEs. Thus, growth in foreign institutional ownership is important for improving Chinese CG. It is proposed that company and securities laws be enhanced safeguarding both the domestic and foreign institutional investors.

On another note, this study provides a review on whether Chinese CG converge toward the Anglo-American practices or continue to diverge from the Anglo-American model based on the current literature. This review shows that the Chinese CG mechanism possesses some similarities to both Anglo-American and German models while maintaining its unique attributes after two decades of extensive reform through multiple series of regulatory changes and the development of new rules. The existing Chinese regulatory framework, capital market structure, and institutional factors are found to have considerable influence on the implementation of CG procedures, code, and regulation although China has predominantly embraced the Anglo-Saxon CG mechanism. However, the severe damages caused by the 2008 global financial crisis on the world economy has, to an extent, overturned the credence of the market-based Anglo-American CG system being the only effective and efficient universal standard of CG model. At the same time, the German CG model is far from universal norm. Thus, this review concurs with the notion of many researchers that there is no one-size-fits-all CG model given the diverse and dynamic environment of emerging economies. This study, therefore, offers useful empirical guidance concerning CG for Chinese policymakers and regulatory authorities to consider the need to not only enhancing the quality of CG but also reshaping its CG codes and regulations based on their distinctive economic conditions, history, financial system, legal framework, social development, cultural aspects, competition, ownership structure, capital market framework, and industry- and firm-specific characteristics that truly reflect their own realities in order to smoothen their transition from a planned economy to a fully market-oriented economy.

There are limitations in this study. Firstly, this study is based on narrative review method, and this technique has been criticized for its subjective and biased methodology. Another limitation is that the focus of this study is only on China and hence the findings of this study cannot be fully generalized to other emerging economies given that countries have their own distinctive characteristics as revealed in previous empirical studies. However, this review provides general suggestion and empirical guidance for emerging countries with homogeneous institutional elements.

In 2018, the CSRC has issued the revised Guidelines on the Governance of Listed Companies (the first revision since 2002). Major changes to the updated guidelines

include the recommendation of board diversity, enhancement of the functions of the audit committee, confining the powers of controlling shareholders, the requirement of environmental, social and governance guidelines and etc. The introduction of the revised CG guidelines, coupled with the expansion of new company law in 2019, is continuously changing the Chinese CG landscape. Hence, this review suggests that further studies are needed to not only investigate the effect of these recent changes on country-level and firm-level outcomes but also to review the themes of this paper (or other relevant themes) using different methodologies to deepen the understanding of foreign investors and foreign corporate practitioners on contemporary CG in China.

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Shy Lih Wong is currently pursuing a doctoral degree in Business Administration at UCSI University, Malaysia. His experience of over 20 years spans many fields, including property development, property investment, construction, fund management, and corporate finance. Prior to pursuing his doctorate, he was a manager in his family-owned firms which are principally involved in housing development and commercial property investment. He holds a Master of Finance and a Bachelor of Business (Economics and Finance) with Distinction from RMIT University in Melbourne, Australia. His current research interests focus on environmental, social, and governance as well as corporate social responsibility.