REVISITING EXECUTIVE PAY OF CHINA'S STATE-OWNED ENTERPRISES: FORMAL DESIGN, FRESH DATA, AND FURTHER DOUBTS

LI-WEN LIN*

ABSTRACT

A hallmark feature of China's state capitalism is the central role of about 100 large, non-financial state-owned enterprises (SOEs) controlled by the State-Owned Assets Supervision and Administration Commission. These companies are often dubbed China's "national champions." Despite the importance of these SOEs in the global economy, their executive compensation system – an incentive mechanism commonly deemed important for modern organizational management – remains mysterious. This article traces the regulatory changes and, more importantly, explores the pay data recently disclosed for the very first time by the central SOEs in China. It shows a mixture of modern and traditional practices, commercial and non-commercial goals, as well as market and government governance. It exposes the political agenda and industrial policies underlying the financial evaluation criteria. It reveals an ostensible link between pay and performance, in which performance is specifically defined on the state-owner's own terms. Meanwhile, it raises doubts about the credibility of the compensation data published by Chinese SOEs, whether listed or unlisted. Finally, this study of Chinese SOE executive pay carries important implications for the contemporary contentious debate about how to regulate Chinese SOEs' global activities as well as insights for the governance of both SOEs and non-SOE's worldwide.

Keywords: executive pay, state-owned enterprise, pay-for-performance, CEO-worker pay ratio, non-financial performance, foreign investment law, social enterprise

TABLE OF CONTENTS

INTRODUCTION

China's economy is often presented as the global poster child of state capitalism. A hallmark feature of China's state capitalism is the central role of about 100 large, non-financial state-owned enterprises (SOEs) formally controlled by the State-Owned Assets Supervision and Administration Commission (SASAC) of the State Council.[1] These flagship SOEs account for ten per cent of the world's largest 500 companies (by revenue) on the Fortune Global list.[2] They are often dubbed China's "national champions"[3] or "*yangqi*" (meaning "central enterprises" in Chinese). Despite being conspicuous due to their size, until very recently, these globally significant SOEs' organizational structure and governance practices were a black box to outsiders. While recent research has explored the SOEs' ownership structures and institutional links to various organs of the party-state,[4] there remains very limited research that exposes the national champions' executive compensation system – an incentive mechanism commonly deemed important for modern organizational management.

---

* Lin is an assistant professor at the University of British Columbia Peter A. Allard School of Law, Vancouver, Canada.

1 *See, e.g.*, 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).

2 *See Fortune Global 500 List*, FORTUNE (Oct. 9, 2018), http://fortune.com/global500/.

3 *See We are the Champions*, THE ECONOMIST, (Mar. 18, 2004), http://www.economist.com/node/2495172.

4 *See supra* note 1.

The lack of research on the national champions' executive compensation mainly stems from the scarcity of data. While studies on Chinese executive compensation have proliferated over the past decade, they only focus on the listed companies.[5] This research focus is mainly driven by data availability, as listed companies are required to publish annual reports under securities regulations.[6] However, most of the important SOEs under SASAC's control are non-listed companies and have limited disclosure obligations. Moreover, the listed companies' annual reports provide only a partial picture of executive pay of China's state-owned sector. As I have shown elsewhere, large numbers of top managers of Chinese listed companies do not disclose any pay information in annual reports because they are paid by the unlisted parent SOEs rather than by listed subsidiaries.[7] Thus, it is important to examine the parent SOEs to understand the pay practices of China's state-owned sector.

In December 2016, the central SOEs, following SASAC's instructions, publicly disclosed their executive compensation data for the very first time.[8] This disclosure initiative is part of the SOE reform agenda to promote corporate governance and curb corruption.[9] The new data might shed light on the mysterious compensation practices of Chinese SOEs. While the government advertises the disclosure initiative as an important step toward transparency, does it live up to what it proclaims? Does the new data reveal any previously unknown findings or instead give rise to more puzzles?

By tracing the regulatory history, this article shows SASAC's evolving approach to SOE executive compensation. It reveals that the performance indicators applied to Chinese SOEs are quite different from those commonly tested in academic literature. There are political agendas and industrial policies underlying the seemingly financial evaluation criteria. More importantly, with the new data, this article empirically analyzes how the numerical data corresponds to the law on the books. Although the new data overall appears quite consistent with the law on the books, the empirical findings raise significant concerns about the

---

5 *See, e.g.*, Peter Rampling et al., *Executive Remuneration in China: A Literature Review*, 21 ASIAN REV. ACCT. 128 (2013) (reviewing literature of executive pay of China's listed companies).

6 China Securities Regulatory Commission, Administrative Measures for the Disclosure of Information of Listed Companies, art. 19 (Jan. 30, 2007).

7 *See* Li-Wen Lin, *Behind the Numbers: State Capitalism and Executive Compensation in China*, 12 U. PA. ASIAN L. REV. 140, 160–68 (2016). It shows that 65% of the chairmen, 57% of the directors (excluding chairmen and independent directors), 44% of the supervisors of the listed firms under the central government's control are unpaid according to the corporate annual reports.

8 SASAC, *2015 Executive Compensation Disclosure of Enterprises under SASAC*, (Dec. 29, 2016), http://old.sasac.gov.cn/n85463/n327265/n327406/n327425/c2513588/content.html.

9 SASAC, *Unswervingly Making State-Owned Enterprises Stronger, Better and Bigger – Theory and Implementation of the State-Owned Enterprise Reform since the Eighteenth Congress of the Communist Party of China* (2017), http://www.sasac.gov.cn/n2588025/n2588119/c4599036/content.html.

data quality published by Chinese SOEs, including listed and unlisted ones. There are great discrepancies between the compensation figures released by the parent SOEs and those published by their listed subsidiaries. The information gaps are alarming, and they leave outsiders more puzzled about the executive pay practices of Chinese SOEs.

In addition, this article examines two prevailing inquiries of executive compensation literature: (1) Is executive pay tied to performance? (2) What explains the pay differentials among the top managers? The empirical findings suggest an ostensibly positive correlation between pay and performance. This pay-performance correlation, whether real or fictitious, is made possible through the visible hand of SASAC. Moreover, the pay differential among Chinese SOE executives is minimal, which is a result of the political pursuit of social harmony and equality. The small pay differentials indicate the importance of non-monetary compensation and the problem of systematic corruption given China's political backdrop.

China's SOE compensation system represents a hybrid of modern and traditional pay practices, commercial and non-commercial goals, as well as market and government governance. It remains unclear how this ongoing compensation experiment that is full of conflicting principles will be sustained or will evolve in the future. Meanwhile, China's SOE executive pay design may add fire to the contemporary contentious debate about how to regulate Chinese SOEs' global activities. This study of Chinese SOE executive pay also suggests the limitations of the mainstream policy discourse and the conventional scholarly approach to the governance of Chinese SOEs and beyond. It urgently calls for in-depth comparative research on SOE executive compensation, given the continuing significance of SOEs worldwide. Furthermore, it raises questions about executive pay practices of various emerging forms of non-SOE business organizations that have goals beyond profit maximization, commonly referred to as "social enterprises."

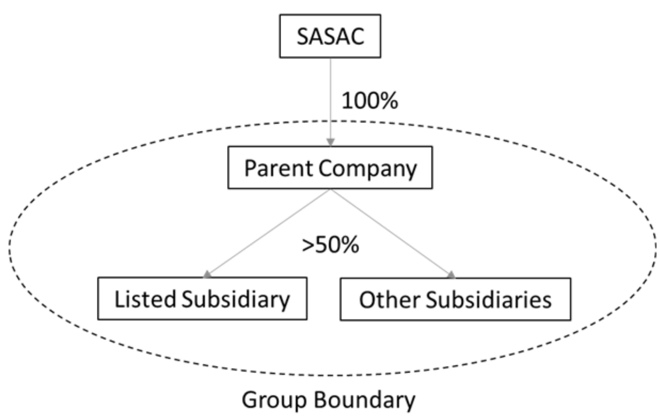
This article proceeds as follows. Section I provides an overview of the organizational structure of the central SOEs in China. It explains why it is important to look beyond listed SOEs and examine their parents. Section II discusses the state-owner's rules governing SOE executive pay, which reveals the state-owner's philosophies and goals in setting executive compensation. Section III provides a summary of the pay data recently released by China's central SOEs. Section IV compares the fresh pay figures released by the parent SOEs with those disclosed in annual reports of their listed subsidiaries, the typical source of pay information. Among various findings, the comparison raises a glaring concern of data credibility. Section V empirically examines the relationship between pay and performance indicators defined by the state-owner. Section VI discusses the compressed pay scale among the SOE executives and its implications for alternative incentive mechanisms including career advancements.

Section VII examines the implications for Chinese SOE reforms, international investment law, and comparative SOE governance; it also provides insights for private firms (non-SOEs).

I. THE FLAGSHIP STATE-OWNED ENTERPRISES UNDER SASAC

China's largest non-financial SOEs are controlled by the central government's ownership agency, known as the State-Owned Assets Supervision and Administration Commission (SASAC).[10] Each SOE under SASAC's control is typically organized as a vertically-integrated business group, as illustrated in Figure 1. Atop the group is SASAC, which owns 100 per cent of the parent company. Beneath the parent company, there are many subsidiaries including listed firms, finance companies, research institutes and many other firms related to the production chain.[11] A national business group is usually known by its listed subsidiary. For example, PetroChina, one of China's major oil companies, the shares of which are listed on the Shanghai and New York Stock Exchanges, is the external face of the China National Petroleum Corporation ("CNPC") Group. CNPC, the parent company, is the fourth largest company in the world according to the Fortune Global 500.[12] Within a group, there are often significant personnel overlaps among member firms. For example, the chairman, CEO, and five vice-CEOs of the parent company in the CNPC Group are also board members and/or executives of PetroChina, the listed subsidiary.

Figure 1. Typical Structure of a Business Group under SASAC



---

[10] *See supra* note 1.

[11] For a detailed discussion on the organization and governance of the business groups under SASAC's control, *see* Lin & Milhaupt, *supra* note 1.

[12] Fortune Global 500 List, http://fortune.com/global500/list/

Existing research of Chinese executive compensation focuses on listed companies, including the listed subsidiaries in Figure 1. Most studies analyze compensation data disclosed in annual reports of the listed subsidiaries. To be sure, this prevailing approach has produced insights, but it has great limitations in illuminating the operation of executive compensation of Chinese SOEs. Chinese listed SOEs' annual reports have failed to disclose compensation of a considerable number of top managers.[13] A main reason for the missing data problem is that these top managers of the state-controlled listed subsidiaries are also managers of the parent companies, and they are paid by the parent companies (subject to SASAC's determination) rather than by the listed subsidiaries. Under Chinese securities regulations, listed companies are required to disclose only remuneration of top managers who are paid by the listed companies themselves.[14] As a result, listed companies' top managers who are paid by their parent companies rather than the listed subsidiaries themselves are not subject to disclosure, leaving a big loophole in executive pay information. Therefore, it is important to look beyond the state-controlled listed subsidiaries and extend our attention to their parent companies to obtain a better grasp of the SOE executive pay system. Unfortunately, there has been a shortage of scholarship on executive compensation of the parent SOEs under SASAC. One of the purposes of this article is to fill this void.

II. SASAC'S EXECUTIVE COMPENSATION RULES

Since its establishment in 2003, SASAC, in cooperation with relevant government and party organs, has introduced a series of measures to reform the SOE executive pay system.[15] In 2003, SASAC conducted a survey to investigate the SOE executive compensation practices. Based on the survey results, SASAC identified a number of problems, including little oversight by the state-owner, weak relationships between pay and performance, no long-term incentives, etc.[16] Aiming to fix the problems, SASAC introduced a compensation system in 2004

---

13 *See* Lin, *supra* note 7.

14 China Securities Regulatory Commission, *Regulation No. 2 on the Content and Format of Information Disclosure by Publicly-Traded Companies – The Content and Format of the Annual Report*, art. 55 (2017 version).

15 The regulations were usually promulgated jointly by the Organization Department of the Chinese Communist Party (i.e., the Party's human resources department), the Ministry of Human Resources and Social Security, the Ministry of Finance, the National Audit Office, the Ministry of Inspection and SASAC. For more details, *see* Lin, *supra* note 7, at 144–51.

16 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N, CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION 2004 YEARBOOK 85–86 (2004).

for the first time and has revised it multiple times over the years.[17] According to SASAC's latest design, the basic structure of managerial compensation includes three parts: base salary, annual bonus, and term incentives.

SOE executives receive base salaries monthly. Initially, SASAC set the base salary based on a complex formula that considered factors including firm size, profitability, management difficulties, the average worker's pay, etc.[18] As a result, different SOEs would have different base salaries for their executives. However, recently, SASAC abolished this method in the face of mounting questions over excessive pay for SOE executives. According to the latest rules effective January 2015,[19] the base salary for SOE executives is fixed at two times the prior-year average worker's wage of all the central SOEs under SASAC's supervision. In other words, all the central SOEs offer the same base salary for their executives, regardless of firm size and other factors. Unfortunately, SASAC does not regularly disclose the average worker's wage of the central SOEs under its supervision.[20] According to the National Bureau of Statistics of China, the average worker's annual wage of all the SOEs (not limited to the central SOEs) in 2014 was 57,296 RMB.[21] In other words, the 2015 annual base salary for the central SOE executives could be more or less 110,000 RMB (about 16,900 USD). The base salary structure reflects two logics: nonmarket and social harmony. Regardless of firm size, industry, and management challenges, all of the central SOEs adopt the same base salary for their executives. It is feasible only under bureaucratic authority rather than market operation. Moreover, benchmarking the executive base salary against the average worker's pay denotes a historical trace to socialism and civil service pay,[22] and more importantly, the contemporary concern for the worsening income inequality that threatens the Party's ruling stability.

The annual bonus has more complicated structures and payment schedules. The annual bonus is contingent on the annual performance review and the triennial term review. Sixty percent of the bonus is paid right after the annual

---

17 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., PROVISIONAL MEASURES ON EXECUTIVE COMPENSATION OF CENTRAL ENTERPRISES (2004).

18 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., IMPLEMENTATION RULES FOR PROVISIONAL MEASURES ON EXECUTIVE COMPENSATION OF CENTRAL ENTERPRISES (2004).

19 Poliburo of the Communist Party of China, *Proposal on Reforming Executive Compensation of Central Enterprises*, (Aug. 29, 2014).

20 A former SASAC's chairman disclosed at a SOE reform forum that the average worker's wage of the central SOEs under SASAC's supervision for 2010 was 54,000 RMB. *The Director Of The State-Owned Assets Supervision And Administration Commission Revealed That The Average Annual Salary Of Employees In The Central Enterprises Is Currently 54,000,* CHINA TRADE UNION NEWS (Aug. 20, 2010), http://acftu.people.com.cn/GB/12493256.html.

21 NAT'L BUREAU OF STATISTICS OF CHINA, CHINA STATISTICAL YEARBOOK fig.4-11 (2015).

22 *See* ALFRED M. WU, GOVERNING CIVIL SERVICE PAY IN CHINA (2014); Hon S. Chan & Jun Ma, *How Are They Paid? A Study of Civil Service Pay in China*, 77 INT'L REV. ADMIN. SCI. 294 (2011).

evaluation. The remaining forty percent is delayed to the end of the three-year term review, which is intended to act as term incentives.[23]

The annual performance review is conducted at the end of every fiscal year. In the fourth quarter of every year, top managers should propose to SASAC their performance goals for the next year.[24] SASAC examines the proposed performance goals based on the principle of "the same industry, the same indicators," macro-economic conditions, industrial lifecycle, and firm-specific conditions.[25] SASAC and top managers then sign an annual performance agreement. The agreement specifies the responsible parties, evaluation criteria, rewards and punishments, and conditions to terminate or change the agreement. Top managers have an obligation to submit a semi-annual report to SASAC to report their performance of the obligations required in the agreement.[26]

The indicators used in the annual performance review have evolved over the years along with SASAC's continuous experiments with its evaluation scheme. Initially, annual pre-tax profit and return on equity (ROE) were the two primary evaluation indicators.[27] ROE is the amount of net income returned as a percentage of shareholders' equity. It is a commonly-used measure of a firm's profitability by showing how much profit a firm generates with the money invested by shareholders. In 2010, SASAC formally replaced ROE with economic value added (EVA).[28] EVA is the net profit less the cost of the firm's capital, including debt and equity.[29] This measure is devised and trademarked by Stern Stewart & Co., a New York-based consulting firm. EVA has been touted as a better measure than ROE as it takes into account the opportunity costs of capital invested.

It is interesting to note that SASAC's adoption of EVA is an attempt to emulate the evaluation method of Temasek Holdings Private Limited

---

23 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., PROVISIONAL MEASURES ON EVALUATING OPERATING PERFORMANCE OF EXECUTIVES OF CENTRAL ENTERPRISES (2013). The provisional measures are now replaced with Measures on Evaluating Operating Performance of Executives of Central Enterprises, effective of December 12, 2016.

24 *See id.*

25 *See id.*

26 *See id.*

27 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., PROVISIONAL MEASURES ON EVALUATING OPERATING PERFORMANCE OF EXECUTIVES OF CENTRAL ENTERPRISES (2004).

28 STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., PROVISIONAL MEASURES ON EVALUATING OPERATING PERFORMANCE OF EXECUTIVES OF CENTRAL ENTERPRISES (2009).

29 EVA permits a variety of possible adjustments. Different users may include different adjustments to EVA. SASAC's EVA formula is as follows: EVA= net operating profit after taxes – adjusted invested capital * weighted average cost of capital (EACC). Net operating profit after taxes =net profit + (interest expenses + R&D expenses – non-operating income*50%) * (1-25%); adjusted invested capital = average shareholders' equity + average liabilities – average non-interest-bearing current liability – average construction in progress.

(abbreviated as "Temasek"), a state-owned holding company controlled by the government of Singapore.[30] SASAC has frequently sent officials to investigate Temasek's operations in order to imitate them. Since the 1990s, Temasek, with Stern Stewart & Co.'s assistance, has used EVA as one of its performance evaluation methods. On Temasek's recommendation, SASAC developed a strong interest in EVA and Stern Stewart & Co.[31] In 2006, SASAC retained Stern Stewart & Co. for advice. In the following year, SASAC introduced the trial scheme of EVA and encouraged the SOEs to voluntarily adopt it.[32] The trial culminated in the mandatory adoption of EVA in 2010. Since then, EVA has become a major financial indicator used to evaluate the SOEs under SASAC's control.[33]

As noted, EVA is the net profit subtracting the firm's cost of capital. One of the challenges of calculating EVA is determining the firm's cost of capital. SASAC initially set the cost of capital at 5.5% of invested capital for most SOEs. Recently, it adopted a more nuanced approach in which the rate depends on the nature of the enterprise.[34] The cost of capital set by SASAC has been criticized for being below the market rate and favoring SOE managers. The relatively low cost of capital, to some extent, reflects the SOE's access to cheap capital provided by the state-controlled banks. This is likely a reflection of political and economic realities. When EVA was first mandated in 2010, a majority of the SOEs had problems delivering a positive EVA despite its artificially low cost of capital.[35]

SASAC's EVA formula reveals how the government intends the SOEs to behave. Research and development (R&D) expenses are counted positively toward after-tax net profit. This encourages SOEs to engage in technological investment. Meanwhile, non-operating income is counted negatively. This is

---

[30] *See* Christopher Chen, *Solving the Puzzle of Corporate Governance of State-Owned Enterprises: The Path of Temasek Model in Singapore and Lessons for China*, 36 NW J. INT'L L. & BUS. 303 (2016) (overviewing the governance of Temasek and discussing the challenges for China to emulate).

[31] *See* Li Li, *The Return of a Financial Company*, ECON. OBSERVER (Apr. 26, 2010), http://www.eeo.com.cn/2010/0406/166790.shtml (interviewing the CEO of Stern Stewart and SASAC officials).

[32] According to SASAC's data, 87 central SOEs voluntarily experimented with EVA in 2007, 93 in 2008 and 100 in 2009.

[33] STATE-OWNED ASSETS SUPERVISION & ADMIN. COMM'N ET AL., PROVISIONAL MEASURES ON EVALUATING OPERATING PERFORMANCE OF EXECUTIVES OF CENTRAL ENTERPRISES (2009).

[34] For SOEs mainly for commercial purposes in competitive industries, the cost of capital is 6.5%; for SOEs mainly for national security and backbone economic industries, 5.5%; for SOEs in military, power, agricultural and storage, the cost of capital may be lowered by 0.5%. In addition, the cost of capital is adjusted by whether the SOE falls within the high leverage range defined by SASAC.

[35] *See* Duxia Zhang, *Negative EVA for a Majority of the Central SOEs, SASAC Discourages Blinded Expansion*, SHANGHAI SEC. POST (Dec. 10, 2009).

intended to limit earnings management as well as to incentivize the SOEs to focus on their main business.

Each year, SOEs are evaluated against pre-tax profit and EVA goals; both of which are mainly set against prior-year performance. SOEs that outperform the pre-agreed goals will be rewarded while those failing to meet the targets will be punished. Besides pre-tax profit and EVA goals as the major benchmarks in the annual performance review, miscellaneous minor indicators are taken into account as well. For instance, SOEs are also rated positively for significant technological innovations, undertaking national economic policies and significant charitable donations. Pre-tax profit, EVA and these other indicators combined produce an annual performance score which is ultimately converted into a letter grade ranging from A to D. A-grade executives are entitled to a performance bonus equivalent to 2-3 times the pre-agreed base bonus, while executives of other grades receive less or even nothing.

The term review is conducted every three years. At the beginning of every term, top managers propose performance targets to SASAC. Similar to the procedure of the annual performance review, in the term review, SASAC reviews the targets and reaches an agreement with top managers. In the term review, SASAC also considers corporate innovation ability, energy efficiency, environmental protection, sustainable growth ability, etc. Triennial performance scores are also translated into letter grades from A to D. SASAC uses the ratings to determine whether and to what amount executives may receive the delayed 40 percent of the performance bonus.

The evaluation scheme reflects some governance beliefs held by the state-owner. As the evaluation system is linked with compensation and appointments, it influences the SOE managers' decision-making. Base salary tied with the average worker's wage clearly reflects the government's emphasis on "harmonious society."[36] Furthermore, the Chinese government has proclaimed the grand mission of making SOEs "bigger, stronger and better."[37] The evaluation indicators provide an objective and substantive meaning of "bigger, stronger and better." Annual pre-tax profit represents the absolute amount of profits, rather than the rate of efficiency. It manifests the pursuit of "bigness." Although EVA takes efficiency into account, it remains an absolute value, in which net profit is adjusted by the cost of capital. Also, the compensation system provides incentives

---

[36] The concept of "harmonious society" was first formally proposed in the fourth all-member meeting of the 16th Central Committee of the Communist Party of China, held on September 19, 2014. The formal report of the meeting is available at http://cpc.people.com.cn/GB/64162/66174/4527266.html.

[37] *President Xi Jinping: Decisive Victory in Building A Well-Off Society in An All-Round Way to Win A Great Victory in Socialism with Chinese Characteristics in The New Era - Report at the 19th National Congress of The Communist Party of China,* XINHUA NEWS AGENCY (Oct. 27, 2017), http://www.gov.cn/zhuanti/2017-10/27/content_5234876.htm.

for SOE managers to implement national policies. Clearly, the state-owner not only seeks profits but also non-financial goals. Therefore, it reinforces such dual goals through the executive compensation system.

An obvious question arising from the compensation rules is how much the SOE executives are paid based on the rules. Although SASAC published the detailed compensation rules, it did not make any formal or systematic disclosure of the compensation figures until very recently. In the past, outsiders could only guess by SASAC officials' informal remarks and a few SOE managers' occasional self-disclosure in media or personal blogs. The pay figures remained a mystery. Recently, the government began to unveil the SOE executive pay as part of its anti-corruption campaign. In 2014, the Political Bureau of the Chinese Communist Party's Central Committee presided by President Xi Jinping passed a set of rules to reform SOE executive compensation.[38] One of the reform measures was public disclosure of executive pay. As a result, the central SOEs under SASAC's supervision recently disclosed their executive compensation for the very first time. The new data might provide some insight into the puzzle of Chinese SOE executive pay.

III. THE PAY FIGURES AT A GLANCE

In December 2016, the 111 SOEs under SASAC's control disclosed their 2015 executive compensation information on their respective corporate websites. It was the very first time that the central SOEs publicly disclosed their executive pay. The compensation data in this article were manually collected from the corporate websites in early February 2017. At the time of data collection, six of the 111 SOEs had already removed the compensation information from their websites.[39] As a result, the sample in this article includes 930 executives of the 105 SOEs under SASAC's control. The disclosure format is standardized by SASAC. The disclosed information includes: executive's name; position; term of office; payable compensation (set by SASAC); the total of pension, health insurance and housing subsidies paid by the SOE employer; other monetary

---

[38] The rules include: Reform Scheme on Executive Compensation of the Central State-Owned Enterprises; Opinions on Rationalizing and Strictly Regulating Position-Related Treatments and Business-Related Expenses of Top Managers of the Central State-Owned Enterprises, passed by the Central Political Bureau of the Communist Party of China on August 29, 2014. A summary of the rules is available on the website of the Ministry of Human Resources and Social Security of China. MINISTRY OF HUMAN RES. AND SOC. SEC. OF THE PEOPLE'S REPUBLIC OF CHINA, APPLICABLE SCOPE SALARY DETERMINATION SUPERVISION IMPLEMENTATION (Sept. 3, 2014), http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/buneiyaowen/201409/t20140903_139627.htm.

[39] The six missing companies in the dataset are China Guodian Corporation, Shenhua Group Corporation, China Three Gorges Corporation, Dongfang Electric Corporation, China National Salt Industry Corporation, and China National Cotton Reserves Corporation.

compensation; total compensation; whether the executive is paid by shareholders or affiliates; the amount paid by affiliates. Table 1 shows a summary of the compensation data.

To precisely measure how much the SOE executives are paid, the executives are divided into two groups by whether the executive held office for the full year of 2015. This is to address the concern that many executives held office only part of 2015 (e.g., several months), and their compensation does not reflect the full-year pay. As a result, the calculations may underestimate the averages. This concern is confirmed by Table 1. The average pay of the executives who did not hold office for the full year of 2015 was much lower than the average pay of those who were in office for the full year. This article will focus on the compensation of the full-year executives.

Table 1. 2015 Executive Pay Summary of the Central SOEs under SASAC's Supervision

	Whether held office for the *full* year of 2015		
	Yes	No	Total
Number of Executives	716	214	930
(a) Average of Payable Salaries and Bonuses (1,000 RMB)	466.194	327.277	434.228
(b) Average of Pension, Health Insurance and Housing Subsidies Paid by SOE Employer (1,000 RMB)	124.871	87.831	116.348
(c) Average of Other Monetary Compensation (1,000 RMB)	17.245	7.075	14.905
(d) Average of Total Compensation =(a)+(b)+(c) (1,000 RMB)	608.310	422.183	565.481
Whether paid by Shareholders or Affiliates	0	0	0
Amount Paid by Affiliates	0	0	0

Data: collected and compiled by author. It covers 105 SOEs.

The average of payable salaries and bonuses for the full-year executives is about 466 thousand RMB (roughly equivalent to 72,000 USD). Unfortunately, SASAC does not require disclosure of how exactly the base salary, current and delayed bonuses constitute the payable amount for each executive. The salaries and bonuses set by SASAC in Table 1 appear to be much lower than the unofficially disclosed pay figures for previous years. [40] The government's recent pay-cut decree may have precipitated this downward movement of executive compensation.

While SASAC determines salaries and bonuses (i.e. row (a) in Table 1), other parts of compensation (including rows (b) and (c) in Table 1) are set by the SOEs themselves or other government entities. The average of pension, health insurance and housing subsidies is about 125 thousand RMB (roughly 19,000 USD). Some believe that Chinese SOE executives are heavily compensated by subsidies, known as "on-duty consumption," that include a variety of subsidies such as housing allowances, travel expenses, personal use of corporate cars and entertainment expenditures. However, the disclosed data does not show significant subsidies. This is likely because the data only covers housing subsidies rather than subsidies of all kinds.

Of all the 930 executives, only 71 executives received other monetary compensation in 2015. The data reveals that other monetary compensation may be one of the three types: special allowances paid by the State Council (the central government of China), transportation allowances, or overseas subsidies.

Special allowances are awarded to experts who make outstanding contributions to a professional field (e.g., fellows of Chinese Academy of Sciences). Transportation allowances appear standardized at 60 thousand RMB per year. Transportation allowances are a form of on-duty consumption that is commonly believed as an important source of income for SOE executives. However, surprisingly, only 15 executives in the dataset reported to have such payment. Overseas subsidies are an important source of income that significantly raises compensation. The overseas subsidy is standardized at 350 thousand RMB (about 54,000 USD). Thirty-six executives at six different SOEs in the dataset received overseas subsidies.[41] Overseas subsidies are explained by the fact that these SOEs are usually headquartered in Hong Kong or Macau. For example,

---

[40] In August 2008, the then-SASAC chairman (Rongrong Li) in a public meeting disclosed the average pre-tax executive compensation for the central SOEs. The average pay including base salary and bonus was: 350,000 RMB for 2004; 430,000 RMB for 2005; 470,800 RMB for 2006; and 550,000 RMB for 2007. A bureau head of Executive Compensation Department of SASAC in another informal occasion disclosed the average CEO compensation of the central SOEs was 531,000 RMB (around 68,000 USD). *See* 2008 Beijing Int'l Media Ctr., *SASAC Chairman Rongrong Li's Talk on State-Owned Enterprise Reform* (Aug. 10, 2018), http://www.china.com.cn/zhibo/2008-08/10/content_16157590.htm?show=t. In early 2010, the same chairman said in a public speech that the average executive compensation was approximately $600,000 RMB ($88,000). *See* Ziyang Zhang, *Rongrong Li: Central Enterprise's Executive Pay Isn't High with an Average of $600,000 RMB*, CHINA NEWS (Jan. 9, 2010), http://www.chinanews.com/cj/news/2010/01-09/2063314.shtml.

[41] The six central SOEs are China Merchants Group, China Resources Corporation, China National Travel Service Group Corporation, Nam Kwong Group Company, China Nonferrous Metal Mining Corporation, and China Chengtong Holdings Group.

each of the executives of China Merchant Group received an overseas subsidy; the group's chairman and CEO are the highest-paid executives (receiving 1.20 million RMB or approximately 185 thousand USD) in the dataset, primarily because of the overseas subsidies.

The average total compensation for the full-year executives is 608 thousand RMB (94,000 USD). Table 1 also shows that none of the executives are paid by shareholders or affiliates (e.g., listed subsidiaries). According to the government's rules, while a SOE executive may concurrently hold two or more posts of the firm's affiliates, the executive is permitted to receive one pay only.

IV. PAY IN COMPARISON

Before the recent disclosure initiative, listed companies' annual reports were the only formal source by which to systematically examine how much Chinese SOE executives are paid. Does the new data recently published by the central SOEs reveal any different picture from the compensation data disclosed in annual reports of the state-controlled listed subsidiaries? As I have noted elsewhere, a significant percentage of top managers of Chinese state-controlled listed firms do not disclose their compensation in the listed companies' annual reports. This is a significant missing piece of the SOE compensation puzzle.[42] This failure to disclose is due to the reality that many top managers of the listed subsidiaries concurrently hold office in the parent companies and are paid by the parent companies rather than the listed firms. It raises the question of whether the parent companies under SASAC's control pay their executives differently from the listed subsidiaries. More importantly, comparison between the compensation data of the parent companies and of the listed subsidiaries may serve as a way to examine data consistency and reliability.

Table 2 compares executive compensation data of the central SOEs and listed firms in China. The data of the listed companies in this article is taken from Deloitte's comprehensive report on executive compensation in China's A-share listed companies for the year of 2015.[43] Deloitte's report examines the highest executive pay of each firm (usually paid to CEO or the chairman of the firm) and the average pay among the firms. Pay is measured as the "total pay" as disclosed in the compensation table in the annual reports. The general understanding of the "total pay" disclosed in the annual report is the cash amount of salaries and

---

42 *See* Lin, *supra* note 7.

43 The sample includes 2,845 A-share companies, which covers virtually all A-share companies. The raw data were collected from the annual reports of the sample firms. DELOITTE, *2015-2016 China A-Share Listed Company Executive Compensation and Incentive Research Reports*, https://www2.deloitte.com/cn/zh/pages/human-capital/articles/a-share-listed-company-executives-salary-report-2015-2016.html (last visited Dec. 9, 2017).

bonuses.[44] It does not include equity-based pay such as stock and stock options. This ordinary understanding allows comparability between the two information sources.

Table 2. Executive Pay Comparison between Central SOEs and Listed Firms (2015)

Type of Firm	Average Highest Executive Pay (salaries and cash bonuses only) (1,000 RMB)
Central SOEs directly controlled by SASAC	652 (N=105)
All Listed Firms in China	938 (N=2845)
Non-SOE Listed Firms without Controlling Shareholders	2,220 (N=125)
Non-SOE Listed Firms with Controlling Shareholders	864 (N=1605)
Central-Government-Controlled Listed Firms	993 (N=341)
Local-Government-Controlled Listed Firms	804 (N=637)

Source: Data for the central SOEs directly controlled by SASAC collected by author; all the data for listed firms from Deloitte's report.

Table 2 shows that executive compensation of the central SOEs (i.e. parent companies) under SASAC's supervision is much lower than the pay of listed firms, regardless of the listed firm's ownership type, including listed firms controlled by the central government. One explanation may be that the central SOEs are closely held by SASAC and subject to more government supervision while the listed firms are subject to capital market pressure, and their pay may be rather oriented to market rates. However, this market exposure explanation is far from complete. After taking a closer look at the data, the pay gaps involve more than meets the eye. Of the 930 executives in the 105 central SOEs, 143 (involving 25 different SOEs) also disclosed their pay in the 2015 annual reports of the listed subsidiaries. All the 143 executives claimed in the 2015 annual reports that they were paid by the listed companies only rather than by any affiliates. Yet, according to the parent SOEs' recent disclosure, these same executives were only paid solely by the parent companies, rather than by their listed subsidiaries or any other affiliates. Startlingly, the pay figures disclosed in the listed subsidiaries'

44 *See* Lin, *supra* note 7 (providing an analysis of how empirical studies of executive pay of Chinese listed companies interpret the pay data disclosed in annual reports).

annual reports are entirely different from the new data recently released by the parent SOEs.

Table 3 summarizes the difference between the pay disclosed in the listed subsidiaries' annual reports and the pay disclosed by the parent SOEs. The pay gaps are fairly dispersed (the standard deviation is as almost as large as the mean). Some executives received as little as 12-17% of the amount disclosed in the listed subsidiaries' annual reports, while other executives earned up to 4-5 times of that.

The information discrepancies between the central SOEs and their listed subsidiaries appear to bear out a perennial claim made by SOE executives. In recent years, a number of SOE executives publicly explained that their compensation was strikingly different from the figures as disclosed in the annual reports of listed subsidiaries.[45] The numbers disclosed in the annual reports were said to be nominal so as to satisfy the capital market standards, and that the gap between nominal and actual pay reportedly could be as large as the distance between "the sky and the earth."[46] In this newly disclosed dataset, China Railway Group Limited, unashamedly gave an explicit warning to investors that the compensation data disclosed in its listed subsidiary's annual reports was misleading and that actual executive pay was significantly *less* than the figures disclosed therein.[47] However, Table 3 suggests that over the years, SOE executives only told the public half the story. As Table 3 shows, many SOEs'

---

[45] A high-profile example involves the executive pay of CNOOC Ltd, one of the largest state-owned oil companies in China and listed on the Hong Kong and New York Stock Exchanges. CNOOC's annual reports disclosed that several of its top managers were paid multi million dollars (RMB) annually, which aroused public anger in 2009. In response, CNOOC clarified that since the first day of the listings in 2001, all the top managers had agreed to donate the pay approved by the board of directors to the parent company and they received the amount determined by SASAC rather than the amount published in the annual reports. According to CNOOC, the difference between the actual pay and the nominal pay was like "the sky and the earth." *See CNOOC Reply to Ten Million Annual Pay: Actual and Nominal Pay like Sky and the Earth*, XINHUA NEWS (Apr. 14, 2009), https://perma.cc/X5UE-FQMW. CNOOC's statements were consistent with information given by SASAC's officials in interviews. *See SASAC Experts: Annual Executive Pay at Central SOEs often 400 Thousand Dollars, No One over One Million*, CHINA ECON. WKLY.(Sep. 21, 2009), https://perma.cc/BHA8-4EB2.

[46] *See* CHINA ECON. WKLY., *supra* note 45; XINHUA NEWS, *supra* note 45.

[47] According to the listed subsidiary's 2015 annual report, the chairman (Changjin Li)'s and the vice chairman (Guiqing Yao)'s pay each was 960 thousand RMB (salary and bonus) and the CEO (Hegan Dai)'s pay was 840 RMB; each of them did not receive any from any affiliate of the listed company. However, according to the parent company's disclosure, these two executives were not paid by the listed subsidiary at all but by the parent company; the chairman was paid only for 346 thousand RMB (salary and bonus), the vice chairman was for 647 RMB and the CEO was for 173 RMB. The figures disclosed by the parent company could be as little as 20% of the numbers disclosed in the listed company's annual report. *See* CHINA RY. GRP. LTD., ANNUAL REPORT (2015), http://www.mzcan.com/china/601390/financial/17/EN/2015%20Annual%20Report_kc74G56aJiDb.pdf.

formal pay is significantly *higher*, not lower, than the pay disclosed in the listed subsidiaries' annual reports.

This inconsistent information is sobering as the top management teams of the parent SOEs and those of their listed subsidiaries usually overlap. The Chinese government asserts that the purpose of the new pay data disclosure is to promote transparency. However, transparency is impossible without credible data. The new data contributes more confusion to already puzzling questions.

Table 3. Pay Gaps for Overlapped Executives

Pay Gaps	Number of Observations	Median	Mean	Standard Deviation	Minimum	Maximum
Pay=salary and cash bonus only						
(Pay disclosed by parent company) - (Pay disclosed in listed subsidiary's annual report)	143	146,500 (RMB)	-129,759 (RMB)	260,946 (RMB)	-815,519 (RMB)	476,400 (RMB)
(Pay disclosed by parent company) / (Pay disclosed in listed subsidiary's annual report)	143	77%	105%	90%	12%	417%
Pay=salary, cash bonus, subsidies and other monetary compensation						
(Pay disclosed by parent company) - (Pay disclosed in listed subsidiary's annual report)	143	-24,600 (RMB)	2,478 (RMB)	266,372 (RMB)	-739,706 (RMB)	644,200 (RMB)
(Pay disclosed by parent company) / (Pay disclosed in listed subsidiary's annual report)	143	96%	133%	115%	17%	553%

Note: Pay is measured in two ways in Table 3. As the common understanding of total pay disclosed in Chinese listed companies' annual reports is the cash sum of salary and bonuses, the pay comparison of salary and cash bonus only is more appropriate than the comparison of salary, cash bonus, subsidies and other monetary compensation.

Finally, another important reference point for the SOE executive compensation data is civil service pay. Chinese SOE executives are often characterized to be more of civil servants than business managers. Many SOE executives have career paths zigzagging between the government bureaus and state-owned business entities.[48] This hybrid identity may be reflected in the compensation level. According to publicly available information, the annual salary (subsidies not included) of the top-rank civil servant is 136,620 RMB, which accounts for 30% of the total compensation, with allowances accounting for the remaining 70%.[49] In other words, the total annual pay (including salary and subsidies) of the top-ranking officer in China is estimated at 455,000 RMB, which is much lower than the average SOE executive pay of about 600,000 RMB (only partial subsidies included) as reported in Table 1. As a result, it is clearly understood that the formal pay of SOE executives is higher than that of civil servants. Meanwhile, as Table 2 indicates, the executive pay of central SOEs under SASAC's control is much lower than their more market-oriented counterparts – including SOE and non-SOE listed firms. The data suggest that the level of pay for central SOE executives is formally designed to be somewhere between the civil service pay and the market-based executive pay. Such a system reflects the hybrid identity and mixed governance logic of the state and market.

V. PAY-FOR-PERFORMANCE?

The most important inquiry of executive pay literature concerns the link between pay and performance. The theoretical underpinning of "pay-for-performance" is agency theory in economics.[50] Agency theory views the relationship between shareholders and executives as an agency relationship in which shareholders (principals) and executives (agents) have divergent interests and motivations. It postulates that, to motivate executives to act in the best interest of shareholders, executive compensation should be contingent on measurable performance outcomes. But how is performance defined and measured? Existing scholarship of executive compensation typically equates performance with total shareholder return, earnings per share, return on equity, return on assets, or return on capital.[51] These performance ratios are intended to

---

48 *See* Li-Wen Lin, *Reforming China's State-Owned Enterprises: From Structure to People*, 229 CHINA Q. 107 (2017).

49 *See* Michael Forsythe, *Xi Gets a Raise, But Beijing Apartments Still Out of His Reach,* N.Y. TIMES CHINA, Jan. 21, 2015, http://www.nytchina.com/china/20150121/c21xi/en-us/ (citing data from the Ministry of Human Resources and Social Security of China).

50 *See* Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

51 *See* Alex Edmans et al., *Executive Compensation: A Survey of Theory and Evidence*, (Nat'l Bureau of Econ. Research, Working Paper No. 23596, 2017) (observing that "accounting-based performance metrics are used more frequently than stock-price based metrics, and the use of accounting metrics has increased over time. Earnings-based metrics, such as earnings-per-share, are the most common accounting measures, while total shareholder return is the most popular stock-based metric.").

measure profitability or efficiency. To date, scholarship of executive compensation offers inconclusive findings on the relationship between pay and performance, partly due to variant metrics of performance.[52] At any rate, scholars rarely consider SASAC's evaluation approach (using whether and to what extent the company achieves (adjusted) profit targets as performance indicators) when examining the relationship between pay and performance for Chinese SOEs.

As stated in SASAC's compensation rules, pre-tax profit and EVA (after-tax net operating profit adjusted by cost of capital) goals are the major performance indicators. SOEs are evaluated against whether and how well they meet the pre-agreed profit targets. These rules raise obvious empirical questions: What is the relationship between executive pay and profit targets for central SOEs under SASAC's control? How do the data support the rules?

As noted, base salary does not present any variation across SOEs because it is fixed at two times the pay of the average central SOE worker from the previous year. Bonuses and subsidies are the sources of pay variations across the firms. Bonuses are contingent on performance as measured by a set of financial and non-financial goals. The evaluation results are translated into A to D ratings. According to SASAC's rules, executives of A-grade firms receive more bonuses than those of other rating firms.[53] SASAC publishes an annual list of A-grade SOEs. Table 4 shows that A-grade firms demonstrate higher executive pay than non-A-grade firms, consistent with current law. This data shows that there is a link between pay and performance, where performance is defined on the state-owner's own terms.

Table 4. Pay Difference between A-Grade and Non-A-Grade Firms (2015)

Type	Observations	Mean pay (salary and bonus)	Mean total pay (salary, bonus, subsidies and others)
A-Grade Firms (a)	42	559.867	717.046
Non-A-Grade Firms (b)	63	403.528	535.565
Difference in percentage {(a-b)/b}		38.7%	33.9%

Note: Pay is measured as the average pay of the full-year executives and in thousand RMB.

52 *See* Henry L. Tosi et al., *How Much Does Performance Matter? A Meta-Analysis of CEO Pay Studies,* 26 J. MGMT. 301 (2000) (providing a quantitative review analysis given the large number of studies that show conflicting results).

53 Measures on Evaluating Operating Performance of Executives of Central Enterprises (promulgated by State-owned Assets Supervision & Admin Comm'n, effective of Dec. 8, 2016), http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c8108632/content.html.

The performance ratings published by SASAC are summary results of financial and non-financial indicators. It would be helpful to confirm, empirically and in more detail, the relationship between the performance indicators and pay results. Unfortunately, SASAC does not disclose any financial or non-financial performance data for individual SOEs. Furthermore, the central SOEs are non-listed companies and have very limited disclosure obligations. Still, some central SOEs publicly issue bonds and are required to disclose some financial data. This article manually collected financial data from the bond prospectuses and audited financial reports of those central SOEs that publicly issued bonds.[54] As a result, the sample encompasses 60 of the central SOEs under SASAC's supervision.[55] The descriptive statistics are reported in Appendix.

Table 5 shows the multivariat regression analysis of the determinants of exectuvie pay at the central SOEs under SASAC's control. As discussed in Section II, bonuses are contingent on financial, political, and environmental performance. Financial performance concerns whether and to what extent the SOE meets its pre-tax profit and EVA targets. This article focuses on pre-tax profit only because important adjustment items (i.e., R&D and interest expenses) of EVA are often undisclosed in the financial reports.[56] Financial performance is measured by whether and how well the SOE outperforms the bechmark—prior year pre-tax profit, an important component in financial goal setting.

Political performance takes into account the implementation of national policies. This article uses SASAC's categorization of SOEs as a proxy for political performance. SASAC divides SOEs into three categories: SOEs for public good (e.g. China National Cotton Reserves Corporation); SOEs tasked to protect national security and the national economy (e.g. SOEs in oil, power, telecom and military indutries, etc); and SOEs established mainly for economic profits (a majority of the SOEs are in this category). SOEs in the first two categories are expected to score better in terms of political performance.

Environmental performance is measured by a proxy because SASAC does not disclose its environmental evaluaiton method: whether the SOE receives

---

54 The prospectuses and annual reports were downloaded from the three websites designated by the government for information and trading of the Chinese bond market: China Foreign Exchange Trade System (CFETS) (www.chinamoney.com); Shanghai Clearing House (www.shclearing.com); China Central Depository & Clearing Co., Ltd. (CCDC) (http://www.chinabond.com.cn/).

55 The sample may not be representative because SOEs that bear certain features may be more likely to issue bonds publicly. Still, given the limited data availability, the sample provides a way to examine the relationship between pay and performance.

56 In China, companies that publicly issue bonds are required to publish financial statements; however, the disclosure standards are quite loose, compared to the standards for listed companies. Often bond issuers do not breakdown their operating expenses (including research and development expenses) and non-operating expenses (including interest expense) in their income statements.

an environmental award ("Energy Saving and Carbon Reduction Award") granted by SASAC during the evalaution period. Finally, subsidies, when dislcosed, are usually related to overseas employement. Thus, it is predicted that SOEs headquarted outside mainland China (i.e., Hong Kong and Macau) are more likely to offer subsidies and as a result, higher compensation.

Table 5. OLS Regression Analysis of Pay and Performance

	Dependent Variable: Logged Total Pay				
	(1)	(2)	(3)	(4)	(5)
Base salary factors					
(no variation)					
Bonus factors					
Financial performance:					
Whether or not outperform prior-year pre-tax profit (Yes=1; No=0)	.180*** (.047)				
Extent of outperformance (pre-tax profit growth rate)		.003** (.001)			
Common financial performance indicators but not considered in SASAC's formula:					
Return on equity (ROE)				1.013* (.409)	
Return on assets (ROA)					2.764* (1.219)
Political performance proxy:					
SOEs for public good and national interests defined by SASAC (Yes=1; No=0)	.183*** (.033)	.202*** (.037)		.175*** (.037)	.163*** (.041)
Environmental performance proxy:					
Energy saving and carbon reduction award by SASAC (Yes=1; No=0)	.070 (.037)	.059 (.048)		.070* (.032)	.077* (.033)
Combined performance determined by SASAC: A grade (2015) (Yes=1; No=0)			.294*** (.030)		
Subsidies and other pay factor					
Headquartered in Hong Kong or Macau (Yes=1; No=0)	.668*** (.027)	.726*** (.029)	.498*** (.009)	.416** (.132)	.617*** (.063)
Constant	3.888*** (.044)	4.009*** (.029)	3.945*** (.029)	3.975*** (.030)	3.969*** (.028)
R-Squared	.589	.481	.687	.534	.560
Observations	60	60	60	60	60

*p <.05; p **<.01; *** p <.001. Robust standard errors in parentheses.

Models 1 and 2 in Table 5 show that outperforming prior-year pre-tax profit is significantly correlated with executive pay, confirming the compensation rules on the books. It also shows that executives of SOEs undertaking national policies receive higher compensation, which is consistent with the compensation rules that give favorable treatment to those implementing national policies. Environmental performance, measured by whether the SOE received an environmental award granted by SASAC in the evalaution period, is positively but insignicantly correlated with executive pay. The insignificance of this result may be partly due to the possibility that the award is not a good proxy for enviornmental performance. Moreover, according to the compensation rules, environmental performance is a minor rather than major factor; the impact of environmetnal performance may be cancelled out by other more improtant factors.

While SASAC did not disclose data on financial, political and environmental performance, it disclosed which SOEs received an A grade, an evaulation rating that combines financial, political and environemtnal performance. Executives of A-grade SOEs are entitled to a larger bonus than executives of non-A-grade SOEs. Model 3 in Table 5 shows that executives of A-grade SOEs are more highly compensated than those of non-A-grade firms. This result conforms to the compensation rules.

SASAC's compensation scheme does not consider return on equity (ROE) and return on assets (ROA), two prevailing finanical indciators tested in existing compensation scholarship. Still, this article includes them to investigate whether or not the commonly-tested pay-for-performance relationship exists. Models 4 and 5 in Table 5 show that both ROE and ROA are positively and significantly correlated with pay, even though these metrics are not considered by SASAC's rules. As ROE and ROA are metrics for efficiency, the findings suggest that the disclosed SOE executive pay is connected to efficency to some degree. Finally, all the models in Table 5 show that SOEs headquarted in Hong Kong or Macau have higher executive compensation than those headquartered in mainland China. This is attributable to subsidies offered to employees working overseas.

Overall, the empirical results are quite consistent with SASAC's compensation rules. There also appears to be a positive link between pay and performance. Yet, the nature of the data-rule consistency remains unclear: Is it a real fact about the SOE compensation practices or simply a fabricated image of good governance? Nevertheless, the bottom-line is clear, the state-owner intends to pursue financial and non-financial performance.

Like elsewhere, the pay system has demonstrated a perilous unintended consequence of pay-for-performance: executives attempting to manipulate or falsify metrics to extract personal wealth. Under SASAC rules, financial performance is mainly tied to sheer profit size. As a result, SOE executives have incentives to inflate profits. As the National Audit Office of China recently reported, 18 of the 20 central SOEs subject to its latest audit overstated profits in their 2015 financial statements and some of the SOEs did so by creating fraudulent sales.[57] Yet, publicly available information does not show any of the complicated SOE executives were removed or demoted due to fraudulent accounting activity. It also remains entirely unclear whether the state-owner enforces any clawbacks against executives.[58] If performance fraud goes unpunished, the positive link between pay and performance is simply an illusion of better SOE governance. The positive link between pay and performance may be an artificial correlation produced by the government and SOEs to make data match the formal rules.

VI. PAY DIFFERENTIALS AND NON-MONETARY INCENTIVES

Another important inquiry of executive compensation literature seeks to explain pay differences among top management team members. Western scholarship often relies on two competing theories to explain the degree of pay disparity between CEO and other top management team members: tournament theory and teamwork theory.[59] Tournament theory posits the need for substantial pay variations among top executives of a corporation. Those competing for the CEO position are contestants in a tournament and the high pay given to the CEO serves as a prize that incentivizes lower-ranking executives to work hard. Tournament theory asserts that the prize size is positively associated with the number of contestants and that corporate performance is positively correlated with executive pay dispersion.

In contrast, teamwork theory stresses the important impact of equity and social relations on output. Pay equity reduces rivalry office politics by which an individual executive seeks career advantages over others. As such, pay equity is especially important when the output depends on collaboration among team members. Senior managers are highly interdependent on each other to accomplish managerial tasks. As a result, teamwork theory argues that pay equity promotes cooperation and enhances output.

Empirical evidence from Western companies often demonstrates a large pay gap between the CEO and other executive members. In the United States for

---

[57] *See* National Audit Office of China, *2017 Public Announcement Nos. 10-29* (June 23, 2017) http://www.audit.gov.cn/n5/n25/index.html.

[58] Clawback policies refer to the recovery of compensation from executive officers in the event of fraud, malfeasance and/or a material financial restatement for the amount awarded in excess of what would have been paid under the restatement.

[59] *See* Brian G. M. Main et al., *Top Executive Pay: Tournament or Teamwork?,* 11 J. LAB. ECON. 606, 623-24 (1993).

example, executive compensation increases as large as 140% when an executive is promoted to the top rank from a lower rank.[60] In China, listed companies demonstrate that on average the highest paid executive earns 31.5% more than the second-highest paid executive.[61] In contrast, as Table 6 shows, the central SOEs directly under SASAC's supervision demonstrate that the pay gap between the highest and the second highest paid executives is as little as 6.1%. Table 7 shows pay differences by position – these pay variations are relatively paltry. The average chairman's pay is 5.6% higher than the average CEO pay and the average CEO pay is 8.3% higher than the average vice CEO pay.

Table 6. Comparison of the Highest and Second Highest Executive Pay across Firms

	RMB in thousand
Average of the Highest Pay (a)	664.560
Average of the Second Highest Pay (b)	626.106
Average Difference between the Highest and the Second Highest Pay {(a)-(b)}	38.454
Average of Percentage of Difference {[(a)-(b)]/(b)}	6.142%
Number of Observations (Firms)	105

Source: raw data collected and compiled by author.

60 *See id.* at 611–13.
61 *See* Jing Chen et al., *Managerial Power Theory, Tournament Theory, and Executive Pay in China,* 17 J. CORP. FIN. 1176 (2011).

Table 7. Average Total Compensation of Full-Year Executives, by Position (2015)

	Number of Executives	Average Total Compensation (1,000 RMB)	% of Pay Increase (over the next highest paid position)
Chairman	57	686.245	5.616%
CEO	69	649.754	8.253%
Vice CEO	366	600.211	1.880%
Other positions (e.g., party secretary, chief accountant)[62]	213	589.135	0.661%
Vice Chairman[63]	11	585.269	—
Total	716	608.310	—

Source: raw data collected and compiled by author.

In light of the tournament versus teamwork theory framework, the small pay gaps appear to endorse the teamwork theory. However, this pay equality is more rooted in China's political and economic history than the Western positive theories. Many Chinese SOEs were originally government bureaus and followed the civil service pay system.[64] The compressed pay scale is a legacy of China's civil service pay system that traditionally had minimal salary differentials between ordinary workers and high-rank employees.[65] The small pay gaps are also consistent with the SOE compensation rules that support egalitarianism. According to SASAC's compensation rules, SOE executives' base salaries are fixed at two times the average workers' pay, while the bonuses of non-lead executives' (e.g. vice CEOs) are fixed at 60-90% of those of lead executives (i.e. chairmen or CEOs).[66]

---

[62] This category includes managers who do not assume other positions. If they take positions in other categories, they are counted in other categories.

[63] Two vice chairmen are simultaneously CEOs; they are counted as CEOs.

[64] For a brief history of SOE executive pay in China, *see* Lin Lin, *Regulating Executive Compensation in China: Problems and Solutions* 32 J. L. & COM. 207, 213–18 (2014).

[65] *See* Hon S. Chan & Jun Ma, *How Are They Paid? A Study of Civil Service Pay in China*, 77 INT'L REV. ADMIN. SCI. 294 (2011) (exploring the evolution and the current condition of civil service pay in China).

[66] Measures on Evaluating Operating Performance of Executives of Central Enterprises (promulgated by State-owned Assets Supervision & Admin Comm'n, effective of Dec. 8, 2016), http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c8108632/content.html.

Moreover, the pay rules deemphasize individual triumphs and underscore collective achievements. As stated in the evaluation rules, the unit of performance assessment is a management team rather than an individual manager. The de-emphasis of individualism is also partly reflected in that executives holding the same title within the same firm often have the same compensation package.[67] Compensation is associated more with positions than individual abilities, which is consistent with how civil servants are compensated. In the dataset, approximately 45% of the SOEs demonstrate this position-oriented pay pattern for their full-year vice CEOs. Even where there is a pay difference between the vice CEOs of the same firm, the average pay difference is slight.[68]

The small pay variations among top management team members suggest that the SOE executives are probably not solely motivated by monetary compensation. According to government rules, evaluation results guide both remuneration and appointment decisions.[69] Poor-performing management teams are subject to reshuffling by the state-owner. Meanwhile, executives that deliver outstanding performance expect better compensation and career advancements (or at least job security) as rewards. In China, political promotions serve as significant incentive for SOE executives, because greater political power begets greater opportunities to build corrupt patronage networks to amass personal wealth.[70] Prior studies *all* based on Chinese listed firms offer inconclusive evidence on the relationship between firm performance and CEO turnovers but do offer seemingly positive evidence on the relationship between firm performance and subsequent political promotions.[71] What is the relationship between firm

---

[67] For instance, all CNOOC's four full-year vice CEOs were paid the same, regardless of each individual executive's attributes.

[68] Of the 94 firms that have full-year vice CEOs, the average full-year vice CEO pay is 600.210 thousand RMB. The average standard deviation of the pays for full-year vice CEOs at each firm is 17.95 thousand RMB; the average pay range (max-min) each firm is 44.325 thousand RMB.

[69] Measures on Evaluating Operating Performance of Executives of Central Enterprises (promulgated by the St.-owned Assets Supervision and Admin. Comm'n of St. Council, effective Dec. 8, 2016), http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c8108632/content.html. Also see the earlier version of the regulation. Provisional Measures on Evaluating Operating Performance of Executives of Central Enterprises (promulgated by the St.-owned Assets Supervision and Admin. Comm'n of St. Council. Dec. 29, 2012, effective Jan. 1, 2013), http://www.gov.cn/flfg/2013-02/01/content_2324949.htm.

[70] *See* MINXIN PEI, CHINA'S CRONY CAPITALISM (2016).

[71] For studies of performance and CEO turnover in China, *see* Martin J. Conyon & Lerong He, *CEO Turnover in China: The Role of Market-Based and Accounting Performance*, 20 EUR. J. FIN. MEASURES 659 (2014); Martin J. Conyon & Lerong He, *Executive Compensation and Corporate Governance in China*, 17 J. CORP. FIN. 1158 (2011); Xunan Feng & Anders C. Johansson, *CEO Incentives in Chinese State-Controlled Firms*, 65 ECON. DEV. & CULTURE CHANGE 223 (2017); Michael Firth et al., *Firm Performance, Governance Structure, and Top Management Turnover in a Transitional Economy*, 43 J. MGMT. STUD. 1289 (2006); Fang Hu & Sidney C.M. Leung, *Top Management Turnover, Firm Performance and Government Control: Evidence from China's*

performance and career-related outcomes for these wholly state-owned central enterprises? As the wholly state-owned central SOEs are relatively insulated from capital market pressure and more deeply embedded in the party-state system than their partially state-owned listed subsidiaries, it is expected that more politics play out in personnel decisions, which makes career outcomes more unpredictable.

This article investigates the relationship between SASAC's 2013-2015 triennial term performance review results and subsequent CEO turnovers (2016). Table 8 shows that almost a third of the 105 SOEs experienced a leadership change; the turnover rate appears quite high. Both A-grade and non-A-grade SOEs demonstrate very similar turnover rates, around 31%. It gives little support to the common hypothesis that better performing firms are less likely to have leadership turnovers. Good performance is an elusive predicator for job stability for the central SOE executives.

Listed State-Owned Enterprises, 47 INT'L J. ACCOUNT. 235 (2012); Takao Kato & Cheryl Long, *CEO Turnover, Firm Performance, and Enterprise Reform in China: Evidence from New Micro Data*, 34 J. COMP. ECON. 796 (2006); Takao Kato & Cheryl Long, Executive Turnover and Firm Performance in China, 96 AM. ECON. REV. 363 (2006); Bin Ke et al., *Hong Kong Stock Listing and the Sensitivity of Managerial Compensation to Firm Performance in State-Controlled Chinese Firms*, 17 REV. ACCOUNT. Stud. 166 (2012); Liao et al., *Policy Burdens, Firm Performance, and Management Turnover*, 20 CHINA ECON. REV.15 (2009); Jiwei Wang, *A Comparison of Shareholder Identity and Governance Mechanisms in the Monitoring of CEOs of Listed Companies in China*, 21 CHINA ECON. REV. 24 (2010).

For studies of firm performance and political promotions in China, *see* Xunan Feng & Anders C. Johansson, *CEO Incentives in Chinese State-Controlled Firms*, 65 ECON. DEV. & CULTURAL CHANGE 223 (2017); Jerry Cao et al., *Political Promotion, CEO Incentives, And The Relationship Between Pay And Performance* (Unpublished Working Paper, June 21, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1914033; Hui Chen et al., *Career Concerns and Unpaid Executives* (Unpublished Working Paper, July 24, 2016), https://ssrn.com/abstract=2822622 (based on a sample of Chinese listed firms finding that unpaid executives are more likely to get promotions than paid executives and they generally have better financial performance).

Table 8. Term Review Results and CEO Turnovers

		2013-2015 Term Review Result: A-Grade Firm		
		Yes	No	Total
CEO Turnover (2016)	Yes	12 (31.6%)	21 (31.3%)	33 (31.4%)
	No	26 (68.4%)	46 (68.7%)	72 (68.6%)
	Total	38 (100%)	67 (100%)	105 (100%)

Source: CEO turnover data manually collected from personnel announcements made in the period of 2016 by SASAC and the Central Organization Department. Term review results collected from SASAC's website.

Furthermore, Table 9 investigates the career outcomes of the outgoing CEOs. It gives little assurance that good performance leads to immediate career promotions. A CEO could be promoted to the chairman of the board.[72] Two of the 12 A-grade CEOs and two of the 21 non-A-grade CEOs had such promotions. Meanwhile, three A-grade CEOs were removed but remained as Party Secretaries. This career pattern could not be characterized as a promotion given the norm of cross-appointments between corporate executives and party committee members.[73]

---

[72] For Chinese SOEs, chairmen usually have a higher status than CEOs. When the SOE has a chairman and a CEO, the chair is usually called the "first leader" (*yibashou*) and the CEO "the second leader" (*erbashou*). The status hierarchy is also evidenced in the notable pattern that chairmen of the central SOEs are often members of the elite political bodies including the National People's Congress, the National People's Political Consultative Conference, and the National People's Congress of the Chinese Communist Party; however, CEOs are less likely to be so. *See* Lin & Milhaupt, *supra* note 1.

[73] There are two parallel personnel systems in all Chinese SOEs: the regular corporate management system and the party system. In the corporate management system, positions are similar to those commonly found in firms else-where, such as CEO, vice CEO, chief accountant, and if the company has a board of directors, a chairman and independent board members. A leadership team in the party system includes the Secretary of the Party Committee, several Deputy Secretaries, and a Secretary of the Discipline Inspection Commission (an anti-corruption office), along with other members of the Party Committee. Institutionalizing party penetration of corporate roles is formal policy, and overlaps between the two systems appear rather uniform, such that a corporate manager of a given rank typically holds a position of equivalent rank in the party system. *See* Lin & Milhaupt, *supra* note 1.

Table 9. Career Outcomes of Outgoing CEOs

	A-Grade SOEs	Non-A-Grade SOEs
Internal Career Movements		
Chairman	2	2
Party secretary only	3	0
Re-org leadership team	0	4
Subsidiary	0	3
External Career Movements		
Rotation to another central SOE	0	5
Under corruption investigation	3	3
Retirement	3	2
Professional independent director	1	2
Total	12	21

Source: Biographic information manually collected from multiple sources including SASAC website, news reports, corporate websites, government publications and websites, and several biography databases (Baidu Baike, Hexun Renwu, and China Vitae).

Four non-A-grade CEOs changed their positions due to mergers and acquisitions of the central SOEs. While SASAC has a policy of reorganizing poorly performing SOEs, these four CEOs remained in the leadership teams of the newly consolidated SOEs. On the other hand, three outgoing CEOs of non-A-grade firms moved to subsidiaries. This movement could be characterized as a demotion.

The Chinese government has an institutionalized practice of rotating SOE executives among the central SOEs in related industries. This rotation practice is said to promote mutual learning and monitoring.[74] Five non-A-grade CEO turnovers reflect this institutional practice.

Three of the 12 outgoing A-grade CEOs and three of the 21 outgoing non-A-grade CEOs were removed for corruption. This indicates that good performance is not necessarily an effective shield from corruption charges. More importantly, approximately one in five (6/33) departing CEOs lost their positions in 2016 due to corruption. This is a very high rate of corruption, which suggests a systemic governance problem inflicting these SOEs.

Retirement due to age is a common reason for leadership changes. For instance, three outgoing CEOs became professional outside directors for the central SOEs. This career pattern is often a transitional stage to retirement. In recent years, SASAC has established the institution of outside directors in the central SOEs. The pool of professional outsider directors is mainly composed of retired or retiring SOE executives.

---

74 *See* Katherina Pistor, *The Governance of China's Finance*, *in* CAPITALIZING CHINA 35–60 (Joseph Fan & Randall Morck eds., 2013).

Overall, unlike listed SOEs, these wholly stated-owned central SOEs do not demonstrate a clear link between performance and immediate political promotions. As the central SOEs are closer to China's political core than their listed subsidiaries, factional affiliation and "princeling" (blue blood) status may outweigh any quantitative measurements of good performance (primarily financial performance).[75] In addition, as SASAC itself acknowledged, the rationality of linking economic performance with political promotions should be taken with caution as it would encourage executives to undertake myopic and excessive business risks with the expectation of quick political career returns.[76] Although the findings here do not show a positive relationship between performance and immediate political promotions, the empirical results here do not preclude a possible connection between performance and long-term political promotions.

VII. IMPLICATIONS AND QUESTIONS

The central SOEs under SASAC are large companies that control political and economic resources of national importance in China. Unlike listed SOEs, they are wholly owned by the state and have limited exposure to capital market demands. The state-owner has wider discretion in governing these wholly-owned SOEs in a way consistent with its wishes. As the central SOEs are deeply embedded in the party-state system, an analysis of the central SOEs' management including executive compensation provides a closer look at the state-owner's ulterior goals. Some governance logics emerges from this study of the regulatory rules and the newly released data. The formal SOE executive pay is designed with a hybrid of modern Western executive pay principles, China's civil service pay tradition, and various political missions. It transplants the notion of pay-for-performance from Western executive compensation practices but simultaneously preserves the socialist tradition of pay equality and celebrates social harmony. The formal design intends to incentivize SOEs to implement national policies in addition to seeking profits. However, there are serious flaws in China's SOE executive pay practices. This section provides reform suggestions for Chinese SOEs. It also offers critical reflections on the dominant policy and scholarly discourse on the governance of SOEs as well as non-SOEs.

---

75 *See* Victor Shih et al., *Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China*, 106 AM. POL. SCI. REV. 166 (2012) (finding "no evidence that strong growth performance was rewarded with higher party ranks at any of the post-reform party congresses" and finding that factional ties with various top leaders and princeling status were the most important factors that boosted the chance of climbing higher in the CCP upper echelons through much of the reform period).

76 YI ZHANG ET AL., RESEARCH AND STUDY: REPORTS ON THE SUPERVISION OF STATED-OWN ASSETS AND THE REFORMATION OF STATED-OWN ENTERPRISES 351 (2012).

A. Chinese SOE Reform Forward

While more transparency is welcome, the current disclosure of Chinese SOE executive pay can be said to be, at best, half transparent and, at worst, totally inadequate and misleading. Three major problems have surfaced from this recent disclosure. First, the parent SOEs and their listed subsidiaries alike disclose the lump sum rather than breakdown of salary and bonuses. Moreover, they disclose only very limited aspects of on-duty consumption that is believed a significant component of SOE executive pay.[77] The new disclosure provides very little information to estimate the scale of on-duty consumption or related benefits. Second, while SASAC apparently evaluates SOEs based on their EVA figures, those EVA figures are not actually disclosed to the public. Thus, it is impossible to see how EVA returns correspond with executive compensation. The calculation of EVA requires detailed accounting information, but the central SOEs do not regularly disclose financial data; even if they do disclose, their financial statements often are oversimplified accounting summaries without detailed breakdowns. Third, and most shockingly, many SOE executives' pay figures in the newly disclosed dataset are significantly different from those reported in the listed subsidiaries' annual reports. The pay gaps are alarming. Rather than clarifying the pay puzzle, the new data raises more doubts about the credibility of executive pay data released by Chinese SOEs, whether listed or unlisted. These three disclosure gaps suggest that it is inadequate to simply reply on data provided by SASAC and Chinese SOEs including those that are listed on stock exchanges and subject to securities regulations and audit requirements.

It is uncertain how SASAC and relevant authorities such as China Securities Regulatory Commission (CSRC) will improve the information transparency in the future. The disclosure initiative of executive compensation of the central SOEs came out against the recent peculiar political backdrop in China. SOE executive compensation is sensitive information. For a long time, the central SOEs had refused to disclose it. The recent turn to disclosure emerged as part of the anti-corruption campaign. This peculiar political context facilitates the move toward transparency of SOE governance. However, as the anti-corruption

---

77 *See* Takao Kato & Cheryl Long, *Executive Compensation, Firm Performance and Corporate Governance in China: Evidence from Firms Listed in the Shanghai and Shenzhen Stock Exchanges*, 54 ECON. DEV. & CULTURAL CHANGE 945, 961 (2006) (estimating that perks could range between 15% and 32% of the total executive compensation in China); Donghua Chen et al., *Do Managers Perform for Perks?* (Unpublished Working Paper, Mar. 1, 2010), http://ssrn.com/abstract=1562003 (estimating that the average managerial perks could be as high as eight times of the average cash pay).

campaign is rife with factional fights in China's politics,[78] the disclosure initiative may progress with political uncertainties.

Beyond the data quality problem, an immediate question arising from the recent SOE executive compensation disclosure is whether the pay is substantively adequate. Is it too high or too low? The disclosed formal executive pay of Chinese SOEs appears meager compared to that of their international or private counterparts. If it is true that SOE executives are not highly remunerated, would they be more likely to turn to corruption for additional income? It is also commonly believed that SOE executives enjoy considerable undisclosed perks. If the undisclosed perks are truly economically significant, it would explain why SOE executives might be willing to accept the apparently low formal pay. However, as undisclosed perks often go unregulated, it gives SOE executives ample room for corruption. Indeed, the prevailing public policy in China is to slash SOE executive pay, which may have some merit.[79] However, low pay may do more harm than good, particularly when complementary institutions such as credible disclosure systems and regulatory enforcement are unavailable to constrain corrupt behavior.

The design of China's SOE executive pay is inextricably linked with its peculiar personnel management. The Chinese government acts as the visible hand that governs the SOE executive labor market. Top managers of important SOEs, like government officials, are evaluated and appointed by the Party. The government frequently rotates people between government bureaus and SOEs as a way to control the management of SOEs.[80] The common personnel linkages inevitably make government officials a peer group for SOE executives. As a result, a SOE executive's pay is implicitly benchmarked against the pay of a government official of equivalent rank whose pay includes a very low salary but considerable undisclosed perks.[81]

---

[78] *See* Fu Hualing, *Wielding the Sword: President Xi's New Anti-Corruption Campaign, in* GREED, CORRUPTION, AND THE MODERN STATE 134 (Susan Rose-Ackerman & Paul Felipe Lagunes eds., 2015).

[79] The Chinese media have frequent reports of excessive pay for SOE executives. Since the 2008 financial crises, the Chinese government has introduced several rounds of pay-cut measures for SOEs. In 2009, the Ministry of Finance placed an annual pay cap at RMB 2.8 million (approximately $410 thousand in USD). In 2015, the Chinese government introduced new measures to further cut SOE executive pay. *See* Hongru Wang, *Pay Reform for 72 Vice-Ministerial Level SOE Executives Confirmed: No More than 8 Times the Average Worker's Pay*, CHINA ECON. WKLY. (Nov. 25, 2014), http://politics.people.com.cn/n/2014/1125/c1001-26087408.html.

[80] *See* Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 2013 COLUM. BUS. L. REV. 743 (2013) (investigating the CEO career paths of Chinese SOEs and finding that generally more than 20% of the CEOs spent some time in government bureaus before their CEO appointments).

[81] *See* Chan & Ma, *supra* note 22.

The personnel linkages across the government and the SOEs also suggest that the hybrid identity of SOE managers – as business managers and government officials (perhaps more of the latter) – has significant impact on incentives. The main incentive of Chinese government officials is political career advancement rather than formal financial remuneration. Political promotions permit greater power to develop corrupt patronage networks, through which SOE executives may engage in systematic looting to amass tremendous personal wealth.[82] In this case, any design of formal executive compensation would be futile.

A true reform of China's SOE executive pay is not a matter of capping the pay level but rather a complex task of rearranging many institutional practices like information disclosure and appointment procedures while redefining the role of the state-owner. The Party's retreat from SOE personnel management and limiting of personnel exchanges between the government and SOEs are critical to making executive compensation meaningful. Unfortunately, today the Party continues to remain unwilling to relinquish its power over the SOE executive personnel.

In recent years, the government has experimented with the idea of recruiting top managers from outside the state sector. However, as I have shown elsewhere, the executive labor market of China's SOEs remains virtually closed to those who are outside the state system.[83] Part of the reason for the absence of professionals recruited from outside the state system is that the pay is too low compared to the prevailing market rate. To handle this problem, the Chinese government has been experimenting with a dual pay system for SOEs. Under this system, the compensation of executives whose careers develop within the state system is unilaterally set by SASAC's evaluation, while those recruited from outside are paid based on market rates through contract negotiation. The latter compensation is usually much higher than the former. It is unclear whether such dualism will work well, because anecdotal evidence indicates that it may brew resentment among those whose pay is subject to SASAC's relatively low pay policy.[84] Moreover, important positions in the eye of the state remain unavailable to outsiders.

---

82 *See* Pei, *supra* note 68.

83 *See* Li-Wen Lin, *Balancing Closure and Openness: The Challenge of Leadership Reform in China's State-Owned Enterprises*, *in* REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM 133 (Benjamin Liebman & Curtis J. Milhaupt, eds., 2015) (showing that only 4.8% of the executives who were hired through the public and more transparent recruitment process were truly from outside the state system; yet 88.7% were still members of the Chinese Communist Party).

84 Jingjing Zhong, *Forty Percent of the Central SOE Executives Recruited Worldwide are from Inside the System*, BEIJING NEWS (May 16, 2011), http://www.bjnews.com.cn/finance/2011/05/16/124409.html (interviewing a SOE CEO who was offered pay at market rate but declined the offer and accepted the lower pay policy because of the potential resentment concern).

B. Implications for Foreign Investment Law

In recent years, Chinese SOEs have been engaging in rapid global expansion.[85] Their active mergers and acquisitions abroad have aroused great controversies under the foreign investment laws in a number of host countries such as Australia, Canada, the United States, and the EU.[86] When a foreign entity acquires control of a domestically-owned business, it may trigger a regulatory review. While different countries' foreign investment regulations vary in one way or another, they often share a common concern when the foreign acquirer is a foreign SOE: What is the motivation of the foreign SOE? Does it pursue any non-commercial goals? The Guidelines of the Commission on Foreign Investment of the United States (CFIUS) considers, among other factors, "the extent to which the basic investment management policies of the investor require investment decisions to be based solely on commercial grounds."[87] At present, foreign investment control is subject to intense legal and political discussions across the Atlantic Ocean, mainly prompted by Chinese firms' active mergers and acquisitions.[88] The finding that Chinese SOE executive pay expressly incorporates non-financial objectives such as undertaking national economic policies and promoting technological innovation deepens national security concerns in host countries.

---

[85] *See* Ministry of Com. of China, *Report on Development of China's Outward Investment and Economic Corporation* (2016), *available at* http://fec.mofcom.gov.cn/article/tzhzcj/tzhz/upload/zgdwtzhzfzbg2016.pdf.

[86] *See* Li-Wen Lin, *China's National Champions: Governance Change through Globalization?,* 11 U. PA ASIAN L. REV. 81 (2015) (discussing the regulatory reactions to business acquisitions by Chinese SOEs in Australia, Canada and the United States).

[87] Guidance Concerning the National Security Review Conducted by CFIUS, 73 Fed. Reg. 74,567, 74,571 (Dec. 8, 2008), https://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf.

[88] For the U.S., *see* Bob Davis, *Trump to Ramp Up Trade Restraints on China*, WALL ST. J. (Mar. 20, 2018), https://www.wsj.com/articles/trump-to-ramp-up-trade-restraints-on-china-1521593091 (reporting the White House plans to raise investment barriers for Chinese firms from acquiring technology of American companies). On September 13, 2017, the European Commission proposed a new regulatory framework on foreign investment control in the EU; the proposal is expected to come into force no later than 2019. Under the proposed regulation, the Commission sends a clear message that investments by state-owned or state-funded investors are under increased scrutiny. *See Proposal for A Regulation of The European Parliament and Of The Council Establishing A Framework For Screening Of Foreign Direct Investments Into The European Union,* COM (2017) 487 final (Sept. 13, 2017). In July 2017, Germany passed an important reform of its foreign investment control regime. The Federal Ministry for Economic Affairs and Energy (Bundes--ministerium für Wirtschaft und Energie – "BMWi") may review and determine whether the direct or indirect acquisition of shares in a German company by a foreign acquirer above a certain threshold poses any threats to public order or security. *See* Neunte Verordnung zur Änderung der Außen-wirtschafts-verordnung [Ninth Ordinance amending the Foreign Trade Regulation], July 2017 BAnz at 17.07.2017 V1.

C. Comparative SOE Governance

SOEs are important economic players not only in China but also in many countries around the world. Contrary to the prediction of their demise following the downfall of socialist economies in Eastern Europe, many SOEs have not only survived the reoccurring privatization waves but also have reemerged as being among the largest multinational enterprises in the global economy. As of 2015, 326 of the world's largest 2,000 publicly listed companies had the state as an owner of more than 10% of their shares.[89] These companies are domiciled not only in developing countries such as China, India, Brazil, and Russia, but also in developed economies including France, Norway, Japan, etc. The rise of SOEs has prompted international policy organizations including the World Bank and the OECD to prescribe corporate governance guidelines for SOEs.[90] These prevailing guidelines recommend that SOE executive remuneration should be "tied to performance and duly disclosed."[91] While the principle of pay-for-performance is clear, little guidance is provided for its practical implementation. As Professors Milhaupt and Pargendler recently critiqued, "although the destination is clearly marked, there is no road map provided to assist in reaching the destination."[92]

In particular, it is more challenging to measure and evaluate the performance of SOEs than the performance of private firms that conventionally hold profit maximization as the single goal. SOEs are known to have financial and non-financial goals. Non-financial goals tend to be amorphous and hard to clearly define. Under the principle of pay-for-performance, how should the state-owner objectively measure non-financial performance and relate it to remuneration? This article has provided a glimpse into China's regulatory means of translating non-economic performance into quantifiable pay figures. However, it remains unclear how Chinese SOEs differ from SOEs of other countries in this regard. Existing literature provides scant information about whether and how other SOE regimes incorporate non-financial indicators into their executive

---

[89] ORG. FOR ECON. COOPERATION AND DEV., STATE-OWNED ENTERPRISES AS GLOBAL COMPETITORS: A CHALLENGE OR AN OPPORTUNITY? 21 (2016), https://read.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-as-global-competitors_9789264262096-en#page2.

[90] *See, e.g.*, ORG. FOR ECON. COOPERATION AND DEV., OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2015), http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm; WORLD BANK GROUP, CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A TOOLKIT (2014) (prescribing corporate governance guidelines for state-owned enterprises), http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf.

[91] ORG. FOR ECON. COOPERATION AND DEV., CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES A SURVEY OF OECD COUNTRIES 222 (2005).

[92] *See* Curtis J. Milhaupt & Mariana Pargendler, *Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and a Framework for Reform,* 50 CORNELL INT'L L. J. 473, 534 (2017).

compensation formula. Most studies discuss at length the rationale and importance of the pay-for-performance principle while giving little information of how the state-owner actually puts it into practice.[93] As SOEs are known for pursuing commercial and non-commercial goals, future research is desperately needed to fill this void. It is unwise to advance any best SOE compensation model while the method by which different SOE regimes factor performance into remuneration remains a black box.

D. Implications Beyond SOEs

Despite the idiosyncratic nature of Chinese SOEs, their executive compensation systems provide some insight for private firms (non-SOEs). A salient point that typically separates SOEs from other firms is that SOEs often do not take profit maximization as their sole corporate purpose.[94] Rather, they often pursue public policy objectives such as promoting employment in addition to profit making. In fact, the pursuit of a mixed financial and non-financial mission is not exclusive to SOEs. This goal duality can be conspicuously observed in the so-called "social enterprise," a new and increasingly popular type of business organization that combines profit-seeking with public benefit purposes. Legislative statutes authorizing such "hybrid organizations" have recently proliferated around the world, including, for instance, the community interest company in the United Kingdom,[95] the community contribution company in British Columbia (Canada),[96] and the benefit corporation, the public benefit corporation, the benefit limited liability corporation, the low-profit limited liability company (L3C), the flexible purpose corporation, and the social purpose corporation in many jurisdictions of the United States.[97] Many European countries – Belgium, Denmark, France, Latvia, and Slovenia, just to name a few

---

93 *See e.g.,* Aldo Musacchio et al., *State-Owned Enterprise Reform in Latin America: Issues and Possible Solutions* (Inter-American Dev. Bank Discussion Paper No. 401, 2015), https://publications.iadb.org/bitstream/handle/11319/7181/FMM%20DP_StateOwned_Enterprise_Reform_in_Latin_America.pdf?sequence=1.

94 *See e.g.*, *State-Owned Enterprises: Catalyst for Public Value Creation?,* PRICEWATERHOUSECOOPERS (Apr. 2015), https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf (surveying and summarizing how SOEs differ from private firms).

95 *See* David Cabrelli, *A Distinct "Social Enterprise" Law in the UK: The Case of the CIC*, (Edinburgh Sch. of Law Research Paper No. 2016/27, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888486.

96 *See* Gail Elizabeth Henderson, *Could Community Contribution Companies Improve Access to Justice?,* 94 CAN. B. REV. 209 (2016).

97 *See* J. Haskell Murray, *The Social Enterprise Law Market*, 75 MD. L. REV. 541, 543–55 (2016) (providing an overview of the social enterprise laws in the United States).

– have formally recognized social enterprises.[98] While social enterprises come in various forms, all share the common element of pursuing the dual mission of financial sustainability and social purpose.

A central question of the social enterprise literature has focused on how to ensure the entity performs its financial and non-financial goals. Scholars have proposed and debated on an array of mechanisms – fiduciary duties, annual performance reports, benefit enforcement proceedings, third-party certification, asset locks, dividend caps, and exit restrictions – to hold managers of social enterprises accountable for the dual goals.[99] Executive compensation, as a very typical incentive device of corporate governance, is surprisingly missing in the current discussion of social enterprises. Similarly, while scholarship of corporate social responsibility (CSR) has grown dramatically over the past decade, there is still very little research on whether and how companies actually use CSR indicators in addition to financial indicators when setting executive compensation.[100] Do advocates of social enterprises or CSR still accept the principle of pay-for-performance or simply scrap it and turn to the salary mode or something else?[101] If pay-for-performance remains valid for social enterprises, should social and environmental performance be linked with remuneration? If yes, how can that be achieved? Social enterprises are required by law to explicitly include corporate objectives in the articles of incorporation.[102] Such social objectives are broadly stated and not readily measurable. Given that there is much less consensus on how to measure social and environmental performance, there is

---

98 *See, e.g.*, European Commission, *A Map of Social Enterprises and Their Eco-System in Europe: Synthesis Report* (2015).

99 *See, e.g.*, Henderson, *supra* note 94; J. Haskell Murray, *Social Enterprise Innovation: Delaware's Public Benefit Corporation Law*, 4 HARV. BUS. L. REV. 345 (2014) (evaluating mechanisms to hold directors responsible under the Delaware law).

100 A small number of studies examine the relationship between CSR and the level/structure of executive pay. Scholars rarely explore how the board of directors uses CSR indicators and specifically ties it to executive pay. It requires an examination of detailed compensation policy stated in corporate reports, surveys and interviews, rather than just regressing pay data on financial or CSR performance. *See e.g.*, Scott J. Callan & Janet M. Thom, *Executive Compensation, Corporate Social Responsibility, and Corporate Financial Performance: A Multi-Equation Framework*, 18 CORP. SOC. RESP. & ENV'T MGMT. 332 (2011); Ming Jian & Kin-Wai Lee, *CEO Compensation and Corporate Social Responsibility*, 29 J. MULTINATIONAL FIN. MGMT. 46 (2015); Lois Schafer Mahoney & Linda Thorn, *An Examination of the Structure of Executive Compensation and Corporate Social Responsibility: A Canadian Investigation*, 69 J. BUS. ETHICS 149 (2006); Patti Collett Miles & Grant Miles, *Corporate Social Responsibility and Executive Compensation: Exploring the Link,* 9 SOC. RESP. J. 76 (2013).

101 *See* MICHAEL DORFF, INDISPENSABLE AND OTHER MYTHS: WHY THE CEO PAY EXPERIMENT FAILED AND HOW TO FIX IT (2014) (arguing that companies should give up performance pay and return to guaranteed salaries); Lynn A. Stout, *Killing Conscience: The Unintended Behavior Consequence of Pay-for-performance*, 39 J. CORP. L. 525 (2014) (showing the dangers of overemphasizing financial rewards and the value of using non-financial rewards).

102 *See supra* notes 91–95 (discussing the social enterprise laws in various jurisdictions).

ample room in designing and selecting performance metrics. How do we ensure the metrics are fair and not subject to manipulation by executives? A detailed explanation of the rationality of performance metrics and how they are linked with remuneration as well as third-party performance audits appear to be good practices for social enterprises.

An important feature of Chinese SOE executive pay is that base salary is fixed at two times the average worker's pay for all of the central SOEs. This pay ratio policy is rooted in the Chinese state-owner's political interest in promoting social equality. It treats inequality as a threat to "social harmony" underpinning its ruling stability.[103] This rigid pay control is feasible by the bureaucratic fiat of the state-owner. Nevertheless, this pay ratio measure is not unique to Chinese SOEs. It has become a popular response to excessive pay in the wake of the global financial crisis. For instance, in 2013 Switzerland held a referendum on limiting CEO pay to 12 times that of the lowest-paid staff, though the referendum failed to gain a majority of votes to pass.[104] The United States adopts a less intrusive approach to address the concern of excessive CEO pay and income inequality. Rather than capping the pay ratio, the Dodd-Frank Act requires public companies to disclose the ratio of the total compensation of its CEO to the median compensation of its employees.[105] It is hoped that this disclosure will create pressure on companies to reduce excessive CEO pay and lower the pay ratio. In the United Kingdom, the Financial Reporting Council (FRC) recently published the 2018 UK Corporate Governance Code that requires listed companies to consider workforce pay when setting executive remuneration.[106] The EU has adopted a policy that companies must explain how the pay and employment conditions of employees of the company have been considered when

---

[103] SHI LI ET AL., RISING INEQUALITY IN CHINA: CHALLENGES TO A HARMONIOUS SOCIETY (2013).

[104] Although Swiss voters rejected to place a pay cap, they previously in the same year had approved a referendum to restrict executive pay including binding say on pay votes, no bonus given to executives joining or leaving the business, or when the business is taken over. Violations could result in penalties up to six years of salary and a prison sentence of up to three years. *See* Jack Ewing, *Swiss Voters Decisively Reject a Measure to Put Limits on Executive Pay*, N.Y. TIMES (Nov. 24, 2013), https://www.nytimes.com/2013/11/25/business/swiss-reject-measure-to-curb-executive-pay.html; Raphael Minder, *Swiss Voters Approve a Plan to Severely Limit Executive Compensation*, N.Y. TIMES (Mar. 2, 2013), https://www.nytimes.com/2013/03/04/business/global/swiss-voters-tighten-countrys-limits-on-executive-pay.html.

[105] In 2015, the Securities Exchange Commission of the United States adopted a rule to implement the pay ratio disclosure requirement mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Starting in the 2018 proxy season, public companies in the United States are required to make such disclosure. *See* 17 C.F.R. § 229, 249 (2018).

[106] A set of rules in the original proposal was to require publicly listed companies to disclose the pay ratio between their CEO and the firm's average UK worker. However, it was omitted in the FCR's final code. UK CORPORATE GOVERNANCE CODE § 33 (2018).

setting a policy on directors' pay.[107] From a comparative perspective, given that different countries have different institutional backgrounds, approaches to the CEO-worker pay ratio vary from country to country. In China, the state uses its controlling shareholder status and regulatory power to impose a rigid pay ratio. In Japan, the CEO-worker pay ratio remains regulated through culture and active monitoring by long-term institutional investors such as banks.[108] The U.S. takes a disclosure-based approach while the U.K. and the EU adopt a softer approach in law. Despite the regulatory diversity, income equality appears to be an emerging, though controversial, international principle of executive compensation.

CONCLUSION

This article has attempted to expose the mysterious executive compensation practices of Chinese large SOEs by investigating the relevant regulatory rules in the context of a fresh compensation dataset. On the one hand, the regulatory rules and the compensation data ostensibly present a quite coherent picture. Consistent with the rules, the data shows a positive relationship between pay and performance, where performance is defined on the Chinese state-owner's own terms. It also suggests a complex relationship between performance and non-monetary incentives given China's politics. On the other hand, the new data raises more doubts than it dispels, which leads to questions around disclosure practices of both listed and unlisted Chinese SOEs. The findings in this article carry important legal and policy implications not only for Chinese firms but also non-Chinese and non-state-owned firms. Fundamentally, it offers a somewhat different perspective from the orthodox understanding of executive compensation where pay is exclusively tied to financial performance. It calls for more research on the rationality and practical specificity of linking executive pay with non-financial performance.

---

[107] Effective June 9 2017, EU Directive 2017/828 amended the so-called Shareholders' Rights Directive (EU Directive 2007/36). The original proposal made by the European Commission required disclosure and justification of the ratio between directors' pay and average employee pay. However, the ratio part was removed from the agreed final text.

[108] *See* Alberto R. Salazar & John Raggiunti, *Why Does Executive Greed Prevail in the United States and Canada but Not in Japan? The Pattern of Low CEO Pay and High Worker Welfare in Japanese Corporations*, 64 AM. J. COMP. L. 721 (2016).

APPENDIX

Variable	Obs.	Mean	Std. Dev.	Min.	Max.
Logged total pay	60	4.100	.204	3.525	4.736
Whether or not outperform prior-year pre-tax profit	60	.700	.462	0	1
Extent of outperformance (pre-tax profit growth rate)	60	-.175	16.107	-75.325	94.229
ROE	60	.046	.078	-.112	.342
ROA	60	.019	.028	-.057	.118
A-Grade Firm	60	.500	.504	0	1
SOEs for public good and national interests defined by SASAC	60	.350	.481	0	1
Energy saving and carbon reduction award by SASAC	60	.150	.360	0	1
Headquartered in Hong Kong or Macau	60	.017	.129	0	1
Number of Executives (Each Firm)	60	9.100	1.515	6	13