On the influence of incentive mechanisms for China's current mixed ownership reform on corporate performance

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2021

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Submitted to Lee Kong Chian School of Business in partial fulfillment of the requirements for the Degree of Doctor of Business Administration

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2021

I hereby declare that this PhD dissertation is my original work
and it has been written by me in its entirety.
I have duly acknowledged all the sources of information
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This PhD dissertation has also not been submitted for any degree
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REN Huiyong
26 February 2021

ABSTRACT

ON THE INFLUENCE OF INCENTIVE MECHANISMS FOR CHINA'S CURRENT MIXED OWNERSHIP REFORM ON CORPORATE PERFORMANCE

REN Huiyong

Since the Central Economic Work Conference set the mixed ownership reform as where China's state-owned enterprises (SOE) can make breakthroughs on reforms in early 2017, enterprises at all levels, from central to local state-owned, have continuously introduced new measures and new deployments involving the reform. The mixed ownership reform (hereinafter referred to as the "mixed reform") introduces flexible market response mechanisms and innovative management systems from private enterprises into state-owned enterprises to enhance the market awareness of state-owned enterprises, to increase their own competitiveness, vitality and creativity. It aims to build a system that conforms to modern corporate governance and better responds to market changes. At present, the mixed reform of state-owned enterprises has achieved initial results. In spite of a gradual increase in the number of enterprises, quite a few are still in a wait-and-see situation. Only a few have actually completed the mixed reform. In addition, although government departments have announced the top-level design plan for the mixed ownership reform, there is no ready-made operating system to borrow experience from. Therefore, it is necessary to conduct research on the

mixed-ownership reform from practical cases and explore its feasible paths to provide reference for other enterprises.

The mixed ownership reform is a comprehensive reform involving property rights, rooted in not only changes to the ownership structure, but also system and mechanism revolutions. In the course of reform, enterprises take different paths and design various incentive mechanisms to suit different markets and governance objectives, which in turn will have an impact on corporate performance. The configuration of incentive mechanisms after the reform comes as the key to assessing whether the reform achieves expected results. On this basis, the paper focuses on the relationship between innovating incentive mechanisms and enterprise performance in the context of the mixed ownership reform of state-owned enterprises and sets the goal of research at incentive mechanisms for mixed-reform enterprises. In the case study of Yunnan Baiyao and Greenland Holdings Corp., Ltd., the paper starts with the internal and external environment of enterprises to analyze the causes and paths of their mixed reforms, examines the relationship between incentive mechanism adjustments and corporate performance in the two companies, reveals the problems existing in incentive mechanisms in the course of practicing the reform, and puts forward suggestions for improvement.

On the basis of the property rights theory, the principal-agent theory and the incentive mechanism theory, the author builds the basic theoretical and practical framework for incentives through analyzing the needs of senior managers, human nature assumptions and behaviors, expounds the impact of the problems occurring in the current mixed ownership reform of state-owned enterprises on incentive elements, and carries out empirical examination and case analysis of incentive mechanisms. For the analysis of core elements, this paper sees the optimal salary system as an entry point and compares such key points as salary incentives, equity incentives, and spiritual incentives. It also tries to construct a complete and practice-oriented incentive system against the background of the mixed property rights reform, supplemented by management systems with Chinese characteristics, including the governance structure of “three meetings and one layer”, the disciplinary mechanism of party organization supervision, and the market-oriented recruitment of managers.

Our work has led us to four conclusions as follows. Firstly, increasing capital and shares should be a new breakthrough in the mixed ownership reform of state-owned enterprises, by which corporate capital can be expanded (to make a larger company) and corporate vitality strengthened (to make a stronger company). In particular, it can effectively promote the governance efficiency of state-owned enterprises during the mixed ownership and formulate a win-win situation. Secondly, equity incentives have become a common model to drive company performance. Under the incentive model of virtual equity, senior managers can enjoy certain dividends and the rights of share price appreciation without weakening the state-owned holding status or impairing the equity structure. Meanwhile, immediate right to earnings will work as an effective incentive for managers and in turn affect current corporate profits. Thirdly, status conversion to private enterprises is an effective channel for job transfer and a more appealing incentive than retention in state-owned enterprises. The channels for executive transfer for the mixed ownership reform of state-owned enterprises include the tenure transfer of former state-owned enterprise managers appointed by administration, the market-based recruitment and hiring of external professional managers, and the identity transfer of private entrepreneurs. Fourthly, building a business partner sharing mechanism is a more productive incentive than performance distribution. The mixed ownership reform of state-owned enterprises must bring creative changes to talent management, redefine the relationship between managers and enterprises, treat employees as the “partners of human capital” to break away from the original employment relationship, and turn the management into the owner of an enterprise and professional managers into the masters, thus enabling employees to share the wealth brought by corporate development.

The highlight of this paper rests on the study of problems related to the mixed ownership reform of state-owned enterprises from the perspective of corporate governance through multiple cases. At present, most domestic literature discusses the reform paths from the level of a single equity or case. Few researchers have addressed incentive mechanisms in a systematic way. In the course of analysis, the author fans out from point to area, analyzes the obstacles to the mixed ownership reform of China's state-owned enterprises in a comprehensive, clear pattern, and proposes applicable solutions to paint a reasonable road-map for the reform. Therefore, the value of our contribution lies in two aspects. In terms of theory, it explores the internal mechanism that explains how the property rights reform contributes to corporate performance from the angle of incentive mechanisms and enriches multidimensional theoretical research on incentive mechanisms. Supported by the analysis of the principal-agent system in the mixed ownership reform, this paper connects the system with the incentive mechanisms of the property rights reform, deduces the internal mechanism of the property rights reform that works on corporate performance improvement, studies the relationship between incentive mechanisms and the improvement of corporate performance, and investigates the key mechanism that enhances corporate performance via deconstruction analysis. With respect to practice, our research aims to provide Chinese state-owned enterprises with theoretical guidance on the paths of the mixed ownership reform and offer insights into the formulation of policies for the mixed reform.

CONTENTS

List of Tables & Figures

ACKNOWLEDGEMENT

On the very outset of this dissertation, I would like to extend my sincere and heartfelt obligation towards Professor Chenggang Xu, Professor Zhe Zhang, and Professor Rong Wang for their conscientious mentoring and guidance. They have left on me an indelible mark for a depth of knowledge, rigorous academic attitude, adhering to excellence. They are a role model in exhibiting tireless teaching and the noble demeanor of being severe with themselves and lenient with others.

From topic selection to the shaping of structure, from theoretical analysis to case studies, the five years of research have witnessed me being enlightened with wisdom and changed to a person with calm and reasonable concentration from the state of total bewilderment. I am ineffably indebted to my mentors for their valuable guidance and feedbacks.

I am grateful for Mr. Wei Yao and classmate Jie Sun for sharing with me tremendous experience in writing papers, answering my doubts, and offering endless encouragement and support in action and even psychologically as a driving force for me. Their generosity and kindness spurred me to keep writing.

At last but not least gratitude goes to my wife and children. Without their tolerance and selfless love, I would not have come this far today. Regardless of whether I am challenged or fulfilled, it is their unyielding support and meticulous care that push me to forge ahead with sheer determination.

Chapter I Introduction

1.1 Background and significance of studying China's mixed ownership economic reform

1.1.1 The theory and policy background of china's mixed ownership economic reform

Research on the framework of mixed ownership by Chinese scholars began as early as the 1980s. Mr. Muqiao Xue (1987), the first to propose the concept of mixed ownership in modern sense, pointed out that the reform of state-owned economy must deal with the diversification and complexity of ownership, with the joint-stock system being one of them. Mixing the property rights of different natures in joint ventures is what he called "mixed ownership enterprises". Yining Li (1994) actively advocated state-owned enterprises to promote the joint-stock system reform, particularly for the Chinese market, where "the mixing of different types of capital involves property rights as a special feature of China's shareholding system". He also urged to establish a unified securities market, to oversee the listing and issuance of stocks, to strengthen the circulation of state-owned shares, and to emphasize equity equality. The economist Jinglian Wu (1997) is also a great contributor in promoting the development of mixed ownership. For the reform strategy of state-owned economy, he claimed to realize the diversification of state-owned enterprise equity while shrinking the state-owned economic front. For the undertaking of state-owned enterprise reform, he advised to vigorously introduce non-state-owned capital under the condition of maintaining state-owned holdings or state-owned shares, improve the corporate system and governance structure, and stimulate the energy of enterprises. Academic research on the mixed ownership reform of state-owned enterprises was then divided by the pro-establishment school represented by Lin Yifu and the reformist school headed by Zhang Weiying. The former believed that the inefficiency of state-owned enterprises should be soft budget constraints under unfair competition, while the latter insisted that the property rights reform was the key to improving the performance of state-owned enterprises (Gang Fan, 1995; Weiying Zhang, 1996).

The Chinese government has also mentioned the issues of mixed-ownership economic reform in many meetings. The Third Plenary Session of the Fourteenth Central Committee of Communist Party of China (CPC) coined the concept of “mixing all economies”; the Fifteenth National Congress of the CPC explicitly acknowledged the existence of “mixed ownership economy”; the Third Plenary Session of the Eighteenth Central Committee clearly stated the new connotation of mixed ownership to be “the cross-shareholding and mutual integration of state-owned, collective and non-public capitals”. Overall China’s mixed ownership reform can be divided into three stages. The first stage lasted from 1993 to 2003 when the central government announced to establish the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). The guiding policy by the government was to establish a modern enterprise system with "clear property rights, clear powers and responsibilities, separation of government and enterprises, and scientific management", to concentrate efforts to grow large state-owned pillar enterprises by "restructuring major ones and relaxing control over small ones". At this stage, the mixed and partial state-owned mode, represented by the form of joint-stock, gradually led the development trend of the state-owned economy. From 1997 to 2003, the number of state-owned enterprises dropped from 238,000 to 150,000. The second development stage was marked by the SASAC establishment. In the Sixteenth National Congress of the Communist Party of China, it was mentioned that the state would push the reform of shareholding system in state-owned large and medium-sized enterprises, gradually shape and enhance the corporate governance structure, and make the joint-stock system the main form of realization for the public economy. By the end of 2013, more than 90% of state-owned enterprises had realized the reform of company system and joint-stock system; the proportion of state-owned enterprises that introduced non-public capital to form mixed-ownership enterprises hit 42%, and that of central enterprises increased to 52%. At this stage, due to the rising status of the non-public economy, mixed ownership began to shift from a partial state-owned model under capital mix to mixed operation. Following is the third stage of deepening the mixed ownership reform since 2013. At this stage, the reform is spreading to multi industries and high levels and constantly expanding industry sectors. In the industries of electricity, natural gas, civil aviation, petroleum, military, railway and telecommunications, three batches of 50 companies with the pilot mixed-ownership reforms have been launched. The CPC's Nineteenth National Congress also called attention to deepening the reform of state-owned enterprises, developing a mixed ownership economy, and nurturing world-class enterprises with global competitiveness. According to "Notice on the Creation of Global Top-Tier Role Model Enterprises by Chinese SOEs", the SASAC would further delegate powers and authorize demonstration enterprises to make independent decisions and comprehensively apply such policies related to the state-owned enterprise reform as mixed ownership, employee stock ownership, and equity incentives to bring into play the effectiveness of reforms.

At present, initial results have been noticed in the mixed reform of state-owned enterprises. However, regardless of vigorous advocacy and efforts by the central and local governments, many problems are still spotted in the development of mixed ownership. In the context of soft budget constraints, diversification of business objectives in state-owned enterprises, and principal-agent issues, we see from current practice a lot to be improved in the positioning of state-owned capital, the protection of property rights by social capital, how to construct corporate governance structures after mix-up, about which non-public enterprises hold doubts. The ultimate goal for the property rights of state-owned enterprises with "the mixed ownership" reform proposed by the Third Plenary Session of the Eighteenth Central Committee is to improve their diversification and corporate performance. However, how to effectively promote the mixed-ownership reform in practice requires further research and exploration.

1.1.2 Issues of research and significance

The problem of enterprise reform and governance, in essence, can be outlined as addressing incentive mechanisms. A crucial guarantee for the effectiveness of the mixed ownership reform of state-owned enterprises is to transform the existing incentive mechanism of state-owned asset management. As the mixed ownership reform is a comprehensive reform involving property rights, its foothold resides in not only changes to the ownership structure, but also revolutionizing systems and mechanisms. In the course of the reform, enterprises take different paths of reform and design various incentive mechanisms to suit different markets and governance objectives, which in turn will affect corporate performance. The configuration of incentive mechanisms after the reform comes as the key to assessing whether the reform achieves expected results. On this basis, this paper centers on the relation between innovations in incentive mechanisms and corporate performance in the context of the mixed ownership reform of state-owned enterprises. In the case study of Yunnan Baiyao and Greenland Holdings Corp., Ltd., the paper starts with the internal and external environment of enterprises to analyze the causes and paths of their mixed reforms, examines the relationship between incentive mechanism adjustments and corporate performance in the two companies, reveals the problems existing in incentive mechanisms in the course of practicing the mixed reform, and puts forward suggestions for improvement.

(1) Theoretical significance

First of all, the paper explores the internal mechanism of the property rights reform that enhances corporate performance. On the basis of analyzing the principal-agent system in the mixed ownership reform of Chinese state-owned enterprises, this paper connects the system with the incentive mechanisms of the property rights reform, deduces the internal mechanism of the property rights reform that works on corporate performance improvement, verifies the relationship between the incentive mechanisms and the enhancement of corporate performance, and investigates the key mechanism that enhances corporate performance via deconstruction analysis.

Secondly, from the viewpoint of the property rights reform, this paper enriches the multi-dimensional theoretical research on the incentive mechanisms. To better the competitiveness of state-owned enterprises, we focus on the distribution of actual control rights after the property rights reform and the choosing of suitable paths for the mixed ownership reform. With regard to equity incentives for the solving of agent problems, scholars have conducted certain research on the broad application of equity incentives in recent years. The existing work in this field largely concentrates on the positive and negative influence of equity incentives, with the positive side being the mainstream of research and the opposite a sprouting branch. Few studies have been published in China, however, both theoretical and empirical. In the previous literature on the effects of equity incentive, those involving control rights are basically empirical studies but lack in-depth analysis and horizontal comparison of specific cases. This paper takes Greenland Holdings Corp., Ltd. and Yunnan Baiyao as examples to study comprehensive incentive mechanisms from the angle of control rights distribution under soft budget constraints as we try to enrich the multi-dimensional theoretical research in this regard.

(2) Practical significance

Firstly, we aim to provide state-owned enterprises with theoretical guidance for the paths of the mixed ownership reform. Combining the party committee's supervision system with Chinese characteristics, this paper dives into the corporate governance system of the two company cases and innovation of the "three meetings and one layer" (general meeting of shareholders, board of directors, board of supervisors and people in management) as well as analyzes the contradictions of multi-layer agents. A comparative analysis of the incentive elements of the property rights reform at different stages in the two cases is also conducted to explore the existing problems of current incentive mechanisms and improvement measures. This provides guidance for the follow-up reform practice in this paper.

Secondly, this paper offers insights into the formulation of mixed ownership reform policies for state-owned enterprises. The relationship between state-owned enterprise property rights reform and corporate performance seems not clear, but the Third Plenary Session of the Eighteenth Central Committee proposed the ultimate goal for the property rights of state-owned enterprises with “the mixed ownership” reform as promoting their diversification and improving corporate performance. So far, many state-owned listed companies in China (a typical case of the property rights reform) have announced equity incentive drafts or planned to implement equity incentive schemes, but their managers fail to obtain a sufficient, holistic and objective understanding of equity incentives. A certain degree of blindness should be expected in drafting the incentive scheme. As matters stand, this paper studies the motives and effects of equity incentive policies adopted in the mixed ownership reform of state-owned enterprises in an objective and comprehensive manner, sorts out the modes and paths of the reform, and intends to supply the Chinese government and enterprise policy makers with reference for relevant decision-makings.

1.2 **Research contents, methodologies and logical framework**

1.2.1 **Research contents**

The research contents of this paper mainly cover six parts as follows:

Chapter One, an introduction, begins with explaining the background and significance of this research and proposes the problems to examine. Secondly, it introduces the research methods applied in the thesis and extracts the logical framework out of an in-depth analysis of research contents. Finally, the innovation and shortcomings of the research are briefly clarified.

Chapter Two serves as the theoretical basis and summary of research. The chapter firstly summarizes the property rights theory, the principal-agent theory and the incentive mechanism theory as the theoretical support for subsequent research. Then it reviews research on the relationship among the mixed ownership reform, the incentive mechanisms and corporate performance by previous scholars, followed by a proper summary and evaluation of the existing literature.

The third chapter centers around the practice of the mixed ownership reform of state-owned enterprises and corresponding incentive problems, with suggestions for improvement listed. This chapter first summarizes the practice of the ownership reform in China's state-owned enterprises. Then it gives a comprehensive summary and analysis of the historical changes of the mixed ownership, and elaborates the characteristics of mixed ownership development in four stages and their corresponding breakthroughs in the incentive and restraint system. Built on the analysis above, it explores and extracts current incentive problems in state-owned enterprises and put forwards suggestions for improvement.

The fourth chapter discusses the current situation of the incentive mechanisms and analyzes incentive elements. In a combination of empirical deduction and literature induction, this chapter deconstructs the key elements of incentives and presents innovative practical suggestions to provide an analysis framework for discussions on the incentive mechanisms in the next chapter.

Chapter Five is typically a case analysis of the mixed ownership reform. Taking Greenland Holdings and Yunnan Baiyao Group Co., Ltd., this chapter analyzes the background, process and realization path of their reform, and discusses in detail the impact of changes in corporate property rights and incentive mechanism adjustments on company performance during the mixed-ownership reform.

Chapter Six lists out suggestions on the incentive mechanisms of China’s current mixed reform. It summarizes the five contradictions faced by state-owned enterprises in the process of mixed-ownership property rights reform with innovative solutions proposed, along with the internal relationship between the property rights reform and corporate performance improvement, and addresses the internal mechanism of property rights reform for performance enhancement. Meanwhile, in view of the limitations of research, the prospect of efforts for the next stage is proposed.

1.2.2 Research methodologies

(1) Literature induction, which runs through this paper. The author collects and sorts Chinese and foreign literature, summarizes literature research, and conducts scientific reasoning about facts. In literature review

and summary analysis of Chapter Two, emphasis is laid on theories related to property rights. The author also extends relevant theories to the variable influence of the controller mechanism and agency costs before pinning down the ideas and methods applicable to this research, laying a solid theoretical groundwork for subsequent practical research. In the fourth chapter that delivers the research results of equity theory and the empirical deduction process of corporate performance optimization, literature research and empirical research merge to form the basic research direction and innovative application of mixed ownership and performance incentives in practice.

(2) In-depth interview. The in-depth interview method is a common strategy to collect data in qualitative research. It refers to a separate and personal interaction between interviewers and interviewees for face-to-face conversations to achieve the purpose of exchanging opinions and constructing meaning. This study carries out one-on-one, face-to-face conversations with the senior executives of the selected companies, and interviews on the causes and consequences of the enterprises' mixed ownership reform, offering first-hand internal information for follow-up research.

(3) Case study, a method that is targeted at specific groups of people, organizations, etc. This study screens out typical corporate cases, investigates their operations, management and structures, digs into the issues related to corporate business development and innovation, and summarizes their typical practical experience in business development and innovation. It can be of

useful reference for business innovation and upgrade. Through the description, analysis and summary of the cases of Greenland Holdings and Yunnan Baiyao, the author conducts a comparative analysis of the corporate governance mechanism and staffing, and a tabular comparison of equity structure, financial data and performance variables before and after the mixed reform to demonstrate the relevance of the incentive mechanisms. Moreover, the synergy of corporate finance, operations and management is explored based on the indicators calculated from financial data and the comparison of performance before and after the reform, followed by a summary of the effectiveness of the mixed reform mechanism in state-owned enterprises and the proposals to build a sound corporate governance mechanism.

1.2.3 Research framework

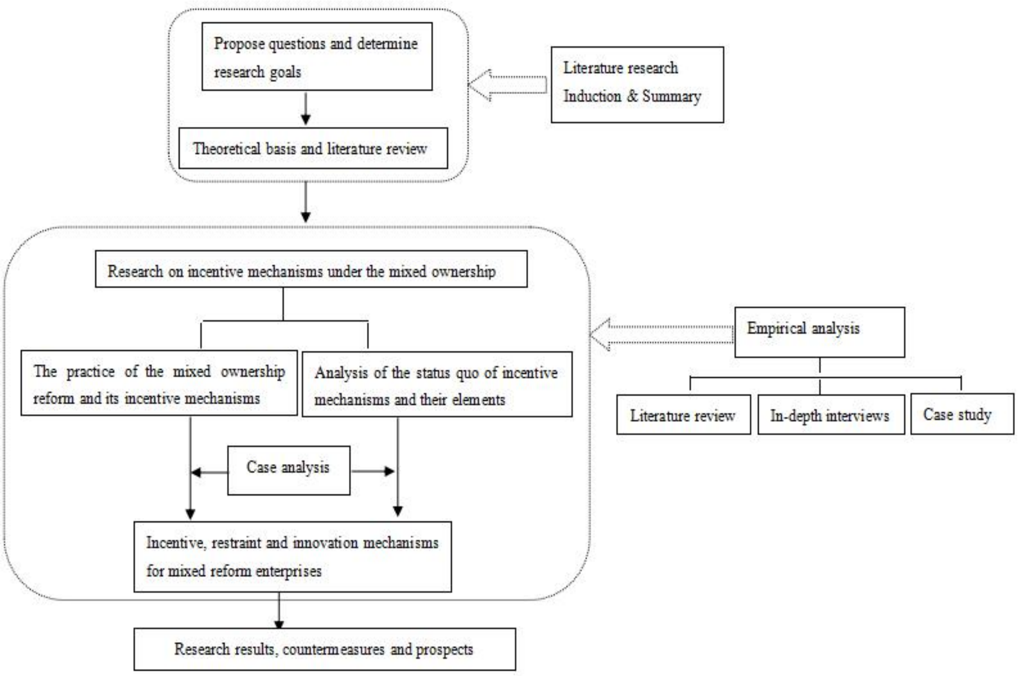

Figure 1-1 Research road map

1.3 Research innovations and insufficiencies

The core of deepening the reform at current stage is to marketize state-owned enterprises and stimulate their competitiveness and aggressiveness through improving the corporate mechanism. Supported by policies and theories, many state-owned enterprises have completed their reform. This paper not only takes Green Holdings for its successful efforts in the mixed reform as the research object, but studies Yunnan Baiyao and other companies with no significant progress in the mixed reform in the short term. It also sums up the development ideas, reform enlightenment, and corporate governance mechanism that can guide Chinese state-owned enterprises to carry out the mixed reform through analyzing reform paths of reference significance and the methods and techniques used in the process.

1.3.1 Research innovations

At present, most domestic literature discusses the reform paths from a single equity or case level. Few researchers have addressed the incentive mechanisms in a systematic way. This paper selects companies that improve their modern management level by constructing a balanced and diversified governance structure for case study. In the course of analysis, the author fans out from point to area, analyzes the obstacles to the mixed ownership reform of China’s state-owned enterprises in a comprehensive, clear structure, and proposes applicable solutions to paint a reasonable road-map for the reform. Substantial cases and solid sources rooted in practice add strong research and reference value to the theme. In addition to the “broadband pay theory” for manager incentives, the “optimal compensation balance mechanism” for the equity reform, and the “incentive compatibility mechanism” for the dilemma of property rights reform, this paper creatively combines incentives and restraints as an important driver of the incentive mechanisms.

1.3.2 Research insufficiencies

Chinese state-owned enterprises undertake both corporate performance improvement and key social responsibilities. In the model of measuring the performance of state-owned enterprises, the indicators of social responsibility should be taken into consideration to comprehensively measure the performance of state-owned enterprises and the actual impact of the mixed reform on their performance, apart from market factors and financial indicators. As to the model design of enterprise performance stated in this paper, there is no variable that reflects social responsibilities and its sample data comes from universal enterprise samples in A-shares. The removing of social responsibility variables ensures unified performance measurement standards for state-owned and non-state-owned enterprises. However, the lack of social responsibility variables in the measurement model of state-owned enterprise performance is actually the major shortcoming.

Chapter II Theoretical Foundation and Research Summary

2.1 Theories about property rights

2.1.1 The concept of property rights

The concept of property rights sprouted as early as in ancient Greece and Rome. As the economic activities of ancient Greece, a region that gave birth to Western civilization, took shape, the scarcity of products in the real world drew the attention of scholars like Plato and Aristotle. Taking human selfishness as the basic premise of research on property rights, they took a holistic perspective to discuss property rights arrangements from the perspective of a country or city state in the hope of adjusting the conflicts caused by scarcity in the society（Marx and Engels, 1975）. The core ideas of ancient Greek scholars were then inherited and developed by Ancient Rome, which built a complete legal system that protected private property rights by expanding their attention to property rights from the perspective of city state to individual rights. Though a clear concept of property rights was not established in Roman law, the rights to possession, use, earnings and disposal was mentioned. Generally speaking, since the economic activities at that time failed to break through the scope of natural economy, the large proportion of original public property rights in social arrangements crippled the establishment of a clear concept of absolute property rights. The research on property rights in ancient Greece and Rome therefore stayed at the level of thinking, with no systematic theories developed（Marx and Engels, 1975）.

With the gradual collapse of church authority, the rise of feudal kingship and the budding of capitalism in the 16^{th} century, such Locke launched discussions on the issue of property rights, among which Locke's labor theory of property exerted the most influence. In his systematical expounding of theoretical views on property rights by the natural law school, Locked stated that God gave the land to mankind for common ownership, and individuals should acquire themselves as a property and own their own labor. As long as an individual incorporated his labor into a common property and at the same time meet enough and equally good conditions and non-wasteful conditions, he should have legitimate property rights to the common property. Locke's understanding of property rights set the labor principle and the principle of individual ownership for the later liberal capitalist ownership, and also Marx's theory of property rights. Afterwards, as the European economy recovered and some Western European countries begun to embrace a transitional period, the theory of property rights was further systematized along with the development of economic aggregates, models and structures（Locke, 1824）.

In the 18^{th} century, Adam Smith addressed in the *Wealth of Nations* the natural liberty of labor ownership and the principal-agent problem of the joint-stock company system under the constraints of property rights. He assumed that human beings are motivated both by selfish and social passions and endowed with natural rights to labor—the basis of all other ownership. As stated by Smith, the main characteristics of wealth lies in the right to possess, use and transfer. Lands and capitals based on ownership have natural claims to gains, which explains why their owners strive to maximize profits. The bundles of property rights can be appropriately separated, but such problems as information asymmetry, incentive incompatibility, and responsibility imbalance may follow, given the principal-agent relationship among stakeholders（Smith, 1970）. Soon after, Marx constructed a relatively complete conceptual system of property rights in the sense of economics with a brand-new proletarian worldview. To his belief, property rights are the legal carrier of ownership. The relationship of right is a relationship of will that reflects the economic relationship, a product of history that falls into the category of history（Marx and Engels, 1975）.

Before the end of the 19th century, the understanding of property rights in Western economics circles focused on natural human rights, property rights, or ownership—property rights were not studied as a prerequisite for microeconomic analysis. In 1945, Hayek asserted in *The Road to Serfdom* that the state-owned economy deprived citizens of private property rights, leading to inefficiency, undermining the innovative forces of the market economies, and hindering long-term economic development (Hayek, 1945). In 1960, Coase, the founding father of the New Institutional Economics, emphasized in *The Problem of Social Cost* that the rights to perform certain actions are what is traded on the market. He unfolds his argument regarding how ownership arrangements, which generate external effects, are related to maximizing the value of production and can drive the system into an efficient allocation of resources (Coase, 1960). Coase is believed to be the founder and key representative of the modern property rights theory, and considered by Western economists as the founder of property rights theory.

From then onwards, many scholars have made an effort to further explore the definition and nature of property rights. At first, property rights were regarded as equivalent to property ownership as the right restriction of a series of powers. Later on, the connotation of property rights was expanded. Alchian (1965) argued that property rights were a combination of property ownership and statutory rights like by laws and the state, guaranteeing people's exclusive right to control resources under social customs, legal systems and others. Kreps (1990) joined Alchin in stating property rights as the rights under the concept of social management and commercial contracts. However, Barzel (1997) assumed that property rights, a combination of property ownership and human rights, not only determined people's rights to things, but manipulated social relations between people. North (1990) also pointed out that property rights, being exclusive, manifested the relation between people and actions, between people and people. Barzel et al. distinguished the concept of legal property rights and economic property rights, with emphasis on the commercial value of property rights.

Some economists tried to define property rights from the angle of functionality. Harold and Demsetz (1979) proposed property rights as a collection of rights that could benefit or injure oneself or others, a multifaceted right restriction. Libecap (1989) stated that property rights were a collection of rights to use, to residual income, to dispose of assets. Chang (1989) clarified private property rights as a combination of rights to private use, to enjoy private income, to free transfer. Generally, discussions on traditional property rights were kept on the right to use and the right to enjoy benefits, which should correspond to property owners' right to claim the residual value of an enterprise.

2.1.2 Development of property rights theory

The theory of property rights is gradually established, developed and perfected based on the definition of property rights by such American scholars as Ronald Coase since the 1930s(Coase et al., 1994).

"The Nature of the Firm" by Coase, published in the *Quarterly Journal of Economics* in 1937, signalized the being of property rights. The development or gradual maturity of property rights in modern Western was represented by "The Problem of Social Cost" by Coase in 1960. In his article, Coase coined the theory of transaction costs, stating that transactions are scarce, the operation of the market generates costs, and market trading fees are the costs of using the price mechanism. The Coase theorem proposed by Coase is a theorem about the internal connection among transaction costs, the defining of property rights, and the effectiveness of resource allocation. The unclear division of property rights of economic entities leads to the presence of externalities, making it possible to infringe on the interests of others. One of the functions of property rights is to clearly define how each party is entitled to benefits or loses, so that externalities can be internalized. When discussing property rights, Western scholars generated their views generally based on transaction costs and externalities—the core concept and theoretical foundation of property rights.

In reality, the property rights system is basically a combination or mixed form of public property rights and private property rights. Inspired by Coase, scholars applied the concept of transaction costs to delve into the characteristics of people's different behaviors under the common and private property rights systems from the perspective of rational self-interest. Based on this, the general conclusion that public property rights are inefficient while private property rights are efficient was proposed. In details, the subject of private property rights is clearly defined, exclusive, and freely transferable in a market economy. Once privately possessed, the owner himself can exclusively use and enjoy the benefits. He will also care about his own property rights not infringed by others and promote the formation of a system to define and protect private property rights. On the other hand, public property rights are shared, indivisible, non-exclusive, non-transferable and bear high transaction costs, so that they are prone to problems like free-riding, excessive consumption, and insufficient incentives. Therefore, the resource allocation efficiency of public property rights is lower than that of private property rights.

Based on Coase's transaction cost theory, Grossman and Hart (1986) pioneered the concept of "stakeholder" in the contract theory (the incomplete contracting paradigm) and the notion of residual control rights. The paradigm argues that an enterprise and its marginal benefits are determined by the optimal allocation of the rights of the parties to transactions. It is noted that people's rights and obligations are specified in detail under the framework of complete contracts, and there are no unspecified rights in an enterprise. Grossman and Hart (1986) believed that people were bounded rationality and contracts could not fully stipulate all possible future contingencies—there would be residual rights of control that were not specified in contracts and should belong to asset owners. From the perspective of incomplete contracts, they identified a firm as all the nonhuman assets that belonged to it. He stated that the ownership of physical capital—the basis of power—bestowed control rights on the owner. Therefore, incomplete contracts highlighted the significance of residual rights of control. A step further, Hart (1988) divided the income of an enterprise into two sections: control rights income and currency income. Since the relationship between entrepreneurs and investors sees dynamic changes over time, property owners, as the owner of residual claims, can enjoy a company's residual income and meanwhile enjoy the rights to make decisions on unspecified activities in the contract in the role of the residual control owner. Under the framework of incomplete contracts, different arrangements of property rights should bring different incentives for operators and different benefits. The “stakeholder theory” also advocated that a firm should provide equal incentives, responsibilities and rights to other interest parties (senior managers, actual controllers) in addition to shareholders, to cut transaction costs and promote corporate efficiency.

The modern property rights theory, recognized by the scholars represented by Professor Hart, is one of the theoretical foundations for China's state-owned enterprise reform. The new round of the mixed reform tries to solve the issue of owner vacancy faced by state-owned enterprises in the past by introducing strategic investors with private capital support and clear profit motives at the shareholder level. On the one hand, these newly introduced strategic investors with private capital background joint hands with state-owned capital to assume the risks of business operations in the future. On the other hand, these strategic investors can actively make full use of governance platforms like shareholder meetings and the board of directors along with the ability of legal protection to supervise managers, so that the authority of corporate governance can return to shareholders and state-owned enterprises can fulfill their transformation into a modern corporate system. Meanwhile, property rights arrangements in the new round of state-owned enterprise reform should be able to address long-term incentives for shareholders that are supposed to be introduced and designed as part of incentive mechanisms for managers.

2.1.3 Principal-agent theory

In a firm where ownership are separated from management, there will be such problems as inconsistency of interests between owners and operators, information asymmetry, and inconsistency in the responsibility of undertaking business results (Lin Yifu et al., 1993). It was Adam Smith who first observed this theory. To his belief, in terms of money handling, the directors of a joint-stock company do their best for others, while the private partnership is driven by self-interest. There is a difference in interest orientation between the principal and the agent of a firm, and it is difficult for the principal to effectively supervise the agent. On this basis, in 1932, American economists Berle and Means, put forward the “principal-agent theory” （Babeau et al.,1969）, which states that the specialized division of labor can tap into the comparative advantages of agents and conflicts do exist between direct business operators and business owners in terms of incentives and responsibilities. Business operators pursue the maximization of their own income, leisure and consumption, while the principal is dedicated to the maximization of their own wealth and company profits. Business operators pursue the maximization of their own income, leisure and consumption, while the principal is dedicated to the maximization of their own wealth and company profits. Given the different aims of the principal and the agent, the conflicts of interest between them should be inevitable. Therefore, the principal-agent theory further explores how companies can resolve the contradiction between ownership and management rights, between principals and agents in terms of residual claim rights, with the incentive mechanisms. According to the theory, the uncertainty of business operations requires a complete supervision system to measure and supervise the performance of operators, which will inevitably increase the agency costs of a firm. Therefore, business owners need to implement incentives to business operators through negotiation, transactions, contracts, etc., and improve business performance and realize property rights benefits by exploiting residual control to generate more efficient property rights structure and distribution contracts. Let the principal set an optimal incentive and introduce effective competition in the manager market, product market, and capital market come as the key to reduce agency costs (Hart, 1995).

The emergence of incomplete contracts and the principal-agent theory suffice the theoretical basis for the improvement and development of corporate governance models. According to the incomplete contract paradigm, the problem of corporate governance stems from the incompleteness of contracts but corporate governance can tackle those problems that cannot be clearly specified and the leftover in contracts. The incompleteness of contracts makes corporate governance necessary. For state-owned enterprises, the establishment of a modern enterprise system can be equivalent to the invention of a set of checks and balances between the principal and the agent. Only in this way can the principal's benefits be maximized and the agent's maximum personal interests guaranteed. If fulfilled, we can maximize the allocation of various resources and effectively put the governance mechanism and operating system of state-owned enterprises in place.

2.1.4 Soft budget constraints

In the 1970s when the Hungarian economist Kornai (1980) studied the traditional model of socialist market economy, he spotted that state-owned enterprises with long-term losses were protected from being eliminated from the market due to financial subsidies or other forms of assistance. Thus, the so-called problem of "soft budget constraints" came into being, which was rooted in the "paternalism" of socialist countries. Built on Kornai's concept of soft budget constraints, subsequent scholars introduced new economic theories and methods to further analyze and explore the causes of soft constraints, and analyzed the impact of soft budgets with models to publish their own theories. Nowadays, soft budget constraints are widely discussed as the main source of inefficiency in different economic systems. Maskin, Eric, and Chenggang (2001) states that the essential feature of the centrally planned economy is the domination of state-owned sector. The lack of financial constraints in the state sector has been seen as a common major problem in all socialist countries in transition. This is because the threat of bankruptcy is unenforceable and the state sector enjoys a variety of subsidies, credits and price support. Similarly, state-owned enterprises that are in core politically connected to the government can be saved from being eliminated by the market thanks to financial subsidies or bailouts, even though they suffer from long-term losses, as the government intends to maintain employment, tax growth and social stability. Soft budget constraints directly affect the efficiency of the state-owned sector by influencing the expectations of managers in state-owned enterprises, resulting in the lack of innovation and low market competitiveness.

To harden budget constraints is one of the main tasks for the state-owned enterprise reform. Chenggang Xu and Yingyi Qian (1998) have offered a solution to this regard based on the theory of soft budget constraints. They believe that the market can select projects when the prospects get clear, while the centrally planned economy is unable to do so due to soft budget constraints but can only rely on less effective pre-bureaucratic screening. Therefore, the current path chosen for the reform of China's state-owned enterprises should be endowing enterprises with the right to adjust investments, then reduce their mandatory plans, and adjust labor input. The measures proposed by the Chinese government to formally promote the establishment of a modern enterprise system include: "making proper concessions while progressing", "leaving some things undone in order to do other things", "classified ownership and management of state-owned assets by the central and local governments". In policies, the Sixteenth National

Congress of the Communist Party of China required to “establish the principle that labor, capital, technology, managerial expertise and other production factors participate in the distribution of income in accordance with their contributions”. Even the Congress for the first time proposed to make technology and management a factor of production to participate in the distribution, laying a theoretical foundation for deepening the reform of state-owned enterprises. In essence, we can interpret the move as a reform path for China’s state-owned enterprises to harden “soft budget constraints” as a function to serve the national economy and people’s livelihood through the establishment of a modern enterprise system. The key to the realization of the modern enterprise system lies in the establishment of an effective incentive and restraint mechanism, with particular emphasis given to the internal governance system and external restraint system of an enterprise. The “principle of compatibility between incentives and restraints” that this paper focuses on is an innovation for the governance mechanism of state-owned enterprises with Chinese characteristics.

2.2 Incentive mechanism theory

2.2.1 Overview of incentives

Incentive refers to the degree of people’s willingness to pursue certain goals and takes individuals and groups as the objects of implementation. It stimulates people’s thoughts and behaviors by stimulating motivation, encouraging behaviors, and taking actions, so as to maximally stimulate and mobilize positivity, creativity, and initiative. Incentives in a firm refer to the design of a harmonious working environment and scientific external rewards, supplemented by certain behavioral norms and punitive measures, to guide, inspire, maintain and plan the salary of organization members through information communication. In the field of management, incentive measures are a form of reward that can promote the purposeful, planned and directional efforts of employees. The formation of a set of measures that can motivate employees to actively achieve their goals is called an incentive mechanism.

Incentives consist of two parts: positive economic incentives and spiritual rewards; negative soft and hard constraints. Weihrich and Koontz （1994） believes incentives to be a hybrid of motivation and restraint, with reward and punishment being the two most basic incentive measures. The motivating and encouraging side of incentives refers to the induction of expected behaviors through rewards, which is called positive motivation. Restraint refers to the regulation of human behaviors through punishment to prevent unwanted behaviors from occurring, which is called negative incentive (Zhongyi Li, 2009). In some scholars, motivation is to mobilize the enthusiasm of production and operation entities by virtue of economic and non-economic methods. Restraint is to restrict the behavior subject through external checks and balances and internal constraints (Jinsheng Xie, 1999).

2.2.2 Incentive theory

The incentive theory originates from behaviorism in psychology.

Incentive research in the field of psychology starts with a need to explain people's behavior motivation. Since the 1970s, breakthroughs have been made in the study of economic incentive approach. The starting point lies in the achieving of a win-win situation between enterprises and individuals in the case of information asymmetry. Modern incentive theory in the economic sense can be roughly divided into explicit incentive theory and invisible incentive theory. Explicit incentive is to link the expected income of the incentive object to the business performance of a firm or organization in the form of an explicit incentive contract and induce the incentive object to focus on achieving the owner's interest goals with annual salary, stock options, and talent share plans. The principal-agent theory and the property right of human capital are typical explicit incentive theories. The implicit incentive approach advocates the incentive object as "a social person" with multiple needs. It mobilizes economic and cultural factors inside and outside a firm like occupational reputation and organizational culture to stimulate the execution efficiency of the incentive object in the form of invisible contracts. The effect of implicit incentives is relatively long-lasting and far-reaching, but it is difficult to manipulate. Typical examples are reputation mechanism and internal labor market.

Research on incentives started early abroad. Generally speaking, incentive theories can be divided into content-based and process-based. Hypothesis of human nature, hierarchy of needs, the ERG theory and the two-factor theory fall into the content-based category. Hypothesis of human nature, being an important foundation of incentive theories, embrace the proposal of Rational Economic Man (Schein), Social Man (Mayo), Self-Actualizing Man (McGregor), Complex Man (Schein), Cultural Man, etc. Maslow introduced the hierarchy of needs in his 1943 paper "A Theory of

Human Motivation”, stating that humans are motivated to fulfill their needs in a hierarchical order: physiological needs, safety needs, love and belonging needs, esteem needs, and self-actualization needs. The order of these five needs varies from person to person. People are often dominated by a specific need at different stages, but only when lower-level needs are realized can higher ones dominate the next stage. In 1969, the ERG theory by Clayton P. Alderfer condensed Maslow’s theory into three categories: Existence, Relatedness and Growth. It shows that if the fulfillment of a higher-level need is subdued, there is an increase in desire for satisfying a lower-level need（Shanhua et al.,2017）.

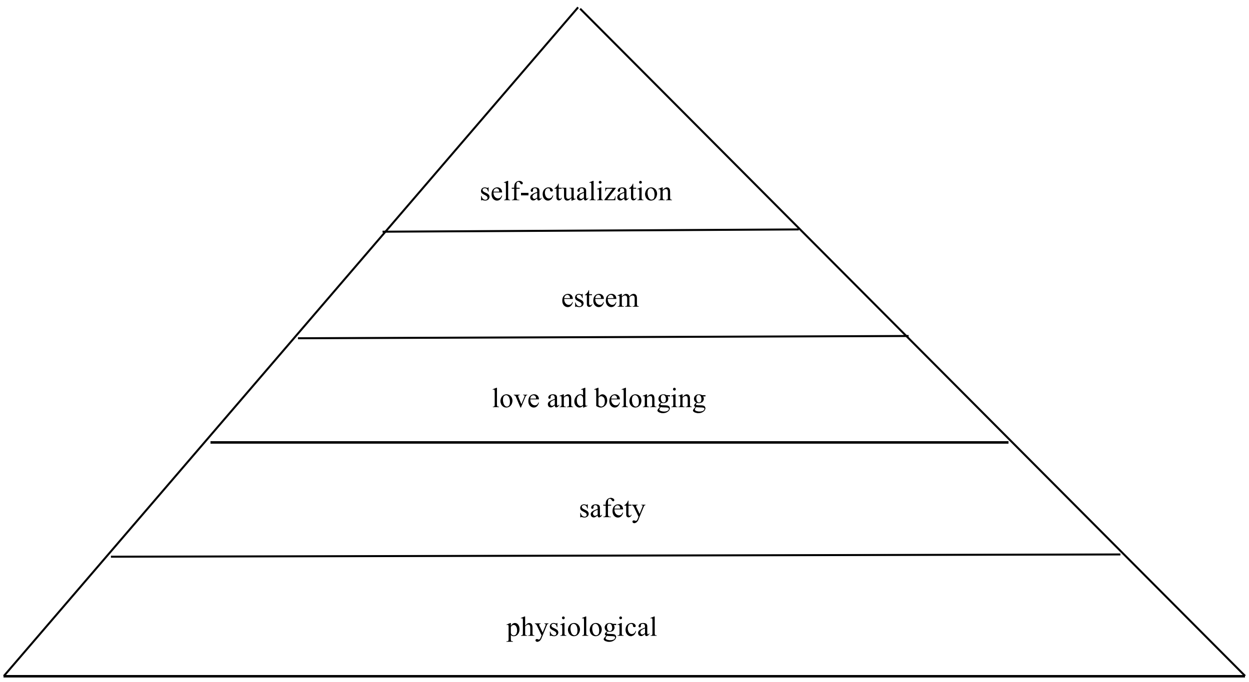

Figure 2-1 Hierarchy of needs

Chinese scholars are more inclined to adopt the process-based incentive system and pay attention to its practicality in the management system. Professor Wenzhao Yu initiated the concept of synchronous incentive in the 1980s based on China’s actual situations. In his theory, only when material and spiritual, natural needs and social needs are organically integrated and implemented simultaneously can the greatest incentive effect be achieved. These factors are prerequisites for each other and cannot be separated and opposed. If any factor is at a low value, the best effect cannot be achieved, nor the highest force of motivation. The concept of comprehensive incentives, proposed by Professor Chuanwu Xiong (1995), is the result of combining the development and practice of management in China. He argues that there are usually at least three factors accountable for the role of incentives. The first is people, namely, the subject and object of motivation. Following is time and space, that is, the incentive process and the corresponding environment. The third is method and content. His theory clarifies the relationship between these factors, and tries to apply them into the incentive process in a full, reasonable and efficient manner.

In view of the development process of incentive theories, they have experienced historical evolution from a single monetary stimulus to the satisfying of multiple needs, from the generalization of motivation conditions to clear motivation factors, from basic research to exploration of process (Yun Wu, 1996). Compared with the theoretical system of incentive contents, the incentive process is a huge improvement out of system and dynamics. Fundamentally speaking, it is, however, rooted in the psychological characteristics of people and their behavioral characteristics.

2.2.3 Incentive mechanisms for state-owned enterprises

China has entered a new round of economic cycle for structure optimization, which will put the reform of state-owned enterprises in more severe situations (Na Deng, 2016). In the transformation of state-owned enterprises, a key task will be establishing and promoting the internal incentive mechanism of state-owned enterprises to stimulate their innovative spirit and business performance. In such case, as manager incentives and employee incentives are related to each other and their joint implementation exerts an impact on business performance, it is of great significance to strengthen their effective combination, when designing the corporate incentive mechanism. Shibin Dong (2016) called attention to inadequacies in exisiting incentive and restraint mechanisms implemented by China's state-owned enterprises: relatively few spiritual incentives, incomplete performance appraisal and supervision measures, etc. Longhua Zhai (2017) explored the incentive mechanisms of state-owned enterprises a step further. To promote the optimization and development of the human resource structure of state-owned enterprises, he called for the establishment of an incentive mechanism featuring differentiated incentives, reasonableness, and fairness, and concurrent rewards and punishments by introducing material incentives, goal incentives, trust incentives, emotional incentives, rewards and punishments, competition incentives, crisis incentives, etc. In view of the fact that the state-owned enterprises studied in this paper are still controlled by the whole people after the mixed reform, the author believes that the executive human resources incentive mechanism under control is an effective and necessary supplement to solve the incentive effect of the mixed reform at this stage in China.

Management is the implementation of different incentive and restraint measures based on different hypotheses of human nature (Dayuan Li and Yinglong Chen, 2006). China's state-owned enterprises are an organizational form fitting in a specific environment during a special period. Non-economically, they strive to fulfill corresponding political tasks and social responsibilities, while their economic goals are to seek profits and development. Under the dual goals, managers often play the dual roles: "commercial officials" and "senior managers". They are expected to be politically loyal to the party and the country, be equipped with moral character and good management capabilities. Specifically, the executives of state-owned enterprises in the mixed reform are both "social people" and "economic people". "Social people" are responsible for maintaining national political stability and social welfare, while "economic people" need to contribute to production and shareholder return. The single hypothesis of "rational economic man" or "social man" is not suitable for state-owned enterprises, and their managers, therefore, are more inclined to the hypothesis of "complex man". Under China's special cultural background, the managers of mixed-reformed enterprises are also "moral people". They should carry out self-management and self-motivation under the constraints of traditional moral self-discipline, and realize their integration with the society, firms and families.

The incentives for state-owned enterprise managers in the mixed ownership reform should follow the “complex man” hypothesis, as they are both “social man”, “rational economic man”, and “moral man”. Managers, driven by self-interested and beneficial behaviors, pursue both material needs and spiritual and self-realizing needs. Therefore, the board of directors needs clear contract terms to motivate and restrict managers but shares with them complex emotional exchanges as well. Material incentives based on the hypothesis of “rational economic man” can only meet the low-level needs of managers, but spiritual incentives based on the “social man” hypothesis enable them to identify with the company, while cultural shaping and self-discipline based on the hypothesis of “moral man” can exert soft constraints on managers. Hence, for senior managers of state-owned enterprises in the mixed ownership reform, we should adopt a combination of material, spiritual and institutional incentives as well as cultivate better corporate culture to achieve moral restraint and help managers thrive and fulfill self-realization.

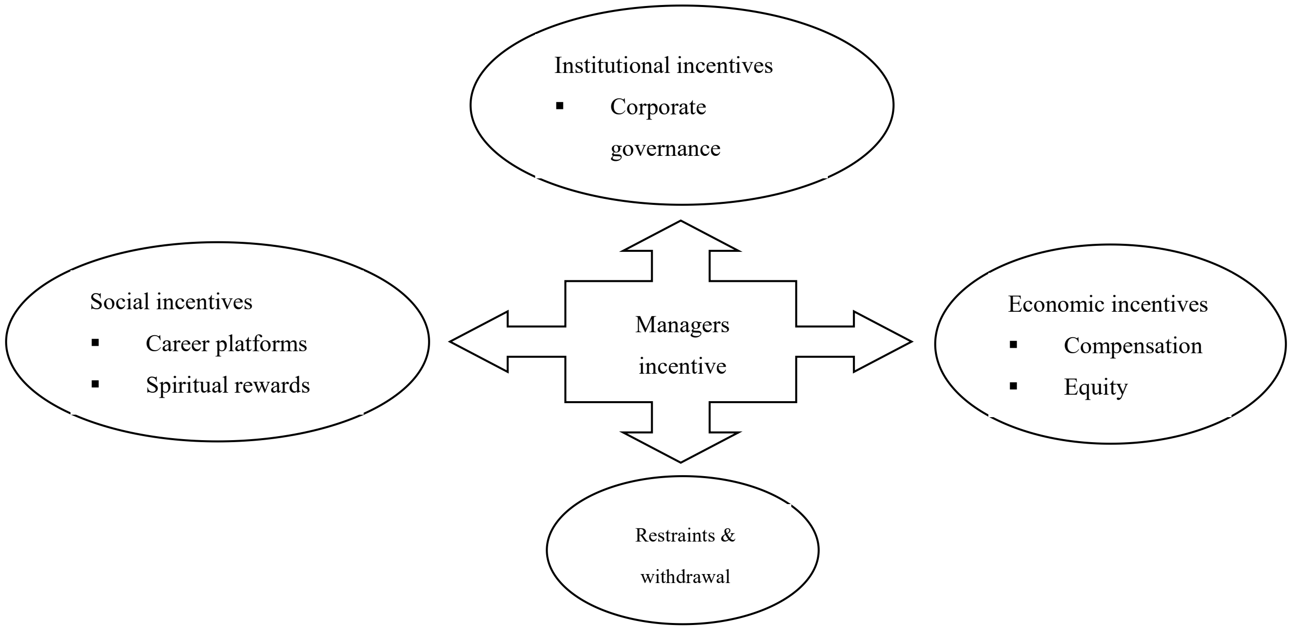

Figure 2-2 Multiplicity of the manager incentive mechanism in enterprises with the mixed reform

2.2.4 Enterprise property rights system and internal incentive mechanisms

With the continuous development of an enterprise, its organizational form, scale, and property rights structure need to be adjusted accordingly in the process of growth and transformation.

The modern enterprise property rights system, a crucial ingredient of the modern enterprise system, has experienced three development forms: single proprietorship, partnership and company system. Company system enterprises are an inevitable result of socialized production and commodity economy in development. In face of technological advancement, economic development and intensified market competitions, companies are investing more and more funds and expanding their scale to increase economic efficiency, therefore imposing more operational risks. In case of this, investors wish to establish a protection system that can effectively reduce risks. Company system enterprises have been rapidly adopted as a universal business form across the world due to strong fund-raising capabilities, standardized legal person property system, diversified operating risks, limited responsibilities for investors, and a robust management organization. The property rights system of company system enterprises feature independent legal person property, separation of ownership and management rights, and the implementation of the limited liability system for corporate investors.

The continuously strengthened modern enterprise system has separated the ownership and management rights, allowing the owner of a firm to retain the right of residual claim and transfer the management right to an exclusive manager. Against this background, much attention should be distributed to whether operators who have actual control of a firm can effectively safeguard the rights and interests of owners, whether control rights and residual claim rights can serve as incentives between owners and operators. The principal-agent theory by Burley and Mein discusses how a company can use the incentive mechanisms to resolve the contradiction between ownership and management rights, between principals and agents regarding residual claim rights. The principal grants the agent the power to make decisions, but they do not share consistent goals. As the principal may not fully understand the agent’ behavioral information, a complete supervision system that measures and monitors operator performance is needed to address the uncertainty of business operations, but this definitely adds to agency costs. To better improve business performance and realize the benefits of property rights, business owners need to implement incentives on business operators through negotiations, transactions, contracts, etc., and ultimately produce more efficient property rights structures and distribution contracts through residual control.

Chang(2010) believes that the design of an effective incentive contract should take into consideration the principal and the agent’ attitudes towards risks and the risk of output fluctuations needs to be distributed between the two parties. In the context of new institutional economics, the key to motivating and constraining the relationship between the principal and the agent resides in whether an incentive-compatible mechanism can be created so as to drive the agent to a higher level of effort, to limit their behaviors in line with the scope of the principal’s interests, to maximize the utility of both the principal and the agent.

From 1985 to 1991, the state implemented a policy of separating ownership and management rights for state-owned enterprises, which did mobilize the spirits of employees. However, given that enterprises only bore profits but not losses under the policy, some business operators took advantages of the right of residual claim, legally or illegally, to maximize their own interests, resulting in short-term exploitation and opportunistic behaviors. Though risk sharing was guaranteed, the policy was criticized for ineffective incentives. Currently, state-owned asset management in China is subjected to problems like fictitious subject of property rights, unclear property rights, ineffective supervision of operations, and mismatched control rights and residual claims, the modern property rights theory comes as a solution to the optimization of state-owned assets in China. To explore property rights reform plans and internal incentive mechanism, guarantee state ownership, and implement enterprise management rights are the important tasks in a new round of reform for state-owned assets and enterprises at this stage, which are also a highlight of this paper.

2.3 A summary of researches on property rights reform, incentive mechanisms and enterprise performance

Much theoretical analysis and empirical research on the relationship between property rights structure and corporate performance has been carried out at home and abroad. Scholars represented by Jinglian Wu (1993), Weiying Zhang (1999), and Shleifer (1997 & 1998) argued that clear property rights were an important feature of the modern enterprise system and the key to improving corporate performance. Reforming the current property rights system and clarifying property rights would be the essential task of improving corporate performance. Yifu Lin (1997), however, believed that the property rights system was not necessarily related to efficiency, that a fully competitive market environment should be the real reason behind efficiency. Some scholars also discussed internal governance in a firm, stating that the ownership of property rights was not the key reason. They concluded that the problem of corporate performance was ultimately a management problem, and the fundamental means to revamp corporate performance should be the strengthening of internal management.

2.3.1 Research on the impact of property rights reform on enterprise performance

A consensus is yet to be reached in the academic circle with regard to the impact that the privatization of state-owned enterprise property rights weighs on corporate performance. Djankov and Murrel (2002) reviewed in detail a voluminous number of empirical studies on corporate performance under different ownership systems from all over the world. They came to a basic conclusion that state-owned enterprises had lower efficiency and less obvious performance than private enterprises—the latter was more efficient in most cases. To study the relationship between corporate ownership and performance, Hu et al (2006) turned to the data collected by the World Bank from over 700 companies in 6 industries in 5 Chinese cities from 1996 to 2001. They found that private ownership and foreign ownership had a greater stimulus effect on the productivity of companies than full ownership by the state. Among all forms of company shares, only private companies witnessed shares being positively correlated to productivity. Groves et al (1994) conducted a sample survey of Chinese state-owned enterprises. The data they collected indicated that the efficiency of state-owned enterprises had indeed improved to a certain extent after the reform, mainly from financial incentives, the level of education, and the quality of human resources. Yao (1997) studied the impact of profit sharing and bonus on the performance of state-owned enterprises in the 1980s. To his finding, more than half of the value-added can be explained by bonus incentives, and the quality of labor could also affect corporate performance. Estrin (2002) cited Claessens & Djankov (1999) on administrator turnover in his paper, which demonstrated the fact that new managers could bring higher productivity to a firm: 6.2% in the Czech Republic and 7.3% in Central Europe. Some scholars also argued that the number of privatizations in developing countries had no significant impact on their development process--their relationship is worth reexamining by researchers (Megginson & Netter, 2001; Estrin et al., 2009). For those state-owned enterprises that were renewed to privatization, they failed to improve significantly in performance because of the diversified goals—performance improvement was not their only goal. Maintaining or increasing employment opportunities was also one of the main goals state-owned enterprises pursued. From a multi-task viewpoint, Bai and Xu (2005) conducted analysis to suggest that the real reason why the state retained a certain proportion of state-owned enterprises was their multiple functions of under the imperfect social welfare system. Sam (2013) stated that

China never agreed to fully privatize its state-owned enterprises but retained them to avoid unemployment resulted from the non-state sector's malfunction in absorbing excess labor. Considering the impact of the reform of state-owned enterprises on employment, D'Souza et al (2003) explored the data of 208 companies listed from 1990 to 1997 and found that the number of employees in listed companies after the reform did not see significant changes in the short term but there's a dramatic drop in the long run.

In the case of divided opinions, most scholars tried to draw more applicable conclusions by comparing the differences between state-owned enterprises and private enterprises, which had completely different property rights structures. Megginson and Netter (2001) compared and analyzed the performance of companies under different ownership systems around the world to conclude that state-owned enterprises were generally more inefficient than private enterprises. With the survey data of nearly 300 state-owned enterprises (SOEs) covering six industries in five Chinese cities from 1996 to 2001, Hu Yifan et al (2006) examined the effect of the privatization of Chinese state-owned enterprises. They pointed out that those with better performance were given priority to be privatized, that the enterprises controlled by private institutions or thoroughly privatized performed better than those that were still state-controlled and partially privatized.

2.3.2 Research on the impact of property rights reform and incentive mechanism on corporate performance

In recent years, as state-owned joint-stock companies, especially a large number of state-owned enterprises, have been listed domestically and overseas through restructuring, mixed-ownership enterprises with state-owned holding or equity participation have become the main organizational form of state-owned enterprises or the main manifestation of operating state-owned assets. The reform of diversifying investment entities in state-owned holding enterprises has been seen as the strategic orientation in the enterprise reform. Under the framework of market economy, differences and contradictions in rights and interests are an inevitable issue among different investment entities within the same ownership system out of their own interests. The emergence of a large number of mixed-ownership enterprises is complicating the analysis of the relationship between property rights structure and enterprise performance. In the course of analyzing the basic logic and paths of the mixed ownership reform affecting the performance of state-owned enterprises, Zhiqing Han and Duo Xu (2019) underlined that both the internal governance structure and external competitive environment could impact corporate performance, directly or indirectly. From the perspective of improving the internal governance structure of state-owned enterprises, the mixed ownership reform changed corporate governance by adjusting the property rights arrangements of enterprises, promoted the establishment of a diversified pattern of corporate investment entities, broadened financing channels, introduced domestic and foreign strategic investors to optimize their internal corporate governance mechanism, thus bringing a direct impact on corporate performance. Meanwhile, the mixed ownership reform effectively solved the principal-agent problem owing to the separation of the two rights through optimizing the corporate incentive mechanism and establishing a corporate governance mechanism that coexisted with incentives and constraints, thereby improving the performance of state-owned enterprises. With first-hand data collected from a survey on the restructuring of more than 3,000 enterprises based in over 200 Chinese cities, Jie Gan, Yan Guo and Chenggang Xu (2017) launched a comprehensive research on the basis that local governments screened out restructuring plans and the mechanism for improving the performance of restructured state-owned enterprises in the process of reform. Their efforts demonstrated that the partial decision-making power of enterprises was transferred from the government to private owners through restructuring, and the degree of transfer varied with different restructuring methods. The restructuring methods included direct sales to external investors, management buyouts (MBO), listing, joint ventures, contract leasing, and employee stock ownership. Among them, the majority of companies preferred the MBO approach, which reduced government intervention and support for enterprises, imposed hard budget constraints on enterprises but brought flexibility in fulfilling corporate reorganization to better company performance—replacing the core management team, strengthening incentives to the management through compensation policies, establishing a board of directors, introducing internationally accepted accounting and auditing standards, to name a few. The above-mentioned viewpoint was confirmed by some foreign scholars. Blair et al. (1995) emphasized that the core of corporate governance should be deciding whom to benefit from corporate decisions, that is, how property rights would be arranged.

In sum, the impact of property rights arrangements and the governance mechanism on corporate performance have received much attention. The property rights reform of mixed ownership have a direct impact on the benefits of enterprises and trigger profound changes in the performance mechanism, management model, and governance system. To make enterprises glow with vitality and creativity in the reform, a clear property rights system and scientific management methods should be in place. Against the backdrop of a new round of state-owned enterprise restructuring in China, to study the incentive elements that can promote changes in property rights and mechanisms in accordance with the principle of incentive and restraint compatibility, especially the impact of incentive and restraint mechanisms on performance variables after enterprise restructuring, will be of great importance to subsequent system design and corporate practice. This is also a key direction of research guided by the theoretical review of this chapter.

2.4 Literature review

Theoretical and literature review has stressed that the clarity of property rights is a key factor or even a decisive factor for corporate performance. Only when corporate assets are privately owned can they satisfy the exclusion of property rights. Such exclusivity protects the owner's assets and the benefits brought by their assets from being invaded as well as contributes to the building of an effective incentive mechanism for company owners pertaining to their assets. Also noted is that the basic incentive motivation for business owners to care for corporate performance comes from the possession of surplus profits. The more entrepreneurs have a share of surplus profits, the stronger their motivation to drive corporate efficiency. In other words, the extent of motivation to which business owners pursue corporate performance is proportional to the share of surplus profits. However, the traditional property rights theory is still inadequately explained in the development of commercial society as it overlooks the separation of modern enterprise ownership and management that gives rise to problems in business decision-makings and organizational restructuring. Echoing the traditional property rights theory in attention to shareholders, the modern version is concerned with enterprise stakeholders, cored in the best match of their power in transactions. Apart from corporate shareholders, the modern property rights theory encourages equal incentives, rights and obligations to be distributed to other stakeholders for better business efficiency. In the academic community, there has been some disagreement concerning the privatization of state-owned enterprise property rights on business performance. In many cases that tell the reorganization, restructuring and listing of state-owned enterprises, scholars have identified that the different backgrounds of investment subjects in the mixed ownership reform lead the pursuit of corporate interests to diverse paths and reduce the efficiency of business operations. In this regard, some scholars have reinstated that clear property rights are the key to strengthening corporate performance, while some have proposed that property rights have nothing to do with corporate performance but considered corporate performance as largely management related. Studies on the mechanism that affects the performance of enterprises with different property rights systems have described that clear property rights arrangements and the incentive mechanisms to resolve information asymmetry between the principal and the agent can stimulate the operational potential of reformed enterprises.

There is still some controversy surrounding the impact of the property rights reform on corporate performance, largely because the complexity of the problems faced by restructuring enterprises in practice goes far beyond the theoretical level. Much research work is bounded by a certain angle when studying problems. For example, the traditional property rights theory is limited to the game between the property rights reform and the distribution of controller rights. To address this, case studies from different angles and at different stages could be a solution. In the following, the author will exploit the theories related to property rights and the incentive mechanisms to analyze the history and current situations of China's mixed ownership reform and conduct in-depth discussions on the key elements and ways of integrating incentive and governance mechanisms. Besides, by referring to the experience and lessons of two enterprises with the mixed ownership reform, this paper lists out innovative suggestions for large state-owned enterprises in China at this stage.

Chapter III Practice of the Mixed Ownership Reform in State-owned Enterprises and Incentive Mechanisms

3.1 The mixed ownership reform of state-owned enterprises

China's state-owned enterprises were established as a typical example of the traditional economic system in a socialist country, following the Soviet model. By the 1980s, state-owned industrial enterprises accounted for nearly 80% of China's total industrial output value, becoming the backbone of our country's national economic system. However, the severe disadvantages of state-owned enterprises—lack of incentive and market mechanisms—have been gradually exposed over the course of social development. Having no autonomy to a large extent, state-owned enterprises have become an important policy tool for the Chinese government to control economy. The production of state-owned enterprises is arranged to match government planned indicators rather than market signals, derided for the lack of incentive mechanisms and low economic efficiency. Based on the main theory that the relations of production must conform to the level of the productive forces, the reform of China's economic system has gradually deepened and moved towards a deep-water area of public economic interests after the Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party, with the mixed ownership reform being a major breakthrough for state-owned enterprises. Compared with the direct model of privatizing state-owned enterprises in most countries, the mixed ownership reform has strong Chinese characteristics and constitutes a major part of China's economic transition.

3.1.1 Mixed ownership reform

Unlike the "privatization" in the West and in the Soviet and the Eastern European countries, the mixed ownership reform has its distinctive meaning in China. The definition of "privatization" in *The New Palgrave Dictionary of Economics* refers to the transfer of corporate ownership from the government to private individuals. Chinese scholar Bole Wei (2006) filled "privatization" with a broader meaning, defining it as "all actions and initiatives to increase the responsibilities of private companies in the matters of using social resources, making products and providing services by reducing or restricting the role of government authorities". The typical practice of privatization that can be explained by this definition is: such capitalist countries as the UK and France took a series of actions like selling state-owned enterprises to "hedge" against nationalization in the hope of relieving financial pressure and enhancing economic competitiveness after the World War II. In the former Soviet Union and Eastern European countries, privatization was carried out by selling a large number of state-owned enterprises, which resulted in changes in their basic economic system and political system. This practice has profoundly touched China in understanding "privatization". China is more inclined to view "privatization" in a narrow sense. Rather than implementing a single type of private ownership in the practice of the mixed ownership reform, China tries to further advance on the basis of the original traditional public ownership and introduce a variety of forms of ownership, including foreign capital and private capital, to jointly constitute its controlling body.

The mixed ownership reform refers to not only the reform of the public-owned economy, but also the multiple economic manifestations of enterprises in the course of their operations. From a macro perspective, the reform is to change the simplification of the economic ownership structure of a country or region, to allow the coexistence of different ownerships and economic entities. From a micro perspective, it is manifested that entities with multiple ownership properties jointly fund or invest in an enterprise to shape an economic form of different property rights. At the beginning of the reform, China took its efforts in the macro sense. With the continuous deepening of the reform, this micro-level economic reform has begun to emerge as a key role of development. At present, the reform of state-owned enterprises focuses on the reform of mixed ownership.

3.1.2 Background of the mixed ownership reform of state-owned enterprises

In the early days of the founding of the People's Republic of China, state-owned enterprises began to appear as a general form and their scale of development expanded rapidly in a short time. For long, state-owned enterprises always occupied an important position in supporting economic growth, providing social security and maintaining national security and stability. However, after the reform and opening up, the drawbacks of state-owned enterprises have been revealed with the improvement of productivity and China's market economy system. They are prone to problems like the absence of owners, the inefficient operation of state-owned capitals, and imperfect incentive and restraint mechanisms for state-owned enterprise managers. The advancement of the mixed ownership reform requires state-owned enterprises to introduce non-state capitals, promote the diversification of property rights, and establish a modern enterprise system that conforms to the market competition mechanism, which can solve the foregoing problems faced by state-owned enterprises to a certain extent.

3.1.3 The realization paths of the mixed ownership reform

The mixed ownership reform is a reform of not only equity and profits, but governance structure. Therefore, in addition to introducing non-public capital to improve the ownership structure, the mixed reform of state-owned enterprises in China must also improve corporate governance. Specifically, the mixed ownership reform should be performed at two levels. At the equity level, the state-owned economy and other non-state-owned economies are expected to develop into a mixed ownership economy through different forms to create equity diversification. At the level of corporate governance, state-owned enterprises are required to create a modern corporate system and refine corporate governance.

(1) Reform at the level of equity

The so-called mixed reform of state-owned enterprises is to incorporate non-state capital into their property rights, to reduce the proportion of state-owned capital in an orderly and progressive manner for the realization of balanced development between state-owned capital and non-state capital over time. The mixed ownership reform should be conducted level by level. Put it more precisely, the reform of state-owned enterprises based on the equity level take the following paths:

1) Listing. The shareholding reform of state-owned enterprises can be divided into the overall listing of the parent company, the listing of main business assets and the listing of multiple businesses according to the ways that state-owned enterprises take to go public.

2) The mergers and acquisitions of state-owned enterprises: to carry out the reorganization of assets, liabilities and personnel for optimizing the order of the industry, perfecting the industrial structure, and strengthening the enterprise team.

3) Introducing strategic investors. Not only should we introduce non-state capital to refine the equity structure of state-owned enterprises, but also integrate state-owned enterprises into the domestic market and even the world's economic system by way of market and capital flows to help state-owned enterprises realize the marketization and internationalization of capital and technology.

4) Promoting public-private partnership (the PPP model). A

partnership-like cooperative relationship between the government and private organizations can be established to jointly work on the construction of urban infrastructure projects or obtain certain public goods and services on the basis of concession agreements.

5) Employee stock ownership: to reward high-level managers and ordinary employees with the company's stocks and stock options so as to increase their bonding with company as shareholders.

(2) Reform at the level of corporate governance

For a long time, the single ownership system and unreasonable shareholding structures have been a key issue in the corporate governance of state-owned enterprises in China. It is necessary for state-owned enterprises to explore a corporate governance model that suits their own national conditions.

3.2 Paths and incentive mechanisms in different periods

Since the reform and opening up in 1978, China's state-owned enterprises have gone through four stages of reform: decentralization, interest concessions and separation of ownership and management rights; the establishment of a modern enterprise system and annual salary mechanism; state-owned assets supervision and agency; the deepening of reform and mechanism innovation. Each reform took place to suit in a specific background and conditions, in which adjusting the incentive mechanisms was made a key point. The adjustments of the incentive mechanisms in all the stages center on mobilizing the enthusiasm of managers and enhancing the vitality and competitiveness of state-owned enterprises.

3.2.1 Decentralization, interest concessions and separation of ownership and management rights (1978-1992)

The Communique of the Third Plenary Session of the Eleventh Central Committee released in 1978 declared that China should boldly delegate the autonomy of business management under unified guidance, given the state's concentrated management power over local enterprises. To mobilize the production enthusiasm, initiative and creativity of enterprises and workers under the premise of following the planned economic system, the Communique also required enterprises to act in accordance with economic laws, fully mobilize the enthusiasm of cadres and workers for production, adhere to the Party's unified leadership, and strengthen the management personnel's authority in assessment to guarantee effective assessment, rewards and punishments, and promotion.

In the initial stage of decentralization and interest concessions, the state clarified the interest relationship among the state, enterprises and employees by expanding the autonomy of enterprises in operations and management. Its efforts stimulated the enthusiasm of employees for labor and invigorated the economy. However, practice proved that the decentralization and interest concessions were just a transfer of profits. To achieve one factory and one policy in state-owned enterprises, the unified concession approach was not feasible. As the operators of state-owned enterprises basically did nothing in terms of incentives and innovations, the management of factory directors (managers) placed more emphasis on economic responsibilities, administrative penalties, economic penalties, and power constraints. The absence of incentive mechanisms put corporate resources in an ineffective state. Factory directors (managers) were only granted such material and spiritual incentives as the factory director's authority, administrative treatment, basic salary, bonus, welfare, and honorary titles. For factory directors who made special contributions, they could only be promoted via recommendation by the workers' congress and approval from the higher authorities. Under the mode of low salary during the planned economy period, intrinsic incentives like spiritual, honorable and emotional incentives did play a crucial role. For the operators of state-owned enterprises, this stage highlighted sufficient spiritual incentives, inadequate material incentives, excessive constraints and responsibilities.

In 1983, the State Council circulated the "Report on Pushing forward the Substitution of Tax Payment for Profit Delivery in State-owned Enterprises (Draft)", requiring the implementation of "substitution of tax payment for profit delivery" on state-owned enterprises and changing the profit-distribution system into collecting income tax and regulation tax with the after-tax profits at the discretion of the enterprises. Among them, the employee welfare and incentive funds shall not exceed 40% of the total retained profits. The substitution strategy enabled companies to keep a portion to pay employee salary, benefits, and bonuses while turning over profits to the state in the form of income tax. Any loss should be taken care of by companies themselves. Such a reform approach highly unified the rights, responsibilities, and interests of a firm, stimulated the production motivation of the business operators and employees and made them responsible for business outcomes. The reform on the substitution of tax payment for profit allowed enterprises and employees to obtain their own interests, which in turn inspired tremendous enthusiasm. Compared with the economic responsibility system, the substitution of tax payment, of obvious limitations, alleviated some problems, but never fundamentally solved the market entities of state-owned enterprises. In this stage, the reform can be attributed to the level of management rights, focusing on changes in the freedom of management, without touching the government's control of enterprises.

In 1984, the Third Plenary Session of the Twelfth Central Committee put forward the decision to reform the economic system and determined the new focus of China's economic system reform should be shifting from rural areas to cities to comprehensively enhance the vitality of state-owned enterprises. The separation of two rights—ownership right and management right—in state-owned enterprises was also proposed.

In 1986, the State Council announced the "Provisions on Deepening the Reform and Enhancing Vitality of Enterprises" to promote a contracted management responsibility system nationwide, stating that the distribution relationship between the state and enterprises shall be determined under the principles of contracting for a fixed base amount, ensuring enterprises turn over profits, and requiring enterprises to retain their excessive profits and make up the shortage thereof. The original intention of the contracted management responsibility system was to give business operators more residual claim and control rights during the contract period, but it only dealt with the problem of the responsible person. Even it was widely criticized for deriving a series of problems including right rent-seeking and rent-setting.

To further mobilize the enthusiasm of business operators and regulate the incomes of operators and employees, the State Council issued the "Opinions on Improving and Perfecting the Income Distribution Methods for the Operators of Enterprises Owned by the People". It proposed to match the salary and bonuses of the operators with their contracted results to reflect the principle of more pay for more work, to pay their income on a monthly basis. The opinion also demanded to keep the work level of operators at a reasonable distance from other employees but avoid big gaps. Besides, contractors should face economic penalties if they brought about debts that were higher than the total assets or manipulated false profits.

A look back at the contracted management responsibility system, we can conclude that the system partially activated the incentive mechanisms of factory directors and managers and allowed operators to obtain a certain amount of surplus after fulfilling their tasks. If not, they had to assume the corresponding liability for breach of contracts. Such an incentive and restraint mechanism rendered more operating efficiency of state-owned enterprises and promoted economic development. However, those measures were obvious pragmatic based on the immediate problems faced by state-owned enterprises in practice, rather than fundamental and overall strategic planning and thinking out of theoretical discussions and foresights (Dazhong Lv, 2010). A pragmatic reform could produce immediate results, but it failed to fundamentally touch the ills of state-owned enterprises and completely tackle the integration of state-owned enterprises with the market economy system . The short-term benefit of such reform was characterized by the stimulation of vitality, but without a big picture in the long run, the entrepreneurial spirit would not be stimulated, not to mention the low efficiency of state-owned enterprises.

3.2.2 Modern enterprise management system and annual salary system (1993-2002)

The "Decision on Some Issues concerning the Establishment of a Socialist Market Economic Structure", adopted at the Third Plenary Session of the Fourteenth Central Committee of the Communist Party of China in 1993, laid down the task of building a socialist market economic structure with public ownership as the mainstay and allowing diverse economic forms to develop side by side, establishing a modern enterprise system which meets the requirements of the market economy and in which the property rights as well as the rights and responsibilities of enterprises are clearly defined, government administration and enterprise management are separated and scientific management is established. This indicates that the reform of state-owned enterprises has entered a new stage—from the stage of decentralization and interest concessions to the stage of innovating the enterprise system.

The Ministry of Labor issued the “Trial Measures for the Annual Salary System of Enterprise Operators” in 1994, which stipulated the practice of the annual salary system for enterprise operators in the form of a national policy for the first time. Subsequently, the State Council chose 100 state-owned enterprises to carry out a pilot reform of the modern enterprise system and promote the annual salary system, with contents including the pilot reform of the legal person system, company organization form, and company governance structure. The 100 pilot enterprises were grouped into four restructuring forms, as shown in the following table:

Table 3-1 Restructuring summary of 100 pilot enterprises

	Multi-shareholding companies		State-owned companies		Wholly state-owned holding companies	Structural adjustments according to the principle of reorganization followed by restructuring
Changed to	Company limited by shares	Limited liability companies	First wholly state-owned companies and then joint stock or limited liability companies	Wholly state-owned companies		
Count	11	6	29	40	10	2

Source: Haibo Wang, 2001, *Technological and Industrial History of China,* Shanxi Economic Publishing House

The Fourth Plenary Session of the Fifteenth CPC Central Committee in 1999 reiterated the establishment of a modern enterprise system as the direction of the state-owned enterprise reform. According to the tracking statistics of 4371 key enterprises nationwide by the Enterprise Survey Department of the National Bureau of Statistics, among the 3,322 reformed companies as of the end of 2001, 1987 of them established shareholder meetings, 31% a board of directors, 27% a board of supervisors, accounting for 80.9%, 96.2% and 83.9% respectively of the total number of restructured companies (state-owned companies do not have shareholders according to the Company Law). 1474 companies implemented an annual salary system for operators, 689 begun to implement a distribution system for operators' equity and stock options, and 1,745 introduced an incentive mechanism for the income distribution of scientific and technological personnel (Haibo Wang, 2005). The incentive mechanisms, supervision and management made up for the lack of operating and management motivation, and enhanced the operational efficiency of state-owned enterprises and the labor enthusiasm of enterprise employees. But in practice, it was difficult to grasp and implement the different standards of annual salary due to the unclear property rights of state-owned enterprises. In particular, the factory directors and managers of state-owned enterprises were the result of the "appointment mechanism", crippling the annual salary system in well reflecting the value of human capital for managers. Unclear assessment standards, implementation targets, and scope of the annual salary system also led to gradual increase in the income gap of state-owned enterprise managers and employees and caused some social conflicts. Therefore, at this stage, the unclear annual salary system resulted in excessive incentives and insufficient constraints.

The core of reform at this stage was to establish and improve corporate governance structure. The reform direction of the modern enterprise system set a clear goal for state-owned enterprises: to improve the operating capacity of state-owned enterprises, operating efficiency and economic performance through perfecting the corporate governance structure, under the premise of keeping corporate ownership. How to rationally arrange the control right of an enterprise remained as an issue to be explored.

3.2.3 State-owned assets supervision & entrusted agency (2003-2013)

In 2013, the 16th National Congress made major adjustments to the management system of state-owned assets, clarified the principles of “three separates, three unifications and three combinations”, and established the SASAC. By the guidance of modern property rights theory, SASAC fulfills the responsibilities of state-owned assets investors, accelerates the layout of state-owned economic strategic planning, promotes the reform of joint-stock system in large and medium-sized state-owned enterprises, gradually establishes and improves corporate governance structure, and makes the joint-stock system as the main realization form of the public ownership economy.

Based on the “Interim Measures for the Supervision and Administration of State-Owned Assets of Enterprises”, the newly established SASAC formulated 16 regulations and over 40 normative documents, including enterprise restructuring, property rights transfer, asset evaluation, performance evaluation, and financial supervision, so as to strengthen the supervision and management of state-owned enterprises. In October 2003, the “Decision on Some Issues concerning the Improvement of the Socialist Market Economy”, adopted at the Fourth Plenary Session of the Sixteenth CPC Central Committee, asserted to vigorously develop a mix sector of the economy shared by state-owned capital, collective capital, non-public capital, etc., realize the diversification of investment sources and make the joint-stock system as the major form for realizing public ownership, to establish a modern property rights system featuring clear-cut ascription, clearly defined rights and responsibilities, strict protection and smooth transfer, thus leading state-owned enterprises to embrace the stage of reforming modern property rights with the shareholding system as its main form. Since then, the mixed ownership economy has expanded rapidly. According to the analysis report on property rights structure and current distribution of central enterprises, by the end of 2012, the number of registered state-owned enterprises and wholly-owned enterprises was 21,828, and the number of registered mixed-ownership enterprises introducing foreign capital and non-governmental investment was 232, accounting for 48% and 52% of the total registered enterprises respectively. According to the property rights registration system of SASAC, by the end of 2013, more than 90% of state-owned enterprises had realized the reform of company system and joint-stock system; 42% of the total mixed ownership enterprises had introduced non-public capital into state-owned enterprises, and 52% of them were central enterprises.

At this stage, due to the rising status of the non-public economy, mixed ownership began to shift from a partial state model under capital mix to mixed operation. Although the state-owned enterprises gradually got out of the business dilemma after the restructuring, inefficiency, the non-separation of government and enterprise, strong government intervention and weak voice of non-public economic components still existed widely, which leaded to the general lack of willingness to integrate non-public economy into the development of public economy. There is still much room for deepening the reform of mixed ownership, that is, mixed ownership enterprises need to change from mixed operator to market-oriented operator.

3.2.4 Deepening of mixed reform and innovation of incentive mechanisms (2013-present)

To reform the shortcomings of mixed ownership reform in the previous stage and create a market-oriented operation subject of mixed ownership, the Third Plenary Session of the Eighteenth Central Committee approved the "Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform" in

2013. As a strategic plan for how to deepen the reform of state-owned enterprises in the new era, the “Decision” encouraged to build a mixed economy with cross holding by and mutual fusion between state-owned capital, collective capital and non-public capital, strengthen state-owned assets oversight with capital management at the core, and accurately define the functions of different SOEs, which should appropriately increase the proportion of market-oriented recruitment. At this point, the reform of state-owned enterprises has also entered into a more comprehensive and deepening stage that focuses on supervision, property rights, and operation.

2016 was known as a pilot year for the reform of state-owned enterprises as the SASAC strengthened the top-level design of the reform and successively issued 7 supplementary documents to share with the “Guidelines on Deepening Reform of SOEs” a “1+N” paper system. The 10 pilot SOE reforms led by the SASAC fully rolled out with contents covering the functions and powers of the board of directors, the recruitment of operating managers, professional manager system, salary distribution reform, state-owned capital investment and operation, central enterprise mergers and reorganizations, mixed ownership reform, employee stock ownership, information disclosure, historical issues, etc. At the same time, the corporate shareholding reform accelerated its pace. The mixed ownership reform was then made a breakthrough and local state-owned enterprises became the main force in the mixed ownership reform. Both Guangdong Province and

Chongqing Municipality declared to raise the proportion of local state-owned enterprises of mixed ownership to around 70% in 2017 and the 3-5 years that follow. Statistical data showed that the reform of state-owned enterprises achieved initial results in 2016. From January to October 2016, central SOEs turned the tables after 18 consecutive months of decline in profits and achieved an operating income of 18.7 trillion yuan, an increase of 1.2% year-on-year and a profit of 1.023.1 billion yuan, an increase of 0.5% year-on-year, initially fulfilling the goal of resuming growth in the benefits of state-owned enterprises.

The Nineteenth National Congress held in 2017 also pointed out that we should focus on the improvement of the property rights system and the market-oriented allocation of elements, and cultivate world-class enterprises through the mixed ownership reform of state-owned enterprises. From this year onward, the reform of state-owned enterprises has entered a deepening stage. Since 2017, local SASACs and state-owned enterprises have implemented new development concepts to vigorously promote the supply-side reform and advance various tasks. As the company system reform accelerates in an all-round way, new progress has been made in board building and corporate classification. The key tasks of the reform are as follows. The first is to deepen the reform of the joint-stock system, make new progress and breakthroughs in key areas as soon as possible, “insist on the reform of mixed ownership as a key breakthrough in the reform of state-owned enterprises, and take substantial steps in the fields of petroleum, telecommunications, civil aviation, natural gas, electric power, railways, and military." Meanwhile, it is necessary to actively introduce all kinds of investors to achieve equity diversification and explore group-level equity diversification reforms. The second is to upgrade the market-oriented operating mechanism. Efforts should be made to deepen the corporate system reform, accelerate the establishment of a market-oriented employment mechanism for enterprises, promote the market-oriented selection mechanism for managers and professional managers and the reform of differentiated salary distribution, and achieve the contracting and tenure management of managers. The third is to intensify efforts to promote the supply-side structural reform, follow the national strategy to continuously optimize key investment directions and drive the rational flow of state-owned capital, steadily press ahead professional reorganization at the corporate level for the integration of steel, coal, and power businesses, completely resolve excess capacity in accordance with the overall requirements of cutting overcapacity, reducing excess inventory, deleveraging, lowering costs, and strengthening areas of weakness, comprehensively strengthen the party building and leadership of state-owned enterprises, and clarify the legal status of party organizations in corporate governance.

By the end of 2018, 69% (66% in 2013) of the central enterprises and their subordinate companies had reformed through the form of mixed ownership, and the amount of capital introduced had exceeded 338.6 billion yuan. The proportion of enterprises with mixed ownership reform in provincial state-owned enterprises and subsidiaries at all levels has increased to 47%;at the same time, the enterprises of mixed ownership reform have undergone a structural transformation from low-level group to high-level expansion; the industry areas of mixed ownership reform are also widening, for example, there are three batches of 50 companies in the fields of power, natural gas, civil aviation, oil, military industry, railway, telecommunications and other industries selected as pilots of mixed ownership reform, including 10 ESOP pilots. At present, the practice of mixed ownership reform in central enterprises has three main characteristics. First, from the perspective of the distribution of the classified reform of state-owned enterprises, the number of mixed ownership enterprises accounts for 74%, 63% and 31% respectively and the degree of mixing decreases in turn. Secondly, from the perspective of industry reform, the degree of mixed ownership in mining, communications, building materials, construction and real estate industries is relatively high, and the proportion of enterprises is 76.8%, 77.9%, 78.3%, 86.3% and 88.3% respectively. Thirdly, the mix ratio is inversely proportional to the enterprise level. At the group level, there are mainly three mixed ownership companies: Shanghai Bell, China Unicom and Hualu Group; from the number of mixed ownership reform of subordinate enterprises, the proportion of first-class sub-enterprises is 22.5%; the proportion of second-class and third-class enterprises is more than 50%, and the proportion of fourth-class and below enterprises is even more than 90%.

Since the reform and opening up, China's state-owned enterprise reform has roughly gone through four stages that see different incentives in each of them. These incentives are applicable to specific stages and China's background, but with the deepening of the reform of state-owned enterprises, the development of a mixed-ownership economy has become an important measure for the reform of state-owned enterprises in the new era, with the adjustment of economic structure being a key solution. Besides, new requirements have been proposed on incentive mechanism matching. The "Guiding Opinions on Deepening the Reform of State-owned Enterprises", released by the State Council in 2015, stated that to implement a salary distribution system compatible with the socialist market economy would not only embody incentives and constraints, efficiency and fairness, but also conform to the distribution mechanism in line with the general laws of enterprises and the characteristics of state-owned enterprises. Later on, the "Opinions of the State Council on Development of An Economy of Mixed-Ownership of State-Run Enterprises" (20 Articles) stipulated that we should establish market-oriented selection and employment and incentive and restraint mechanisms in mixed-ownership enterprises, implement the tenure system and contract management for managers, and explore medium and long-term incentive mechanisms. The four stages of China's state-owned enterprise in the mixed ownership reform and incentive mechanisms are shown in Table 3-2.

Table 3-2 Stages of state-owned enterprise reform and manager incentives

Reform Stages		Incentives
First (1978-1992)	Decentralization, Interest Concessions and Separation of Ownership and Management Rights	.Factory manager responsibility system .Basic salary, bonus, welfare, substitution of tax payment for profit .Contracted management responsibility system; insufficient material incentives and excessive constraints
Second (1993-2002)	Modern Enterprise Management System and Annual Salary System	. Annual salary system . Unclear assessment standards, implementation objects and scope led to excessive incentives and insufficient restraints
Third (2003-2013)	State-owned Assets Supervision & Entrusted Agency	. Annual salary system + management shareholding . Unclear assessment standards, implementation objects and scope led to excessive incentives and insufficient restraints
Four (2013-present)	Deepening of Mixed Reform and Innovation of Incentive Mechanism	. Shareholding system . Unclear assessment standards, implementation objects and scope led to excessive incentives and insufficient restraints

Changfu Tang (2015) argues that incentives are a main function and starting point of business management. The incentive mechanisms of China's state-owned enterprises have roughly steered through three evolution stages: spiritual incentives—material incentives—comprehensive incentives. At present, the incentive mechanisms of state-owned enterprises are challenged to such problems as unclear guidance, weak performance, unreasonable system construction, and uncoordinated supporting measures. To deepen the reform of state-owned enterprises, establishing a sound and effective incentive mechanism should be a key step to take. We must combine the existing theoretical results and practical experience of incentives with the actual conditions of China's state-owned enterprises, link the remuneration of senior managers to performance appraisal under the premise of realizing diverse equity structures and standard corporate governance, establish a medium and long-term equity incentive plan, and standardize the "three meetings and one layer" governance. At the same time, an effective supervision and restraint mechanism should be installed, supplemented by innovative incentive elements, to better stimulate the enthusiasm and creativity of all levels, to enhance the vitality and competitiveness of enterprises in the mixed reform.

3.3 Problems of incentive mechanisms in state-owned enterprises with the mixed reform and suggestions for improvement

3.3.1 Multilayer principal-agent relationship

China's mixed-ownership enterprises have formed a complex principal-agent relationship due to the special property rights system of being owned by people. In the past reforms, the ownership and management rights of state-owned enterprises were continuously separated from the perspective of clarifying property rights, leading to increasing complexity in their external principal-agent relationship and higher agency costs, but no obvious improvement in enterprise performance. Under the existing state-owned enterprise management model, the external agent relationship of enterprises in the mixed reform covers “governments-SASAC”, “SASAC-state-owned assets operating institutions”, and “state-owned assets operating institutions-state-owned enterprise legal entities”. Even in state-owned enterprises, an internal manager agent mechanism exists.

(1) The principal-agent relationship between governments and SASAC

The State-owned Assets Supervision and Administration Commission, a ministerial-level special agency directly under the State Council, supervises all state-owned assets under the central government, except for financial enterprises. In nature, the SASAC is an administrative agency rather than a public institution, let alone a legal person. Therefore, in the principal-agent relationship between governments and SASAC, the latter plays the role of an agent, while governments at all levels serve as the principal and carry out the incentive mechanisms for the agent through administrative performance appraisal. The relationship sees an overlap of administrative jurisdiction and market-based principal-agent. In the course of exercising its power of agency, the SASAC may overuse its authority due to the virtualization of the government’s administrative power. Ultimately, rent-seeking power leads to corruption. In fact, the identity of the SASAC as an agent is vague, which is often counterproductive to increase in corporate profits.

(2) The principal-agent relationship between SASAC and state-owned assets management companies

State-owned assets management companies, authorized by the SASAC, are those law-biding holding groups specializing in the management of state-owned asset property rights to perform the functions of an investor and achieve the goal of market-oriented management and control. Such organizational unit has become more prominent as state-owned assets transit from “asset management” to “capital management”, with specific forms including enterprise groups, state-owned holding companies, state-owned asset management companies, state-owned asset investment companies, financial asset management companies, etc. In this entrusted agent relationship, the SASAC turns to the entrusting party and the owner of the state-owned assets ownership, while holding groups exercise the management power on its behalf under the condition of separation of ownership and management power. State-owned asset holding groups undertake the government’s function in administrative public welfare as an enterprise legal person in its organizational structure, which is different from a market-oriented legal person, but the SASAC’s assessment of state-owned asset holding groups is not entirely based on operating performance in the process of entrusting management rights. This tells the biggest issue behind the entrusted agent relationship—multiple assessments weaken the incentive mechanisms. It should be quite difficult to maximize the performance of enterprises or achieve the Pareto optimal state.

(3) The principal-agent relationship between state-owned assets

management companies and its holding companies of the mixed reform

According to the authorization of the State Council, state-owned holding groups appoint and dismiss the chairman and general manager of wholly state-owned and mixed-reformed holding companies, recommend candidates for directors and supervisors of state-owned holding and shareholding companies, and establish relevant evaluation systems. To a large extent, state-owned holding groups do not directly participate in the operation of mixed-reform enterprises, but their mandatory administrative appointment and influence on “directors, supervisors and senior managers” determines that the status of administrative agency is higher than that of economic agency in a complex social and economic environment, because of which a twisted principal-agent relationship exists. As enterprises are over-targeted in administration, they may ignore economic incentive measures and fail to optimize their benefits. Meanwhile, the artificial management and control system exerts a counterproductive effect on the board of directors and supervisors, putting the market competition mechanism in malfunction. Even opportunism and arbitrary behaviors may dampen the economic benefits of enterprises.

(4) The influence of executives appointed by administrative officers as actual controllers of enterprises

For state-owned enterprises after the mixed-ownership reform, they face not only the above-mentioned three layers of multiple agents, but more obstacles and challenges in internal control as the power of the actual controller is attenuated. In the process of transformation and restructuring, the actual controllers of many state-owned enterprises are still senior executives appointed by the original administration, which has an insufficient understanding and application of the modern enterprise system. When it comes to the course of reforming the shareholding system, the actual controllers are mostly prioritized by stakeholders, in which the marketization of shares is barely achievable. Ownership and management rights are only formalistically separated as the senior managers required for business development are not effectively supplemented after restructuring, which will inevitably affect enterprise performance. For enterprises after the mixed reform, problems like how to effectively establish an incentive mechanism, redo strategic layout, build a market-oriented human resources assessment, and establish a social evaluation system will always be an obstacle to truly successful transformation.

Table 3-3 The 4-layer principal-agent relationship of state-owned enterprises

Principal-agent layer	**Nature**	**Relationship**
First	External principal-agent	The State Council entrusts the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council and other departments.
Second	Middle-level principal-agent	The SASAC entrusts large-scale state-owned holding groups. It has to act as the agent of the previous principal-agent layer as well as the principal of the next principal-agent layer, thus referred as a dual-agent.

Third	Internal principal-agent	Large state-owned holding groups entrust the board of directors, the board entrusts managers, and then the managers entrust specific executive agencies.
Fourth	The principal-agent of actual controller	The actual controller entrusts professional managers.

3.3.2 Soft budget constraints

When studying the traditional model of socialist market economy, Kornai (1982, 1993)discovered that state-owned enterprises that had been losing money for a long time were not eliminated by the market because they always received financial subsidies or other forms of bailouts, thus forming the so-called “soft budget constraint” problem （(Freixas et al.,1985; Goldfeldh and Quandt , 1988; Schaffer，1989；）. Chenggang Xu (2000) pointed out that domination by the state-owned sector was the fundamental feature of the centrally planned economy. The lack of financial constraints in the state sector was a major problem in all socialist countries in transition (Kornai 1982, 1993). This was because the threat of bankruptcy was unenforceable and the state sector was given various subsidies, credits and price support. In 1999, the “Decision on Major Issues Concerning the Reform and Development of State-owned Enterprises” stipulated that the direction for the reform of state-owned enterprises should be setting up a modern corporate system that could make enterprises corporate and market entities that enjoy full management authority and assume full responsibility for their own profits and losses. However, there were still soft budget constraints in the operation of state-owned enterprises, because of which, the current path chosen by China's state-owned enterprises was to give enterprises the right to adjust investment, reduce the mandatory plans carried by enterprises, and finally give them the right to adjust labor input. Soft budget constraints directly affected the efficiency of the state-owned sector by influencing the expectations of state-owned enterprise managers, and ultimately resulted in the lack of innovation and low market competitiveness of state-owned enterprises.

3.3.3 Obvious administrative intervention by government

As mentioned above, enterprises with Chinese characteristics in the mixed reform dealt with four-tiered agency relationship: "governments-SASAC", "SASAC-state-owned assets management companies", "state-owned assets management companies-state-owned enterprises of the mixed reform", "state-owned enterprises of the mixed reform-managers". Although the separation of ownership and management rights was realized in form, information asymmetry and complicated agency relations still brought about high agency costs. In addition, the government's personnel arrangements for senior managers deprived enterprises of marketization and independent operation.

"Separation of government and enterprises" is an established goal for the mixed reform mechanism. As the owner of national property rights, the government actually influences and intervenes in the operation of enterprises after the mixed reform through different channels, but at the same time passes various policies and the supervision of multiple agency relationships to weaken its impact on enterprises. The legal basis for the separation of government and enterprises is including state ownership as a private power into the scope of private law autonomy. However, from the definition of ownership by law, state ownership cannot be defined as a private power, so civil and commercial laws cannot be fully applied. State ownership is closer to public power by nature, that is, administrative power, but the characteristics of this public power is to achieve its public goals through commercial operations, so it is called “public commercial power” (Xu Yawen &Tu Gang, 2016) .

According to the analysis of the entrusted-agent levels, the ultimate controllers of the mixed-reform enterprises are powers like “directors, supervisors, and senior managers”. On this basis, this paper makes the manager incentive system that adapts to Chinese characteristics an important part of research, which also drives the implementation of incentives from “state-owned enterprises” to “state-run enterprises” or from “asset management” to “capital management”. As stated in the “Guiding Opinions on Deepening the Reform of State-owned Enterprises” issued by the State Council in September 2015 as well as the “Opinions on Development of An Economy of Mixed-Ownership of State-Run Enterprises”, we should push state-owned enterprises to improve the modern enterprise system, accurately define the functions of different state-owned enterprises, strengthen the corporate governance structure of state-owned enterprises, rationally increase the ratio of market-based recruitment, and establish a long-term incentive and restraint mechanism. As to case analysis in the following chapter, the study of incentives for senior managers in restructuring enterprises is highlighted, covering the identity conversion channels of operators, tenure and contract management, incentive and restraint measures. The author believes that the long-term restraint mechanism can be a necessary means of incentives for this round of mixed reform, especially for state-owned enterprises from competitive industries and fields, and even a breakthrough for a new round of reform.

3.3.4 Diversified objectives for state-owned enterprises

Compared with non-state-owned enterprises, state-owned enterprises have to fulfill more diversified goals due to their special property rights. The basic goal is outlined by business performance for restructured state-owned enterprises, which is shared by other forms of businesses. With the realization of social welfare being a necessary means, mixed-reformed enterprises are also endowed social responsibilities, featuring Chinese characteristics. Most of the time, to maintain stability, employment arrangements and social welfare at the expense of the short-term performance of enterprises will inevitably affect their sustainable development. Besides, the realization of administrative performance is an auxiliary goal of the restructuring. For state-owned enterprises, the backbone of regional economy, the assessment of administrative functions is a key indicator of corporate performance. In such case, some leaders may act shortsightedly based on personal and local interests, guide enterprises to implement wrong operating policies, pursue short-term effects, and ultimately harm the fundamental interests of shareholders.

The logic of the enterprise reform is to promote China's supply-side structural reform, which is not a new topic (Zheng Zeng, 2016). The core of the reform is to create incentive mechanisms for local governments, producers and consumers, and give full play to the enthusiasm and creativity of all parties involved in the activities of economic construction. Guanru Shi (2017) argues that the senior managers of state-owned enterprises and their actual management capabilities are closely related to the operating efficiency and development prospects of state-owned enterprises. Therefore, how to motivate senior managers with management rights to serve the interests of state-owned enterprise owners on the basis of satisfying their interests justifies the core of balance in incentive mechanisms. On such basis, Yan Miao (2017) puts forward the "incentive compatibility principle". She believes that the current compensation system in state-owned enterprises is plagued by problems like unscientific design, insufficient incentives, and excessive penalties and unquantifiable efforts. The "incentive compatibility principle" emphasizes goal management and aims to achieve a win-win situation for individuals and the common development of enterprises by enhancing the work autonomy of individuals.

Under the "incentive compatibility principle", suggestions on perfecting the mechanism of mixed reform enterprises include streamlining the relationship between the government and enterprises, improving the market environment for professional managers, and establishing a scientific performance appraisal system, particularly an open and fair compensation system, which is an important means of motivating long-term mechanisms. Guaranteeing salary fairness is the driving force, while promoting performance rewards comes as a step forward. The author introduces the broadband salary theory as a new comprehensive system design, ranging from salary to performance. Practice has proved that the introduction of broadband salary can mobilize group power, gradually reduce the role of individuals in enterprise development and stimulate the vitality of core personnel to accentuate their contributions.

3.3.5 Diversity of interest demands by actual controllers

The problem of incentives for actual controllers in the mixed ownership reform boils down to the existence of the principal-agent relationship for it breeds the diversity of demands. The mixed-ownership reform sees a mixture of different ownership capitals, mainly between state-owned capital and non-state-owned capital. Following the reform practice of state-owned holdings, most senior managers of mixed-ownership enterprises are appointed by state-owned assets. They enjoy the dual identities of "senior executives" and "senior officials"—this mixing diversifies and complicates the target positioning and interest demands of actual controllers. The newcomer-non-public identity, however, requires the independent operation of enterprises and seeks the core goal of being benefit-oriented. The conflict of interests and goals between different principals put actual controllers in a dilemma. To deal with this, new institutional arrangements are needed. To tackle the general and specific problems of incentives for the mixed reform, the interests of actual controllers must be consistent with the interests of all shareholders to establish an effective incentive mechanism for senior managers.

In comprehensive comparison, the incentives for managers in the mixed reform are implemented in three aspects: institutional, economic and social. These three aspects are interconnected and complementary to each other and form a complete incentive system. In Yanli Zhang and Qunhui Huang’s study (1999), the incentive and restraint mechanisms for entrepreneurs include compensation, control power, reputation or honor, and supervision and restraint from company and market competition. On the basis of analyzing the process and degree of each incentive and restraint mechanism on entrepreneurial goals, Huang Qunhui (2000) combined the four foregoing types of mechanisms and the entrepreneur generation mechanism, believing that such combination could determine the management behaviors of entrepreneurs and in turn affect corporate efficiency to a large extent. Hao Meirui (2000) pointed out that “the problems existing in the reform of state-owned enterprises like administrative intervention on governance structure, insider control and the lack of scientific incentive mechanism bottlenecked enterprise development”. It would be necessary to establish a market selection mechanism in the construction of the entrepreneurial team, build a sound short-term incentive mechanism for material benefits, a long-term incentive mechanism serving property rights, a spiritual incentive mechanism and a supervision and restraint mechanism.

The primary goal of mixed reform enterprises is to make profits and lay down a manager incentive mechanism different from that of state-owned enterprises for public welfare in accordance with market rules. This mechanism should be market-oriented and give full play to the leading role of the market mechanism in salary incentives and equity incentives. Firstly, the establishment of a market-oriented system for recruiting senior managers is the key and a prerequisite for the effective implementation of economic and social incentives. Secondly, we should remove the administrativeization of senior managers, cut off political promotion demands at the opportunity of the mixed reform, and unify the interest demands with the board of shareholders. The research of Zheng Zhigang et al. (2012) unearths that managers would maneuver their way establishing image projects to attract the attention of the public and superior leaders for political promotion, but it fails the rational allocation of resources and the improvement of long-term corporate performance. Even political promotion incentives come with potential negative effects. Thirdly, while the mixed reform has realized the common progress of the people, it provides actual controllers with a broad career platform, the sharing mechanism for which is built on the realization of material and spiritual needs, including additional benefits, professional training, independence and leadership. The broad stage should affect the performance of long-term incentives from top to bottom.

3.3.6 Lack of market-based punishment and withdrawal mechanisms

State-owned enterprises after the mixed reform inherit the dual identities of executive managers. A survey showed that while more than half of corporate general managers and the chairman of the board were combined into one role, the chairman turned into the actual controller of the enterprise seeking to maximize its own interests, leading to the common phenomenon of insider control and the loss of state-owned assets. Following the party's thinking on managing cadres, the existing political supervision and restraint system is ineffective in improving the performance of enterprises after restructuring. Particularly, in competitive industries, it is a common problem that the efficiency of operation management and the ability to maintain and increase value is constrained by the will and management level of senior management. The lack of market-based punishment and withdrawal mechanisms should be one of the reasons. Once appointed, senior executives, as the internal controller of an enterprise, are usually not subject to severe administrative or economic penalties as long as no major operational and management errors, like political errors or massive corruption, are committed. In addition, most companies have not incorporated the withdrawal of senior executives into the market-oriented professional manager recruitment system, leading to the fact that executives are protected from withdrawal or dismissal and operators lack the necessary sense of crisis and competition. Weihrich and Koontz （1994） believes that incentives include motivation and restraint, with reward and punishment being the two most basic measures. Motivation embodies the meaning of stimulating and inducing and also restraining. The former induces the occurrence of expected behaviors through rewards or other methods, which is called positive incentive. The latter, called negative incentive, adopts punishment to regulate people’s behavior and prevents unwanted behavior from occurring (Zhongyi Li, 2009). Yingyi Qian (1999) compares incentives to the engine of a car and constraints to the brakes—they are indispensable from each other to run a car. Incentives are the use of economic and non-economic methods to mobilize the enthusiasm of production and operation entities, while constraints are restraints on subjects by virtue of external checks and balances and internal constraints (Jinsheng Xie, 1999).

3.3.7 Unsound governance structure

First of all, the dominant share of state-owned enterprises after the mixed reform occupies an absolute controlling position, which often leads to excessive participation in the company and infringes the rights of small and medium shareholders to participate in corporate governance reasonably and legally. Second, the functions of the board of directors and supervisors are weakened. Generally speaking, the decision-making ability and level of the board of directors play a crucial role in the company's operating results. Administrative intervention comprehensively infiltrates corporate governance of state-owned enterprises through personnel appointment and dismissal. The board of directors accepts government designation and cannot independently exercise the company's decision-making power, which can easily lead to political and business non-separation and insider control. Third, the incentive mechanisms of enterprises are insufficient. In the operation process of state-owned enterprises, the government exerts a major influence on personnel appointment and dismissal, business decision-making and incentive mechanisms etc. Although the joint-stock system reform of state-owned listed companies has established a modern enterprise institutional framework including the board of directors, the board of supervisors and managers, this is often mere formality and difficult to play a substantive role.

The "Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform", approved at the Third Plenary Session of the Eighteenth Central Committee, states that diversified ownership integrated by state capital, collective capital and private capital is the prime method for materializing the basic economic system. We should allow more state-owned enterprises and other ownership enterprises to develop into mixed-ownership enterprises. From the successful cases of the mixed reform, it can be told that a suitable shareholding structure and the realization of checks and balances between shareholdings have a direct effect on improving corporate performance. The deepening reform at this stage reflects the participation of diversified-ownership enterprises in the restructuring of state-owned enterprises and diversified ownership integrated by state capital, collective capital and private capital. Diversified ownership comes as an optimal opportunity to balance the corporate governance model of "three meetings and one layer" (general meeting of shareholders, board of directors, board of supervisors and people in management) and tap into the comprehensive allocation of resources. Among them, the board of directors is the highest body for daily decision-makings in an enterprise. The scientific setting and management of directors is the key to balancing the interests of shareholders and operating the enterprise in a market-oriented manner.

To be more specific, we should first introduce external directors with business expertise to cover more than half of the board of directors, set up special committees for strategy and development, compensation and evaluation, risk management and audit, to ensure the work of external directors, further improve the quality of corporate decision-makings and the effectiveness of supervision, and restrain the self-interested behaviors of state-owned enterprise shareholders.

Second, we should reinforce the performance evaluation and incentive system for directors. The remuneration committee managed by independent directors should determine the salary of each director by their performance, thus combining the fixed remuneration of directors with performance and achieving the complementary ties between long-term and short-term incentives.

Third, we should implement the regular reporting system of the board of directors, strengthen the communication between the board of directors, directors and state-owned assets supervision agencies to alleviate the lack of "owners" in asset supervision, and reduce the agency costs of the shareholders and management, controlling shareholders and small and medium shareholders after the mixed reform by upgrading the shareholder governance mechanism under a more scientific decision-making system and power balance mechanism (Li Wengui et al., 2017).

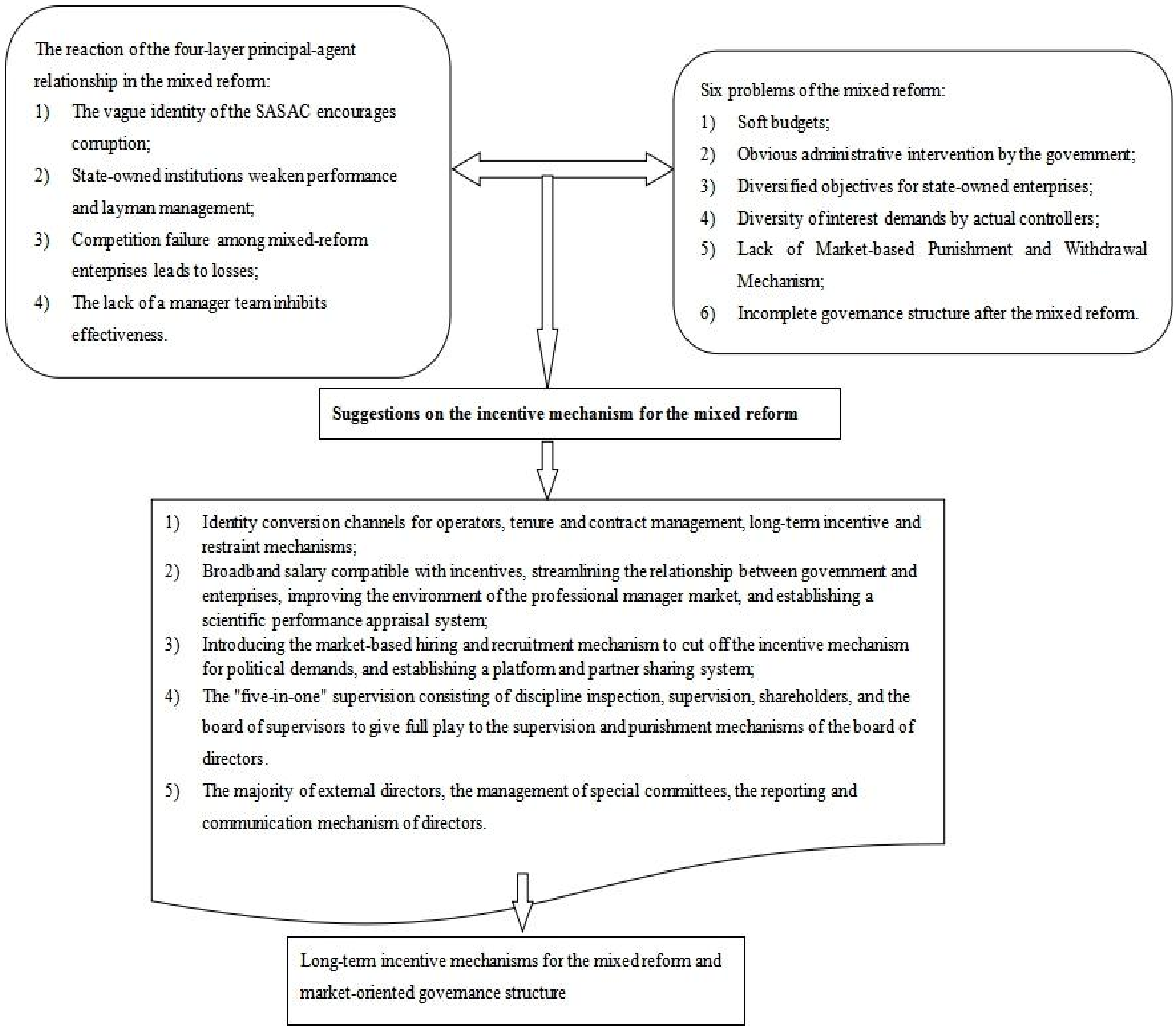

Figure 3-1 Analysis framework of incentive mechanism under the mixed reform of state-owned enterprises

3.4 Summary

In a historical approach, this chapter analyzes the course of reforms in China's state-owned enterprises since the reform and opening up, enumerates the weak points of performance incentives in the four stages of reform, emphatically analyzes problems in the current incentive mechanism for the mixed reform of state-owned enterprises and presents suggestions for improvement. As an initial attempt, we propose such incentive factors as long-term incentive mechanism, the sharing of manager platforms, the opening of identity conversion channels and external professional directors. All these will be demonstrated in detail through quantitative analysis in the subsequent chapter. It is firmly believed that copying foreign theories will not fix the incentive problems faced by Chinese enterprises in the mixed ownership reform. Instead we should establish a diversified mechanism with innovation according to the actual situation as well as introduce incentives together with restraint and supervision—a creative viewpoint proposed in this chapter.

Chapter IV An Empirical Analysis of the Influence of Incentive Elements on the Performance of Mixed-Reform Enterprises

The incentive system of the mixed reform consists of both incentives and restraints. Basic salary incentives, medium- and long-term incentives are effective means to attract and retain talents, while a sound supervision and restraint mechanism ensures the healthy development of enterprises. We should introduce state-owned enterprises with non-public capital and mixed ownerships, clarify the changes in the main body of property rights, and impose stricter and more effective punishments on senior managers in the momentum of reform. We also need to make the hiring and elimination of professional managers market oriented, implement the equity and profit sharing mechanisms to ensure that they are the master of business, set up a sound corporate governance system, replace administrative supervision with market-based punishment and exit mechanisms, mobilize the enthusiasm of state-owned and non-state-owned shareholders to achieve the “five-in-one” supervisory force composed of commission for discipline inspection, supervision, audit, shareholders, and the board of supervisors, and separate the functions of the board of directors and managers to strengthen the board’s disciplinary and supervisory functions on managers.

4.1 Effects of compensation incentives

4.1.1 Evaluation of compensation system

China has repeatedly emphasized in its top-level design plan of the mixed ownership reform and related policy documents that it is necessary to implement a professional manager system and the contractual management of managers, to explore medium- and long-term incentive mechanisms. It can be seen from the will of the state that the mixed ownership reform of state-owned enterprises must take the road of marketization and embrace market-based compensation incentives combined with medium- and long-term ones, with focus on the implementation of economic incentives for senior managers. As stated in the case study of Yunnan Baiyao in Chapter Five, the company fully considered the recommendations by the board of directors after the mixed reform, clarified the salary strategy and the market value of executives based on its business conditions and market position, and matched the salary level of senior executives with their positions and personal performance through contracts. Its remuneration committee divided the remuneration of executives into four parts: basic annual salary rates, performance salary, special award and long-term incentives. Among them, the basic annual salary was determined by position, responsibility, ability and salary at market level; the performance salary was determined according to evaluation results; the special award was set for managers having an important and outstanding contribution to business performance or other specific area; the long-term incentives were mainly stock appreciation rights and stock options.

Table 4-1 Manager's salary structure and performance evaluation methods

	Incentives	Performance evaluation methods
Salary structure	Basic annual salary rates	Depending on industry and enterprise conditions
	Annual performance salary	Assessment on annual targets and social responsibilities
	Tenure incentives	Tenure assessment

The positive correlation between executive compensation and corporate performance has been identified in existing research (Jensen & Meckling, 2007; Huilin Han and Guohui Sun, 2014). A survey of 50 state-owned listed companies by Fengwei Liu, Yu Sun, and Zengquan Li (2017) demonstrated that when other factors were controlled, the higher the degree of market-oriented competition, the higher the correlation between operator salary and company performance; the more government intervention, the lower the correlation. This is because mixed-reform enterprises were still subject to more interference from higher-level competent authorities and bore policy burdens like redundant employees, in addition to pressure on business performance. Such administrative burden significantly lowered enterprises' sensitivity to remuneration and performance, giving rise to the failure of incentives for state-owned enterprise executives (Jiang Du and Shan Huang, 2014). Due to less direct government intervention during operation, corporate shareholders of private enterprises were more willing to motivate senior executives, thus strengthening the close ties between monetary compensation for executives and corporate performance. Besides, regardless of whether it is a state-owned enterprise or a private enterprise, such medium- and long-term incentive measures as equity incentives could promote corporate performance. Compared with state-owned enterprises after the mixed reform, the equity incentives had a greater effect on corporate performance in pure state-owned ones.

4.1.2 Application of Broadband Salary and Optimal Salary Contract Approach

Research by Merhan (1995) has revealed that managers are more motivated by salary structures, but the effect of a single salary structure on managers is very limited. As analyzed above, managers of state-owned enterprises after the mixed reform have inherited the dual identities of "senior officials" (government) and "senior executives" (corporate)--the complexity determines the diversity of their appeals for interests. The broadband compensation approach, guided by economic interests, further improves the compensation system by integrating short-term compensation incentives with medium- and long-term option incentives. Taking monetary remuneration as the basis, the broadband compensation approach covers benefits and hidden income for senior executives and stock options, and creatively quantifies union benefits and non-economic remuneration. The matching of short-term and long-term salary, economic and non-economic indicators have promoted updated salary theories and their practical application in China.

Table 4-2 Structure of broadband salary in the mixed reform

Compensation structure				
Economic compensation		Non-economic compensation		
Direct compensation	Indirect compensation	Position	Work environment	Organizational features
Basic salary, overtime pay, bonus, equity income, various allowances, etc.	Stock options, restricted stock option plans, welfare benefits, social insurance, hidden income, etc.	Personal growth and development, challenges, sense of accomplishment, sense of responsibility, participation in decision-making and management, etc.	Cozy office environment, harmonious interpersonal relationships, flexible working hours, other convenient conditions, etc.	Corporate social status, company rules and regulations, corporate culture, corporate development capabilities, etc.

The proposal of broadband compensation is the best opportunity to integrate and refine original issues and apply them in the practice of incentive mechanisms in China's mixed reform. It intends to give full play to the leading role of the market in the compensation and long-term incentives for executives and managers, as well as level up the efficiency of state-owned enterprises in the mixed ownership reform.

Broadband Salary is targeted at short- and medium-term salary and conforms to the "optimal salary contract theory" to help enterprises establish a complete set of salary management system. With the assumption that shareholders can control the board of directors, the optimal salary contract theory proposes the elected board of directors to see maximizing the interests of shareholders as its own responsibility and hires an agent to sign a fair bargaining contract, so that the principal and the agent share the residual claim and control rights of the enterprise. In this way, the conflict between the principal and the agent can be resolved by designing a reasonable salary contract. The core idea of the theory is to link the agent's salary with company's business performance—the more growth in business performance, the higher the agent's salary. The effect of "incentive compatibility" will be achieved when shareholders and the agent become a community of interests, when the agent take into account both its own benefits and corporate interests. In other words, the theory emphasizes the maximization of the interests of the enterprise and shareholders and pays attention to the personal income of the agent. It not only avoids the utility loss caused by insufficient and excessive incentives, but also clarifies the risks and responsibilities that both parties should take. In short, the optimal salary contract approach can motivate agents to work hard, effectively reduce agency costs, and ultimately achieve the goal of maximizing corporate value or shareholder benefits. In short, the optimal salary contract approach can motivate agents to work hard, effectively reduce agency costs, and ultimately achieve the goal of maximizing corporate value or shareholder benefits. Equity incentive is the main means of the current optimal compensation contract theory. It can effectively solve the problem that monetary compensation in state-owned enterprises cannot meet market standards, make up for insufficient incentives, enable operators to share risks, and link the salary of executive managers with corporate performance to the greatest extent. Chuang Lu et al. (2015) argued that the mitigation effect of equity incentives in state-owned enterprises was significantly greater than that of non-state-owned enterprises. Dian Song et. al (2018) stated that equity incentives could give executives the right to claim the residual value of the company and the right to make business decisions. They could also motivate executives to work hard, keep loyalty to the company and retain their position. However, if executives choose to leave, greater costs should be borne.

4.2 Effect of equity incentive

4.2.1 Empirical evidence of equity incentive

From the perspective of the reform process of state-owned enterprises and the status quo of state-owned enterprise managers' incentives, the incentives for managers in most current state-owned enterprises have moved to the stage of linking the compensation incentives dependable on corporate economic goals with medium- and long-term equity incentives. The long-term incentive theory of managers holding shares can effectively drive the business performance of enterprises. A statistical study of 100 listed companies controlled by state-owned enterprises from 2013 to 2018 have shown that in the composition of executive compensation, equity and options accounted for 20.9% of total compensation. The author randomly selected 100 companies from RESSET and investigated these companies that had implemented managerial stock ownership. Through a comparative analysis of the survey results, the author discovered that the earnings per share and return on average equity of companies with an internal shareholding ratio of more than 20% were obviously higher than those of companies without share reform. It can be concluded that the incentive of managers holding shares has a significant effect on the business' return on assets. A further research on the sample listed companies also suggested that the return on net assets of companies that had issued internal employee shares grew with the increase in employee shareholding ratio, seeing an increasingly obvious trend. The author also examined the annual average return on equity of the state-owned enterprises gone public for five years after 2013 and of those that issued internal shares (restructuring). The result indicated that the restructured companies had a higher annual average return on equity than all listed companies.

In fact, under the medium and long-term incentive system, the "stock option incentive" emerged in listed state-owned enterprises as early as 2005, but the imperfect laws and regulations of equity incentive put it through twists and turns. Things did not change until 2005 when the China Securities Regulatory Commission issued the "Measures for the Administration of Equity Incentive Plans of Listed Companies (For Trial Implementation)". The "Trial Measures for Implementing Equity Incentive Plans by State Holding Listed Companies (Domestic) (2006)" was a subsequent move taken by the SASAC of the State Council and the Ministry of Finance to regulate the equity incentive in state-controlled listed companies. Under the guidance of the trial measures, listed companies have been exploring effective equity incentive methods. However, in the course of practice, state-owned listed companies suffer such problems as incomplete incentive targets, small equity incentive splits, and a long waiting period for the regulatory approval of equity incentive plans. According to relevant regulations promulgated by the SASAC, the number of shares granted for the first implementation of the equity incentive plan should in principle be controlled within the total equity of the listed company, and the cumulative stocks involved in the equity incentive shall not exceed 10% of the total equity of the company. Besides, the equity income of the target person shall not exceed 40% of the salary income, and the exercise price and conditions are constantly increasing. Also worthy of mention is that the equity incentive plan has to go through rounds of approval—the excessively long approval chain and approval timeframe may deprive the equity incentive of the opportunity to be implemented at its prime period. Yanhui Xu (2015) studied the data of 1587 listed companies in Shanghai and Shenzhen in the four years from 2010 to 2013, and conducted multiple linear regression analysis to conclude that executive compensation and performance were positively correlated—their relationship was also the most influential research factor in the executive incentives. In addition, the impact of compensation for middle and senior management in state-owned listed companies on corporate performance was higher than that of non-state-owned listed companies, and the equity incentive was also related to corporate performance. However, due to the imperfect equity incentive system of listed companies in China, its influence was very limited.

4.2.2 Innovative application of equity incentive

As non-state capital joins state-owned enterprises, capital becomes more profit-seeking. The creation of more economic value requires more excellent managers, and the human capital value of senior managers needs to be reflected in the distribution of equity. It can be expected that managers have a higher demand for mid- and long-term incentives in the mixed ownership reform. Besides, equity incentives are a necessary measure to improve the governance mechanism of enterprises as it enhances managers' sense of belonging and identification with the company, also a new way to preserve and increase the value of state-owned assets. Therefore, new practice in the equity incentive system is encouraged in the mixed reform of state-owned enterprises.

(1) Practice of the equity incentive model

The equity incentive model is mainly composed of stock options, restricted stocks, performance stocks, stock appreciation rights, management buyouts, deferred payment and virtual stocks. The first four of them are commonly used by domestic and foreign listed companies and also serve as the commonly adopted incentive options by listed companies since the reform of equity split in China.

Based on the analysis of each equity incentive option, we conducted a comparative study of their characteristics in terms of short-term incentive, long-term incentive, restraints, and incentive cost (see Table 4-3):

Table 4-3 Comparison of the characteristics of equity incentive options

	Short-term incentive	Long-term incentive	Constraints	Incentive cost	Overall Assessment
Stock option	Low	Medium	High	Low	High
Restricted stocks	Medium	High	High	Medium	Mid to high
Performance stocks	Medium	Medium	Medium	High	Medium
Stock appreciation rights	Low	Medium	Low	High	Mid to low
Management buyout	Low	High	Low	High	Medium
Deferred payment plan	Low	High	High	Low	Mid to high
Virtual stocks	High	Medium	Medium	High	Medium

(2) Equity incentives and opportunities

The complexity of the equity incentive system and the defects in arranging the administrative incentive system incite utilitarian and short-term investment and operation by the actual controllers (the chairman) of mixed-reform enterprises, who ignore the long-term development of enterprises. Particularly, in state-owned enterprises, the top leaders aged over 55 tend to seek personal opportunism due to retirement, job transfer, and resignation. We call this phenomenon “smart age”. Profit, as we all know, is an indicator that reflects the current value of an enterprise, and market value can not only reflect the current value, but also its future potential and value in the market. A clever use of market value as “equity incentive” and the establishment of a scientific long-term equity incentive mechanism can be a good solution to the “smart age phenomenon” among the core management.

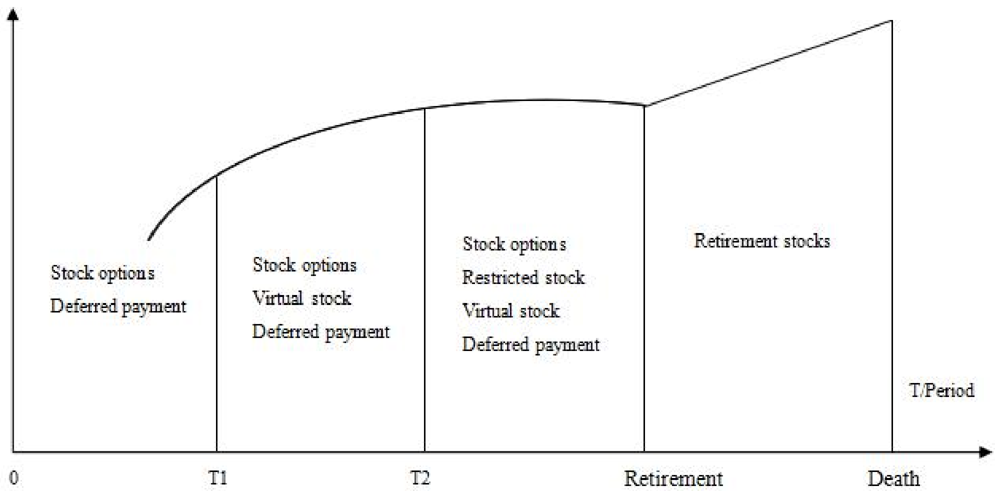

Figure 4-1 Equity incentive options in the mixed ownership reform of competitive state-owned enterprises

4.3 Analysis of the effectiveness and governance of the board of directors

4.3.1 Analysis of the effectiveness of the board of directors

The board of directors is a decision-making body, a place where different shareholders fight for their interests through entrusted agents. An important part of the reform of state-owned enterprises lies in clearly delineating the sources, responsibilities and rights of directors at the board level. There are four sources of directors. The first are the external non-independent directors appointed by the government to represent the interests of state-owned shareholders. The second is the appointment of investors. The state-owned enterprises after the mixed reform, representing the interests of new shareholders, feature a diversified share structure that integrates private shares and investment institutions. In the case that the shareholders meeting is not a permanent establishment, the board of directors would strive for the role of directors as much as possible to avoid the "distortion" of investor voting, to give full play to the "decision-making checks and balance mechanism", to achieve ideal scientific and democratic decision-makings. The third is the market-based selection of external independent directors who represent the interests of all shareholders. The fourth is the high-level management directors selected by an enterprise, that is, the internal directors held by the general manager and other managers. A survey indicates that the board of directors in China's listed companies (state-controlled) is a sample of a relatively complete governance structure. In most cases, the composition of the board of directors covers government officials, entrepreneurs, investors, experts and scholars, and employee representatives. Internal directors (executive directors), as the operating managers of a company, mainly deliver, interpret, and explain its operating conditions and the direction of strategic development to external directors, which is conducive to the implementation of strategic decisions. External directors (non-executive directors) play the role of a consultant, who provides consultation, suggestion, and error correction. Thus, the checks and balances of power is achieved, which can benefit scientific decision-makings. For a joint-stock company, 7-15 members are the appropriate size of its board of directors. If the number is less than 7, a professional discussion system will not be in place, not to mention scientific decisions. For a board of more than 15 members, it will be difficult to reach a unified opinion, which is not conducive to the efficiency of decision-makings. As stated in the regulations for the management of listed companies, state-owned enterprises in the mixed reform need to establish an external independent director system. Among the board seats, external independent directors accounting for the critical point of 50% shall mark the independence of the board of directors.

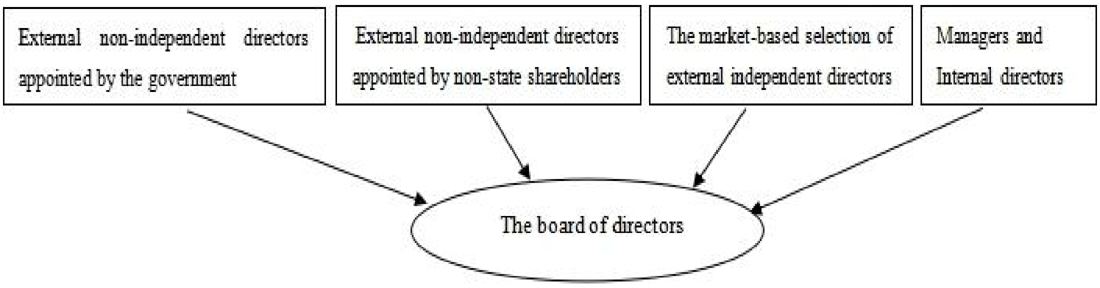

Figure 4-2 Sources of directors for competitive state-owned enterprises in the mixed ownership reform

The connection between the management of an enterprise and its board of directors can affect the profit of the enterprise to a large extent. Likewise, the composition of the board of directors can influence the efficiency of the enterprise to a certain degree. Dedicated to the research of the board of directors, Lorsch (1992) asserted that the most favorable size of the board of directors should be small and medium, that is, 8 or 9 members. If the number was too large, the company's ability to execute would be impaired and decision-makings severely divided, thus intensifying the decentralization of holdings. They investigated the composition of the board of directors of Fortune 500 companies in the past six years to uncover that the board of directors among large listed companies was mostly composed of 8-9 people. Their research result indirectly verified the foregoing opinion.

Shiqiao Zheng et.al (2015) studied 108 listed companies to reach a conclusion: the number of meetings by the board of directors has an inevitable connection with company profits; they are positively correlated to a certain extent. To their observation, in the board of directors, problems are passively resolved when they occur; if no problems appear, the board is set aside. The concept of asking help from “fire trucks” for emergency rescue is commonly seen in state-owned enterprises. When looking into the degree of stock ownership in China’s state-owned listed companies, Maojuan Liu (2014) unveiled the significantly positive correlation between the education level of directors and Tobin’s q on the basis of studying 894 cases from 2009 to 2014. But this positive correlation is only limited to the relationship between the board’s shareholding and corporate profits. The proportion of female directors, however, is only significantly negatively correlated with earnings per share. Besides, there is a positive correlation between the number of board meetings and Tobin’s q, between directors’ salary and corporate performance. This variable research is considered to be of certain theoretical and practical reference for research on board governance.

The standardized operation of the board of directors and managers organically integrates internal checks and balances with market efficiency and improve the quality of decision-makings at the board level and the executive efficiency of the managers. It can be seen that the standardized governance structure and mechanism of the board of directors is to implement market-oriented management of mixed-reformed enterprises.

4.3.2 Analysis of board governance

In Chapter Five, we will study two companies, both of which have established a board structure with external directors exceeding one third. None of the shareholders dominate the board of directors, and all shareholders are in a state of checks and balances. Such structure guarantees democratic decision-makings and takes into account the interests and strategies of all shareholders. State-owned enterprise shareholders do not directly intervene in corporate operation, but are committed to the establishment of a system featuring decentralization, division of responsibilities, and checks and balances among shareholders, the board of directors, and managers. The legal person governance structure with balanced shareholding of such kind lays an institutional guarantee for the decision-makings of the board of directors, managers' incentives and constraints. It not only fully mobilizes the enthusiasm of senior managers, but avoids possible major mistakes in the business process.

When Yunnan Baiyao and Shanghai Jahwa United Co., Ltd. completed restructuring, their general managers were hired by the board of directors, and the manager team was nominated by the general managers and appointed by the board of directors. The general manager responsibility system led by the board of directors effectively prevented “inside control” and arbitrary authority among individual shareholders and the board of directors. As soon as the restructuring of Baiyao was achieved, the management personnel was nominated by Macrolink Group, a private enterprise and two private investment institutions sent directors in proportion to their equity to involve in decision-makings by the board of directors. This case was hailed as an effective combination of the advantages of state-owned enterprises and the vitality of private enterprises.

With a longitudinal comparison of the development history of the case companies, we discovered that they faced problems affecting business performance like irregular governance before the implementation of the mixed ownership reform. Yunnan Baiyao and Greenland Holdings gradually diversified the equity structure after the mixed reform and established a standardized corporate governance structure. The first part was the establishment of a board structure dominated by external directors to enhance the independence, authority and effectiveness of the board. The building of a general manager responsibility system led by the board of directors was the second feature. The companies implemented the contract management of senior managers and determined the market value and salary level of managers according to the company's operating conditions plus international and domestic market status. The third was the standardized operation of the board of directors and managers, which organically integrated internal checks and balances with market efficiency and improved the quality of decision-makings at the board level and the executive efficiency of managers. It is apparent that a standardized governance structure and mechanism for the board of directors serves as a prerequisite for the market-oriented management of mixed-reform enterprises. In the mixed ownership reform, the first priority for state-owned enterprises after optimizing the ownership structure is to develop a scientific governance structure for the board.

4.4 Updated functions of the board of supervisors

4.4.1 Analysis of the supervision effect of the board of supervisors

As illustrated in the "Company Law of the People's Republic of China", the supervisory committee or individual supervisors shall faithfully perform their duties of supervision, particularly on the board of directors and the management team, but the establishment of the board of supervisors is not mandatory. From the actual operating of listed companies in China, it can be seen that the functions and powers of the supervisory committee performs are not related to those stipulated by the law, making it difficult to fulfill the expectations of shareholders. Specific factors are as follows:

(1) The low status of the board of supervisors in reality

The board of supervisors is an internal additional unit in a company, whose appointment is often subject to nomination by the board of directors. In fact, it does not directly serve the supervisory function of the shareholders meeting. In the actual process of operation, the board of directors has direct decision-making power as a permanent body and directly ignores the fact that the board of supervisors is accountable to shareholders. As the board of supervisors does not have substantive powers, for instance, business decision-making and punishing, it becomes a deliberative body for formal voting. The nominal functions of the chairman of the board of supervisors cripple the possibility of exercising supervision power. The parallel dual system model of corporate governance has resulted in "absence of supervisors" in a practical sense.

(2) A weak supervisory motivation of the supervisory committee

A survey shows that among the organizations that set up the board of supervisors, the proportion of internal employee supervisors exceeds 50%. Given the working relationship of the supervisory members, they report to a senior manager concurrently serving as a member of the board of directors, who directly determine their salary and job responsibilities. In such case, supervision on the board of directors and the management team cannot be smoothly implemented in the end. Moreover, supervisors are often formally given supervisory powers without clear responsibilities and deficiencies exist in the details and measures of supervisory contents. To a certain extent, the board of supervisors seems to have only powers but no responsibilities, which ultimately results in "supervisors without supervision".

The development of the board of supervisors in listed companies has been discussed by scholars like Wei'an Li and Chen Hao (2006). Through empirical investigation, they identified that the current level of governance by the supervisory board was relatively low in China, but their existence value of the supervisory board in an enterprise should not be affected or its position replaced. The top priority would be strengthening the management of the board and promote its development conditions. While affirming the value of designing the board of supervisors, they raised questions about the relationship between the board of supervisors and corporate performance—they were positively related but not closed bonded. Lifei Xu (2012) screened out ST listed companies from 2006 to 2009 as a sample to compare non-ST companies, and conducted a descriptive statistical analysis of the two sets of samples in terms of the scale of the board of supervisors, active level, independence and incentive system. The analysis of regression results exhibited that the board of supervisors in China's listed companies did play a certain role in corporate governance, mainly reflected in the degree of corporate debt, but the degree was affected by the independence of the board of supervisors and could not be estimated. Weifeng Yao and Tong Lu (2010) collected data from a total of 108 listed companies from 2002 to 2008 and carried out quantitative research on the relationship between the construction of the board of supervisors and corporate efficiency with stochastic frontier analysis. The efforts unfolded that the establishment of most of the existing supervisory boards failed to achieve the purpose of strengthening supervision. On the contrary, their being added to the overlap of functions and increased company costs, thus bringing down corporate efficiency. Therefore, it is recommended to appropriately reduce the size of the board of supervisors and clarify the relationship between the board of directors and the board of supervisors to perform their duties. As to candidates for the board of supervisors, the scholars suggest selecting persons with a good educational background, rich related work experience, and good personal reputation, preferably with an international perspective, thereby improving the quality of the board of supervisors.

4.4.2 Recommendations on the effectiveness of the board of supervisors

(1) Introduce independent supervisors and optimize the structure of the board

Whether a company has a reasonable upper and lower supervision mechanism depends on the relative independence of its supervision department. Only when the supervision objects are independent can the normal work of supervision be guaranteed. Like “independent directors”, independent supervisors are those who will not hold other positions in the company but themselves only. Also there should not be the existence of supervisor staff that hinders the company and individual shareholders from making fair judgments. The addition of independent supervisors allows the board of supervisors to be independent from the management team and the board of directors, thus promoting the uniform distribution of all benefits within the supervisory board and ensuring the normal implementation of power by the supervisory committee. In response to the two cases in this paper, the author proposes to separate the company's financial verification and the functions and responsibilities of the vice chairman to the board of supervisors, appoint external financial and auditing experts as independent supervisors, and entrust annual financial review and the impeachment rights of directors due to performance failure and violation of discipline to independent supervisors.

(2) Strengthen the supervisory authority of the board of supervisors and supervision on the board of directors

In the dual management structure, the board of supervisors, authorized by the shareholders meeting, grants the power to convene extraordinary shareholders meetings and directly reports to the shareholders meeting. Meanwhile, the board of supervisors can apply for impeachment against the board of directors and senior managers.

(3) Improve the security of governance by the board of supervisors and effectively promote the performance of supervision.

In accordance with the requirements of the Company Law, we need to amend the company's articles of association, set detailed requirements for the duties performed by the board of supervisors legally, and establish an evaluation system with strong execution. It is stipulated in the form of corporate regulations that the proportion of independent supervisors and employee supervisors (representing the labor union) shall not be less than 50%.

4.5 Supplementary mechanism for special committees

The establishment of special committees can avoid two inherent weak points of the board of directors. One is the lack of professionalism. As the board's authority involves operations at all levels, we may expect it to be complicated and have relatively high professional requirements. As the company size and environment changes day by day, the board of directors will be challenged by how to improve their professionalism. The other is the defect of meeting efficiency like financial auditing, salary assessment, strategic planning and other macro and micro issues. The board of directors needs to investigate and evaluate in its daily work and prepare for implementation in a planned way. Regular meetings by the board of directors cannot resolve macro-level issues and lack effectiveness at micro level. Based on this, the establishment of special committees can enable the board of directors to develop professional knowledge and play the role of a temporary board of directors during its adjournment, thus overcoming the ineffectiveness of the board.

To meet the development needs of a company, special committees are generally set up in the following five areas:

1) Budget Management Committee: responsible for reviewing the company's annual business income, expenditure, budget, profit plan, annual final accounts, etc.

2) Audit Supervision Committee: responsible for reviewing and supervising whether the company's external audit procedures are independent, objective and effective; monitoring the company's internal audit system and its implementation; and coordinating the communication between internal audit and external audit.

3) Nomination and Remuneration Committee: responsible for formulating the criteria and procedures to select the company's directors and management personnel; reviewing the company's salary, performance and remuneration implementation plan; and assessing the remuneration of directors, supervisors and senior management.

4) Business Development Committee: responsible for reviewing the company's business development goals and development outlines; studying market expansion and distribution; reviewing and appraising existing and new projects, etc.

5) Strategic Operations Research Committee: responsible for reviewing the company's mid- and long-term development plans and corporate strategies; reexamining the company's development outlines and plans for profit distribution, loss make-up, major investments and other; revisiting increased or decreased registered capital, issuance of corporate bonds, company mergers

and divisions, institutional setup, formulation of management systems, foreign investment and cooperation, the investment and management of subsidiaries, etc.

Each committee shall consist of at least one full-time director and one independent director. At least one independent director in the committee that performs audit and legal affairs has professional qualification. We recommend that the special committee nominates the candidates for the board of directors—the special committee comes before the board of directors.

Figure 4-3 Corporate governance structure of competitive state-owned enterprises in the mixed ownership reform

4.6 Political supervision and restriction by party organizations

Party organizations are one of the indispensable organizations in Chinese state-owned enterprises. The "Company Law" stipulates companies at all levels to establish organizations of the Communist Party of China in accordance with relevant regulations and provide necessary conditions for the activities of those organizations. Party organizations must exist in any enterprise of ownership abiding by the law to strengthen the supervision and control of enterprises and play an active role in promoting the healthy development of enterprises.

To prevent the loss of state-owned assets in the mixed-ownership reform, the SASAC has formulated unwritten regulations for state-owned enterprises (state-controlled) restructured since 2018: A newly established enterprise needs to establish or retain a party branch. The party secretary, chairman and legal person are in principle concurrently served by one person, which is what we call "one for all" in the popular sense. Integrating the party organization into the shareholders' meeting, the board of directors, the board of supervisors, and the management team to establish a relationship of support and balance is the highlight of the reform of state-owned enterprises with Chinese characteristics:

1) For senior executives and government officials who are both officials and businessmen, it will be of help to establish a correct value and outlook on life, regulate the power of executives, prevent abuse, corruption, and bribery, and promote decision-makings by the board of directors and the scientific and democratic implementation of managerial decisions;

2) Conducting regular education and supervision of clean government on

executives through discipline inspection, personnel, the SASAC and other counterpart departments to strengthen self-discipline awareness and self-inspection, build ideological and moral defenses, and eliminate ideological motivations that cause corruption.

3) Leading party members to implement company decisions, conducting independent and creative work under the leadership of the labor union, the Communist Youth League, and other mass organizations, giving full play to the bonding between party members and the masses, and supporting the governance of the shareholders meeting, the board of directors, the board of supervisors and the management.

4.7 Summary

Based on the theoretical framework of previous chapters, this chapter focuses on six incentive elements to analyze the principles and compare effectiveness by way of quantitative analysis and literature deduction, putting forward innovative suggestions. The “broadband salary theory” covers traditional economic incentives and quantifiable social incentives, aimed to solve the diverse demands of the actual controllers of state-owned enterprises. Out of the “optimal salary theory”, long-term equity incentives and the “incentive compatibility principle” are proposed to cope with the “smart age phenomenon” among senior managers. Based on the analysis of the structure and governance of the board of directors, the establishment of special committees in five dimensions is recommended to complement the board’s professionalism and promote its efficiency. The paper also puts forward the supervision and punishment mechanism established by “party organizations” with Chinese characteristics as the last gatekeeper when the board of supervisors system fails. This corresponds to the principle that the incentive mechanisms require reverse restraint in the process of mixed reform.

How have the agency mechanism and the principle of property rights affected performance as the mixed ownership reform of state-owned enterprises has been carried out thus far? What changes have taken place in corporate performance after the mixed ownership reform? How do different incentive elements impact corporate performance? These questions will be analyzed in the fifth chapter through a comparative analysis of cases.

Chapter V Case Analysis for the Mixed Ownership Reform of State-owned Enterprises

5.1 Overview

In the previous chapters, the theoretical framework of incentive mechanisms has been constructed through literature analysis: the trinity hypothesis composed of institutional incentives, economic incentives and social incentives. A preliminary comparison of the results of performance incentives has also been conducted in terms of incentive elements. The restructuring of state-owned enterprises is an emergence topic in China. Compared with private and listed companies, mixed-reformed enterprises lag behind in the implementation of economic incentives and are yet to fully establish market-oriented salary incentives and equity incentives. The mixed ownership reform, however, will help transform the incentive mechanisms to be market centered, drive the efficiency of enterprises, and achieve the preservation and appreciation of state-owned assets. In this chapter, the multi-case analysis method is adopted to discuss the institutional incentives and economic incentives in the mixed ownership reform and specific measures are suggested to better social incentives.

Case analysis in this chapter manages three questions. How can state-owned enterprises achieve institutional incentives through standardized corporate governance and a market-based recruitment system in the initial stage of mixed ownership reform? How can companies establish effective restraint and exit mechanisms and further demonstrate the effectiveness of economic incentives such as salary and equity incentives in the process of restructuring and development? How to transform the previously mentioned theoretical research into practical methods to help actual controllers establish a more effective incentive system?

Following the above-mentioned objectives, this chapter starts from the paths of the mixed reform and selects two iconic reformed enterprises as the object of research. Yunnan Baiyao and Greenland Holdings are a representative case of strategic reorganization, market reorganization, capital reorganization, mechanism reorganization and other mixed reform paths in different dimensions. We would like to compare and analyze the constraints of the paths on the incentive mechanisms from multiple angles. A pilot for the mixed reform, the two enterprises embody the achievements of the reform in different periods. By tracking their development trajectory, it can be deduced that the governance system and the incentive mechanisms have gradually improved over time and sequence, helping us to make better suggestions and prospects for research. The two listed companies are made the key of case study as they provide us with abundant data to track and feature clear restructuring paths and complete stages of development.

Table 5-1 The mixed ownership reform paths of the enterprises in case study

	Yunnan Baiyao	Greenland Holdings
Paths	Introducing strategic investors	Introducing strategic investors, employee stock ownership, and going public

5.2 Case Analysis of Yunnan Baiyao's Mixed Ownership Reform

5.2.1 Background information

(1) Background

In 2016, the central government put forward the concept of "New Normal of Economy" due to insufficient momentum in economic development. With the mixed ownership reform vigorously promoted once again, the SASAC emphasized it as an important breakthrough in the reform of state-owned enterprises, placing the ownership system as the focus of the reform. In this context, Yunnan Province proposed 2017 as a critical stage for the reform of state-owned enterprises and expressed its willingness to actively participate in this round of mixed ownership reform. It listed Yunnan Baiyao as the key member in the first batch of reform and set 2020 as the target year when all the state-owned enterprises in the province would complete the mixed ownership reform. The mixed reform of Yunnan Baiyao was carried out under the active support of the state and the local government and driven by various mixed reform policies–the necessary guarantee for its successful reform.

(2) Profile of Yunnan Baiyao

Yunnan Baiyao Group Co., Ltd. ("Yunnan Baiyao" for short) is a modern pharmaceutical company integrating R&D, production, and sales. Its predecessor was Yunnan Baiyao Factory, which was established in 1971 and transformed into Yunnan's first listed company in 1993. Yunnan Baiyao Holding Co., Ltd., a controlling shareholder, owned 41.52% of the shares of Yunnan Baiyao. This mixed reform was carried out at the level of its controlling shareholder.

Yunnan Baiyao Holding Co., Ltd., established as a wholly state-owned limited liability company on September 19, 1996, belongs to the Yunnan Provincial Government . In 2004, the company was restructured and reorganized with a registered capital of 1.5 billion yuan. The SASAC of Yunnan Province held all the shares of the holding before the mixed ownership reform. Yunnan Baiyao Holding Co., Ltd. is one of the leaders in China's pharmaceutical industry and has topped domestic traditional Chinese medicine industry for six consecutive years with outstanding business performance. The company's leading product "Yunnan Baiyao" is a state secret formula. The holding group has a diversified industrial layout, with the production and sale of drugs as its main industry, and the related industries such as finance and drug cultivation developing simultaneously. In 2016, Baiyao Holding had an asset of 32.5 billion yuan, and its holding subsidiary Yunnan Baiyao Group owned 24.5 billion yuan, equivalent to the three-quarters of the holding's total assets. In the same year, Baiyao Holding achieved a revenue of 22.6 billion yuan, of which 22.4 billion were created by its subsidiary. Over the past five years, Yunnan Baiyao Group has accounted for more than 75% of the holding's assets, and owned a higher business income than its parent company. More than 80% of the net profit of Baiyao Holding is earned by Yunnan Baiyao Group. Although the mixed ownership reform is carried out at the level of Yunnan Baiyao Holding Co., Ltd., the main purpose is to revitalize the internal governance mechanism of Yunnan Baiyao Group and introduce the necessary resources for its strategic goal of 100 billion yuan. The holding company has always been a strategic platform for Yunnan Baiyao Group Co., Ltd., vigorously boosting the reform of mixed ownership.

(3) Profile of Strategic Investors

New Hua Du Industrial Group (referred to as "New Hua Du") is a retail enterprise established in 1995, with Fashu Chen being its controlling shareholder. New Hua Du is operated as a chain of hypermarkets, general supermarkets, and department stores and its business scope cover products and services like food, general merchandise, daily necessities and information services. It cuts a figure as one of the outstanding enterprise representatives in the 30th anniversary of the reform and opening up, a leading enterprise in Fujian Province, placed among China's top 100 commercial chain enterprises for five consecutive years from 2004 to 2009. Being the largest terminal retailer of many well-known brands in Fujian, New Hua Du can provide a broad sales channel for Yunnan Baiyao products. In addition, the industrial group has provided investment, management and consulting services for companies in such industries such mining, tourism, and construction machinery. It has been actively committed to the restructuring and reorganization of assets and possessed rich investment experience in state-owned enterprises.

Jiangsu Yuyue Medical Equipment & Supply Co., Ltd., founded in 2007, specializes in investing the field of medical machinery and the life and health industry, with main business covering the production and sales of medical machinery and equipment for medical digital imaging, home healthcare, oxygen supply, etc. Guangming Wu is the company’s controlling shareholder. The company controls a number of listed medical equipment companies, for example, Yuyue Medical and Wandong Medical. Its operating business largely overlaps with the main business of Yunnan Baiyao—the two enterprises can actively learn from each other’s strengths and produce strong synergies. Jiangsu Yuyue is experienced in marketization. Yunnan Baiyao can rest on its rich experience to improve its equity structure and governance structure and drive business performance to promote its modernization.

5.2.2 Mixed reform process

The mixed reform of Yunnan Baiyao is one of the few top-down styles carried out at the parent company but focuses on its controlling shareholder

Yunnan Baiyao Holding Co., Ltd. The operating income of Baiyao Holding in 2017 was 2.45002033 million yuan, of which Yunnan Baiyao accounting for more than 90%. Baiyao Holding is actually a company established for Yunnan Baiyao with the latter being its main asset. Therefore, the mixed reform of Baiyao Holding is actually a restructuring of Yunnan Baiyao. According to the company's announcement, the paper sorts out the process of the mixed reform of Yunnan Baiyao (see Figure 5-1):

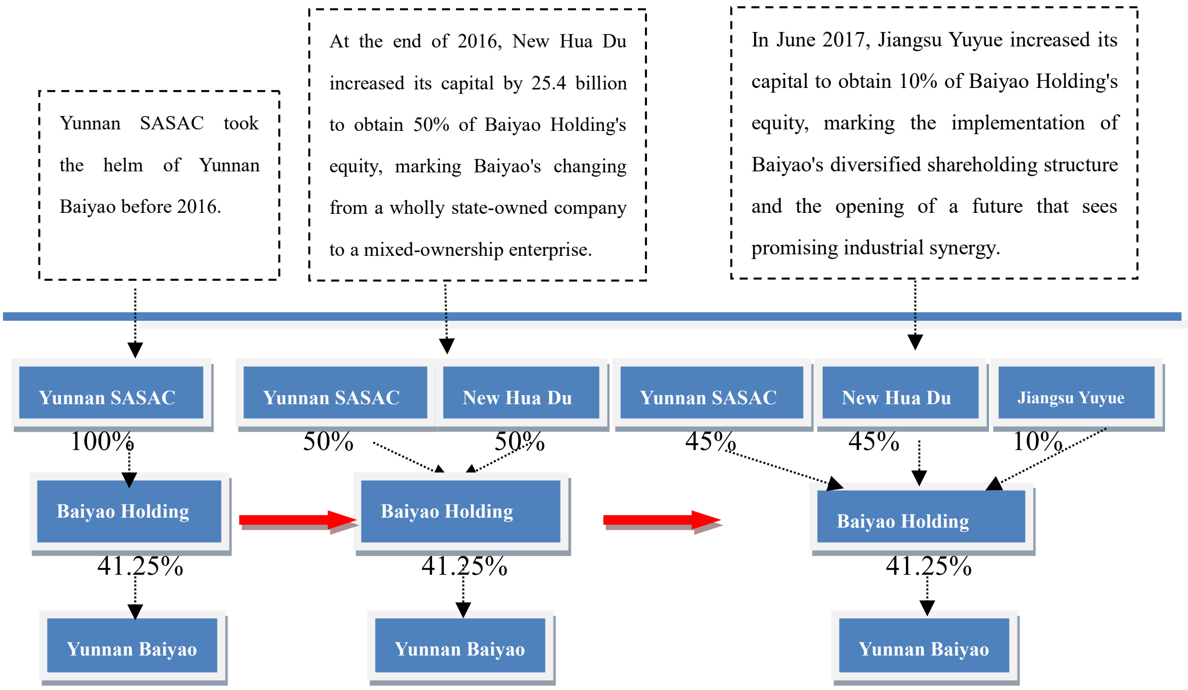

Figure 5-1 Mixed Reform Structure of Yunnan Baiyao Holding Co., Ltd

December 28, 2016 was a big moment for the mixed reform of Yunnan Baiyao, on which Yunnan SASAC, New Hua Du and Yunnan Baiyao Holding Co., Ltd. mailed down a cooperation agreement after rounds of talks. The agreement stipulated that New Hua Du would increase its capital and shares of Baiyao Holding to obtain a 50% stake, while the shareholding ratio of the provincial SASAC would drop from 100% to 50%. The capital increase was completed not until March 16, 2017, symbolizing a 50/50 partnership between the SASAC and New Hua Du. The registered capital of Baiyao Holding then doubled to 3 billion yuan. A general meeting of shareholders was held on April 17, 2017, when the original board of directors was largely replaced. Jianhua Wang, Chunhua Chen, Rong Wang and Pengjie Na from New Hua Du were appointed as directors, and Jianhua Wang also the new chairman. After the capital increase and share expansion, New Hua Du and the SASAC were on equal footing on the board of directors. On June 6, 2017, Jiangsu Yuyue invested 5.638 billion yuan to become a third-party shareholder of Baiyao Holding and obtained a 10% stake. As of June 20, 2017, the proportion of shares held by the provincial SASAC, New Hua Du, and Jiangsu Yuyue in Baiyao Holding was 9:9:2. The three parties also agreed on the 6-year locking before selling their stocks. On June 28, 2017, the industrial and commercial change of capital increase came to a closure as Baiyao Holding was changed to a company without actual controllers, and its registered capital was changed from 3 billion yuan to 3.33 billion yuan. At this point, the reform of Yunnan Baiyao Holding, known as a typical case, was shaped.

The ownership structure of Baiyao Holding changed from 50%-50% to 45%-45%-10%. For the total number of shares of New Hua Du, Jiangsu Yuwell and the SASAC, the sum of any two was greater than the rest, indicating that the decision of Baiyao Holding must be a unanimous agreement of at least two parties in any case. Clearly, the capital and operating capacity of Yunnan Baiyao was strengthened to a certain extent because of the mixed reform. The board of directors of Baiyao Holding consisted of five members to form a new pattern of “2+2+1”—two seats for the SASAC of Yunnan Province and New Hua Du each and one for Jiangsu Yuwell. The joining of Jiangsu Yuyue turned Baiyao Holding to be more powerful in private capital than state-owned capital. However, in this business deal Jiangsu Yuyue was not allowed to become a concerted person of the provincial SASAC and New Hua Du under any circumstances. It was shown that neither private capital nor state-owned capital could obtain control of an enterprise by cliques and factions, between which Jiangsu Yuyue was undertaking a balancing role.

As the mixed reform was settled, Yunnan Baiyao’s shareholding structure, board composition and management compensation system underwent tremendous changes.

5.2.3 Change of governance mechanism

The main purpose of Yunnan Baiyao’s mixed reform was coordinating efficiency and management capabilities rather than the need for financing. Introducing strategic investors could not only provide sales channels for the future industrial layout of Yunnan Baiyao and produce industrial synergy, but also absorb more market-oriented business models and management concepts to gradually straighten out all systems and revitalize governance mechanisms, to strengthen the company's close connection with the market, to facilitate the forming of the management team. After the reform, Yunnan Baiyao Group, a listed subsidiary of Baiyao Holding, has improved its corporate governance mechanism mainly from equity structure, the board of directors and supervisors system, the hiring of management and the incentive mechanisms (shown in Table 5-2).

Table 5-2 Main contents of corporate governance in Baiyao Holdings after the mixed reform

Governance contents	Problems	Solutions
Equity structure	1) 100% holding and administrative intervention by the SASAC; 2) Overlong principal-agent links for state-owned property rights and the absence of the ownership system.	1) Introduce strategic investors to carry out the mixed system reform; 2) Form a diversified and balanced equity structure.
Board of directors and supervisory board system	1) No board of directors and SASAC-controlled decision-making; 2) All SASAC-related members of the board of supervisors and insufficient monitoring.	1) Establish a board of directors and clarify the responsibilities of the board; 2) Re-elect the members of the supervisory board by shareholder representatives and the employee representative assembly.
Management incentive and restraint mechanisms	1) Top management: a combined role of political status and	1) Realize the market-based recruitment of the management;

	businessmen; 2) Management incentives not in place.	2) Establish market-based compensation management methods.

5.2.3.1 Changes to ownership structure

With regard to the shareholding structure, the equity ratio was kept the same, but changes in the nature of equity made Yunnan Baiyao an enterprise with no actual controllers after the reform. Before the mixed reform, Baiyao Holding was wholly-owned by the provincial SASAC. In the course of the reform, New Hua Du joined as a strategic investor and they agreed to introduce Jiangsu Yuyue as a balancer. Yuyue was not allowed to act in concert with the SASAC or New Hua Du at any time. The shares of the three parties were set for a six-year restriction period, and the total shares of Yunnan Baiyao indirectly held by the three parties shall not exceed 5%. Neither Yunnan Baiyao nor New Hua Du could unilaterally expand the shareholding ratio of Yunnan Baiyao without the consent of each other. The articles of association of Baiyao Holding also stated that the decision of the general meeting of shareholders shall require the approval of more than half of the shareholders. Thus, neither Yunnan Baiyao nor New Hua Du could constitute actual control, and the Baiyao holding became an enterprise with no actual controllers.

Table 5-3 Changes to the equity structure of Baiyao Holding

Changes to the equity structure of Baiyao Holding	
Before the mixed reform	After the mixed reform

Yunnan SASAC	100%	Yunnan SASAC	45%
		New Hua Du	45%
		Jiangsu Yuyue	10%

The equity structure of Yunnan Baiyao did not change much before and after the mixed reform, but the transfer of the actual controller of Baiyao Holdings altered the actual controller of Yunnan Baiyao accordingly. The equity structure of Yunnan Baiyao did not change much before and after the mixed reform, but the transfer of the actual controller of Baiyao Holdings changed the actual controller of Yunnan Baiyao accordingly. Yunnan Baiyao Holding accounted for 41.25% of the shares of Yunnan Baiyao before the reform and was 100% controlled by the SASAC, also Yunnan Baiyao's actual controller. Hongta Tobacco Group Company Limited, also a state-controlled enterprise, became the second largest shareholder, accounting for 11.03% of the total shares. The third largest shareholder, China Ping'an Life Insurance Co., Ltd., bought up 9.36% of the shares, while New Hua Du acquired a 3.39% stake of Yunnan Baiyao through the secondary capital market. Meanwhile, Fashu Chen, the actual controller of New Hua Du, purchased 0.86% of the shares. At the closure of the mixed reform, both the Yunnan SASAC and New Hua Du increased their shares of Baiyao Holdings to 45%, while the rest 10% was held by Jiangsu Yuyue. Thus, the shares of Yunnan Baiyao owned by New Hua Du and Fashu Chen hit 22.81% to make them the largest shareholder of Yunnan Baiyao. The SASAC was the second largest shareholder as it accounted for 18.68% of the shares. The share ratio for

Hongta Group, Ping An Life Insurance and Jiangsu Yuyue was then adjusted to 10%, 9.36% and 4.15% respectively. That was how Yunnan Baiyao was transformed into an enterprise without actual controllers.

Table 5-4 Changes to the equity structure of Yunnan Baiyao

Changes to the equity structure of Yunnan Baiyao			
Before the mixed reform		**After the mixed reform**	
Baiyao Holding	41.52%	Yunnan Baiyao Holding Co. Ltd	41.52%
Hongta Tobacco Group Company Limited	11.03%	Yunnan Hehe (Group) Co., Ltd.	10.09%
Ping An Insurance	9.36%	Ping An Life Insurance Company of China Ltd. - self-owned capital	9.36%
New Hua Du	3.39%	Hong Kong Securities Clearing Company Limited	6.51%
China Securities Finance Corp., Ltd.	2.85%	Xinhuadu Industrial Group Co. Ltd	3.39%
Central Huijin Asset Management Ltd.	0.86%	China Securities Finance Corp., Ltd.	2.56%
Mr. Fashu Chen	0.86%	Central Huijin Asset Management Ltd.	1.28%
Shanghai Chongyang Strategic Investment 1	0.79%	Mr. Fashu Chen	1.16%
Shanghai Chongyang Strategic Investment 2	0.73%	National Social Security Fund 414 combination	0.86%
Shanghai Chongyang Strategic Investment 3	0.69%	National Social Security Fund 121 combination	0.55%

5.2.3.2 Changes to the board of directors, board of supervisors, and party committee organizations

(1) Changes to the board of directors

At the level of Yunnan Baiyao Holding, the number of board members changed from 3 to 5: the SASAC and New Hua Du recommended 2 for each and the rest was held by Yuyue. The chairman of the board was replaced by Jianhua Wang recommended by New Hua Du and the list of directors recommended by the Yunnan SASAC was replaced by Pengjie Na and Rong Wang. Although both New Hua Du and the SASAC took up two seats, the chairman was recommended by the latter, accentuating the importance of private capital in the decision-making process.

Table 5-5 Changes to the list of the board of directors in Baiyao Holding

Changes to the list of the board of directors in Baiyao Holding					
Before the mixed reform			**After the mixed reform**		
Minghui Wang	SASAC	Chairman	Jianhua Wang	New Hua Du	Chairman
Liangbo Peng	SASAC	Director	Chunhua Chen	New Hua Du	Director
Yiwen Pan	SASAC	Director	Pengjie Na	SASAC	Director
			Rong Wang	SASAC	Director
			Yong Zhang	Jiangsu Yuyue	Director

At the level of Yunnan Baiyao, its chairman remained as Minghui Wang, but Jianhua Wang (New Hua Du), Xiaohua Qiu (National Bureau of Statistics) and Chengli Song (Ping An Insurance) replaced the original positions of Dexian Chen, Donghong Lu and Yong Yang. They all together formed a new board with the original blood. The average age of Yunnan Baiyao's internal directors was 52.4 before the reform, and among the 7 executive directors, only two held a master's degree or above, which was less than 30%. As the reform completed, the average age was raised to 54, but the proportion of members holding a high educational degree exceeded 50%. For the first time, doctoral degree holders earned a place in the board of directors, tempering the scientific nature of its decisions. Moreover, the members of the board of directors of Yunnan Baiyao were all within the jurisdiction of the SASAC before the reform, who were extremely internal related. After the reform, three board members were not within the jurisdiction of the SASAC, justying the growing independence of the board. At the Baiyao Holding level, the reform ended Minghui Wang's chairmanship, who retained his position as a general manager only. Two of the board members were appointed by New Hua Du, with Jianhua Wang servnig as the new chairman. Beyond question, New Hua Du was granted a substantive right to speak on the board of directors. The more diverse composition of the board of directors along with the improved level of educational background and increased average age shall bring forth more cautious decision-makings.

Table 5-6 Changes to Yunnan Baiyao's board of directors

Changes to Yunnan Baiyao's board of directors					
Before the mixed reform			After the mixed reform		
Minghui Wang	Original Baiyao	Chairman	Minghui Wang	Original Baiyao	Chairman
Changhong Yang	Original Baiyao	Director	Changhong Yang	Original Baiyao	Director
Pinyao Yin	Original Baiyao	Director	Pinyao Yin	Original Baiyao	Director
Hongdong Lu	Original Baiyao	Director	Jianhua Wang	New Hua Du	Director
Yong Yang	Original Baiyao	Director	Xiaohua Qiu	New Hua Du	Director
Shuangyou Li	Hongta Tobacco Group Company Limited	Director	Shuangyou Li	Hongta Tobacco Group Company Limited	Director
Dexian Chen	Ping An Insurance	Vice Chairman	Chengli Song	Ping An Insurance	Director
Huacheng Wang		Independent Director	Huacheng Wang		Independent Director
Fanghua Wang		Independent Director	Fanghua Wang		Independent Director
Ruichao Lin		Independent Director	Ruichao Lin		Independent Director
Jin Liu		Independent Director	Jin Liu		Independent Director

(2) Changes to the Board of Supervisors

From the angle of Baiyao Holding, the number of seats on the board of supervisors increased by two as New Hua Du recommended one supervisor and one employee representative supervisor was added. The SASAC still held two seats on the board of supervisors and recommended Jie Zhong to act as the chairman of the board of supervisors. As detailed in the "Articles of Association", independent directors, supervisors and shareholders with more than 10% of the shares can turn to the board of directors for the convening of a general meeting of shareholders, while the board of supervisors is capable of launching a general meeting of shareholders on its own even if the directory board refuses.

Table 5-7 Changes of Baiyao Holding before and after the mixed reform

Changes of Baiyao Holding before and after the mixed reform					
Before the mixed reform			After the mixed reform		
Guopei Li	SASAC	Chairman of Supervisory Board	Jie Zhong	SASAC	Vice Chairman of Supervisory Board
Hua Fan	SASAC	Chairman of Supervisory Board	Guanghui You	New Hua Du	Vice Chairman of Supervisory Board
			Yanhui Chen	SASAC	Non-employee Supervisor
			Jialong Zhu	Employee Supervisor	Employee Representative Supervisor

We can tell from the perspective of Yunnan Baiyao that the number of seats on the board of supervisors remained the same, but the number of seats recommended by the SASAC was reduced from two to one, and New Hua Du added one more recommended seat. The chairman of the board of supervisors was changed to Guanghui You recommended by New Hua Du, who was also one of the supervisors of Baiyao Holdings.

Table 5-8 Changes to Yunnan Baiyao's board of supervisors

Changes to Yunnan Baiyao's board of supervisors					
Before the mixed reform			After the mixed reform		
Xiaobin Cheng	SASAC	Chairman of Supervisory Board	Guanghui You	New Hua Du	Chairman of Supervisory Board
Yunbo Tang	Hongta Tobacco Group Company Limited	Supervisor	Yunbo Tang	Hongta Tobacco Group Company Limited	Supervisor
Yihong Zhao	SASAC	Supervisor	Jie Zhong	SASAC	Supervisor
Yingxia He		Employee Supervisor	Yingxia He		Employee Supervisor
Yan Li		Employee Supervisor	Yan Li		Employee Supervisor

(3) Changes to party committee organizations

The party committee, a relatively special institution in state-owned enterprises, has always played as a relatively core leadership role. The committee participates in daily decision-makings and its secretary often assumes an important position in a company's management to monitor its development direction. After the mixed reform, the party secretary of Baiyao Holdings changed from the SASAC origin to New Hua Du.

Table 5-9 Changes to party committee members of Baiyao Holdings

Changes to party committee members of Baiyao Holdings					
Before the mixed reform			After the mixed reform		
Minghui Wang	SASAC	Party Secretary	Jianhua Wang	New Hua Du	Party Secretary
Hongdong Lu	SASAC-related	Deputy Party Committee Secretary	Changhong Yang	SASAC	Deputy Party Committee Secretary

5.2.3.3 Changes to management recruitment and incentive mechanisms

(1) Changes to the management team

Few changes were seen in the management team of Baiyao Holdings since the general manager and deputy general manager were still from the origin of Baiyao recommended by the SASAC, but Jing Yan appointed by the SASAC was replaced by Guanghui You from New Hua Du. As a request from New Hua Du, the senior management team fulfilled market-oriented changes and no longer retained the status of civil servants. Therefore, in view of Yunnan Baiyao, its senior management team barely changed and the changes in the equity structure had little impact on the level of operation.

Table 5-10 Changes to the list of senior executives in Baiyao Holdings

Changes to the list of senior executives in Baiyao Holdings					
Before the mixed reform			After the mixed reform		
Minghui Wang	SASAC	General Manager	Minghui Wang	SASAC	General Manager
Changhong Yang	SASAC	Deputy General Manager	Changhong Yang	SASAC	Deputy General Manager
Jing Yan	SASAC	Financial Director	Guanghui You	New Hua Du	Financial Director

Table 5-11 Changes to the top management team of Yunnan Baiyao

Changes to the top management team of Yunnan Baiyao					
Before the mixed reform			After the mixed reform		
Pinyao Yin	Original Baiyao	General Manager	Pinyao Yin	Original Baiyao	General Manager
Yong Yang	Original Baiyao	Deputy General Manager	Jin Wang	Original Baiyao	Deputy General Manager
Jin Wang	Original Baiyao	Deputy General Manager	Yong Yang	Original Baiyao	Deputy General Manager
Haomin Qin	Original Baiyao	Deputy General Manager	Haomin Qin	Original Baiyao	Deputy General Manager
Juan Yu	Original Baiyao	Director of Human Resources	Juan Yu	Original Baiyao	Director of Human Resources
Wei Wu	Original Baiyao	Board Secretary/ Chief Financial Officer	Wei Wu	Original Baiyao	Board Secretary/ Chief Financial Officer

Jin Li	Original Baiyao	Technical Quality Director	Jin Li	Original Baiyao	Technical Quality Director
Zhaoyun Zhu	Original Baiyao	R&D Director	Zhaoyun Zhu	Original Baiyao	R&D Director

(2) A marketed-based recruitment mechanism for the management team

Upon completion of the mixed ownership reform, New Hua Du and Baiyao Holdings reached a "de-administrative" agreement, bought out the administrative ranks of senior executives and became a thorough professional manager. The move that the senior executives of Baiyao Holding and Yunnan Baiyao would no more contain civil servants bespoke the invention of a market-oriented corporate governance system and restrained government intervention in corporate management. The implementation of a professional manager system in mixed-ownership enterprises has expanded and enriched the scope and methods of business managers hiring, making it easier to locate suitable candidates. Furthermore, the professionalism, past performance, personal credit and other information of market-oriented talents are generally publicly recorded or traceable in the market, providing employers with more reliable assurance in the course of recruitment.

(3) Changes to compensation and performance evaluation

At the start of the mixed reform, Yunnan Baiyao barely changed its salary system that had been in use since 2001. The annual compensation of the top paid employee was 130,000 yuan in 2002 and rose to 1.02 million yuan in 2016—a nearly 8-time increase, but the company's market value saw a leap of 28 times during the same period. Executives of Yunnan Baiyao were apparently paid lower than those of Kangmei Pharmaceutical Co., Ltd. and Tasly, which shared a similar market value. As soon as Yunnan Baiyao acted on the path of “de-administration”, its executive compensation was in line with the market and linked to business performance. Hereafter, the enthusiasm of the management was kindled. A vital point came at the ninth meeting by the Eighth Board of Directors held in 2017 as the company issued the “Measures for Yunnan Baiyao Group Co., Ltd. Senior Management Performance and Rewards Management” and the “Measures for Yunnan Baiyao Group Co., Ltd. Independent Director Allowance Management”. There the compensation system for senior executives was adjusted accordingly and tied up with management efficiency, company operating performance and personal performance results. The combination of rewards and punishments broke the original rigid system of state-owned enterprises and realized the matching of value contribution and benefit distribution, constraints, and incentives . Such measure encouraged the management team to be more focused on the company’s future rather than self-interest when making investment decisions (as shown in Table 5-12).

Table 5-12 Changes to Yunnan Baiyao’s top management assessment and incentive methods

Item	Before the mixed reform	After the mixed reform

Evaluation and incentive methods	① The government and its functional departments are responsible for the screening of evaluation methods and the distribution of executive compensation; ② Assessment is based on scientific decision-making, management ability, work performance, and innovation ability.	① Improve the incentive and restraint mechanisms for the top management in accordance with the market-based principle; ② The compensation of executives is linked to the company's performance, operating indicators, and comprehensive management. The annual business scheme, the division of responsibilities for the top management and their work objectives are considered when carrying out comprehensive assessment. Assessment results determine the annual salary distribution of the top management.

In Yunnan Baiyao, the monetary compensation of the management level saw an upsurge after the mixed reform. As told in Figure 5-2, the mixed reform was a watershed for significant salary boost of Yunnan Baiyao's executives from 2014 to 2018: a 96% increase from 7.74 million yuan in 2016 to 15.17 million yuan in 2018, almost doubled. The growth in top management compensation, to some extent, contributed to the company's profitability. As illustrated in Tables 5-13 and 5-14, the remuneration of the top three directors and executives grew with their better performance. The top three directors of Yunnan Baiyao was paid 798,400 yuan more in 2018 than in 2016, a growth of 39.09% and the addition for the top three executives reached 2,500,400 yuan, an increase of 84.02%. A look at the company's annual report, we found that the director Pinyao Yin was paid the most at 2,474,800 yuan in 2018, which is a significant increase in salary compared to 1,017,400 yuan in 2016. The implementation of compensation incentives for the top management brought about a huge jump in their compensation, provoked the enthusiasm of top ranks, prompted them to play a more important role in boosting institutional mechanisms and making wiser business decisions, and accelerated the marketization of mixed-reformed enterprises.

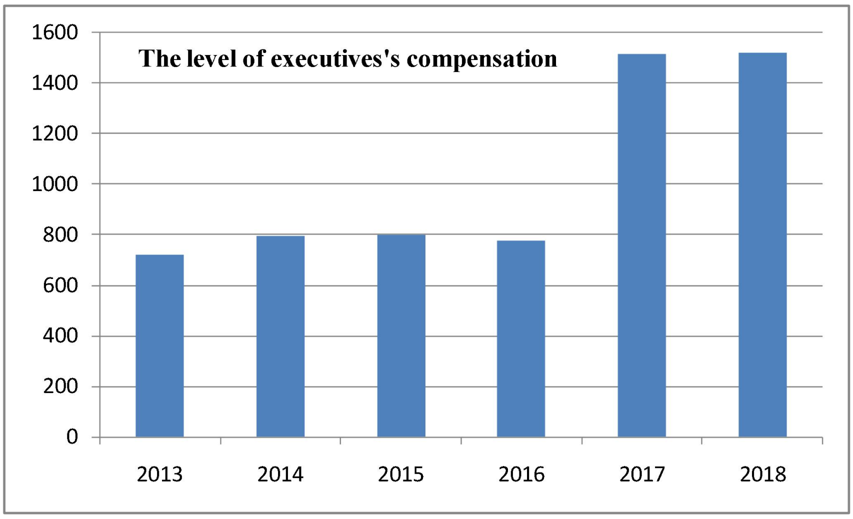

Figure 5-2 Total compensation for Yunnan Baiyao executives

Table 5-13 Changes in Yunnan Baiyao's Operating Performance from 2014 to 2018

Item	2014	2015	2016	2017	2018
Sales revenue	188.14	207.38	224.11	243.15	267.08
Total profits	29.10	32.15	33.98	36.22	38.26

Table 5-14 Changes in Top Management Compensation of Yunnan Baiyao (10,000 yuan)

Item	2014	2015	2016	2017	2018
Remuneration of the top three directors	121.08	188.99	204.24	246.65	284.08
Remuneration of	285.93	293.55	297.59	541.38	547.63

the top three executives					
Highest pay	98.75	101.54	101.74	243.18	247.48

5.2.4 Analysis of restructuring benefits

5.2.4.1 Evaluation on performance in the securities market

Since Yunnan Baiyao Group Co., Ltd. is the core asset of Yunnan Baiyao Holding Co., Ltd., the author tries to assess the optimization of the latter's corporate governance after the mixed reform from the financial performance of Yunnan Baiyao in the securities market, and validate if the optimization of corporate governance had a positive effect on the short-term and future development of the two parties. The stock price changes of Yunnan Baiyao before and after the mixed reform were the indicator we screened out to reflect the company's performance in the securities market. From Figure 5-3, we can see that the stock prices of Yunnan Baiyao soared from the lowest point of 60.95 yuan per share to the highest 103.46 yuan after they announced to embrace the mixed reform, though it fell to 71.96 yuan at the end of 2018. Still the company had a stock yield of 18.06, while the SZSE Component Index took a nose dive to -30.98% during the same period. It can be perceived that the market was optimistic about the mixed reform of Yunnan Baiyao as its stocks maintained a growth rate of 18.06%, despite the overall poor performance of the market.

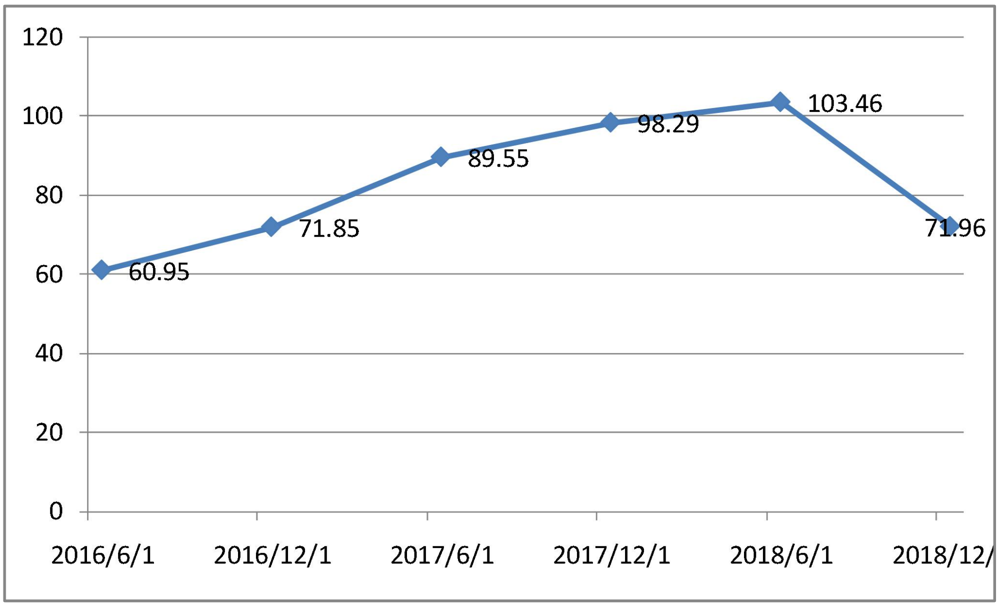

Figure 5-3 Stock prices of Yunnan Baiyao(yuan)

5.2.4.2 Analysis of financial indicators

To evaluate the financial performance of Baiyao Holdings before and after the mixed ownership reform, this paper sorted out seven financial indicators in three dimensions: solvency, profitability and operating ability. For more accuracy, the industry average and three listed A-share companies in the same industry—Tasly (600535.SH), Pien Tze Huang (600436.SH) and Guangzhou Pharmaceutical Company Limited (600332.SH) —were picked out as comparable counterparts for a comparative study.

(1) Analysis of debt-paying ability

Debt-paying ability measures the ability of a company to pay its liabilities, such as debt and the interest on that debt. In this paper, debt to asset ratio and quick ratio were the benchmark to measure the debt-paying ability of an enterprise. The Table 5-14 showed that the debt to asset ratio of Yunnan Baiyao was lower than the industry average. The year of 2016 witnessed an obvious increase in the ratio but it fell again in 2017 when the mixed reform was completed. We can assume that the company's insolvency risk was gradually decreasing after the reform. As to quick ratio, Yunnan Baiyao kept a higher amount than the industry average. From 2016 onward, both the company and the industry average declined a bit.

Table 5-14 Comparison of Yunnan Baiyao's debt-paying ability from 2014 to 2018

		2014	2015	2016	2017	2018
Yunnan Baiyao	Liabilities (100 million yuan)	50.46	57.63	87.73	95.60	139.43
	Assets (100 million yuan)	163.41	192.91	245.87	277.03	539.48
	Debt to Asset Ratio	30.88%	29.87%	35.56%	34.51%	25.84%
	Industry Average	60%	60%	60%	60%	59%
Yunnan Baiyao	Quick Assets	86.94	104.23	103.08	159.82	154.79
	Current Liabilities	39.40	46.76	67.35	75.24	76.22
	Quick ratio	2.30	2.41	2.25	2.19	2.03
	Industry average	0.80	0.82	0.89	0.82	0.69

(2) Analysis of profitability

This paper adopted two indicators—return on total assets (ROA) and return on equity (ROE)—to analyze profitability. As shown in Figures 5-4 and 5-5, there were slight changes in the industry from the perspective of ROA, while Yunnan Baiyao continued to drop but still kept a higher percentage than the industry level throughout the period. This demonstrated that the reason behind the decline in the overall profitability of Yunnan Baiyao should be its own strategic policies and business management instead of industry factors. The mixed ownership reform slowed down the pace of profitability to a certain extent. To be more specific, Yunnan Baiyao obtained sufficient funds for its investment after the reform but it only increased investment in intangible assets, barely influencing actual input and output. Besides, the company's investment utilization rate was largely improved, but its short-term effect was weak. In the light of ROE, both Yunnan Baiyao and the industry were in a downward trend. The ROE of Yunnan Baiyao was higher than that of the industry, so was the downward trend. It was not until the mixed reform that the declining trend smoothed down. At this point of practice, Yunnan Baiyao's profitability in the mixed reform was yet to be enhanced.

Table 5-15 Profitability indicators

		2013	2014	2015	2016	2017	2018
Return on assets (ROA)	Yunnan Baiyao	19.60%	17.09%	15.46%	13.36%	11.98%	11.33%
	Industry Average	7.50%	8.50%	8.50%	6.90%	8.50%	7.20%
Return on equity (ROE)	Yunnan Baiyao	28.03%	24.78%	22.11%	20.70%	18.33%	17.22%
	Industry Average	10.00%	10.00%	9.90%	9.10%	9.90%	9.30%

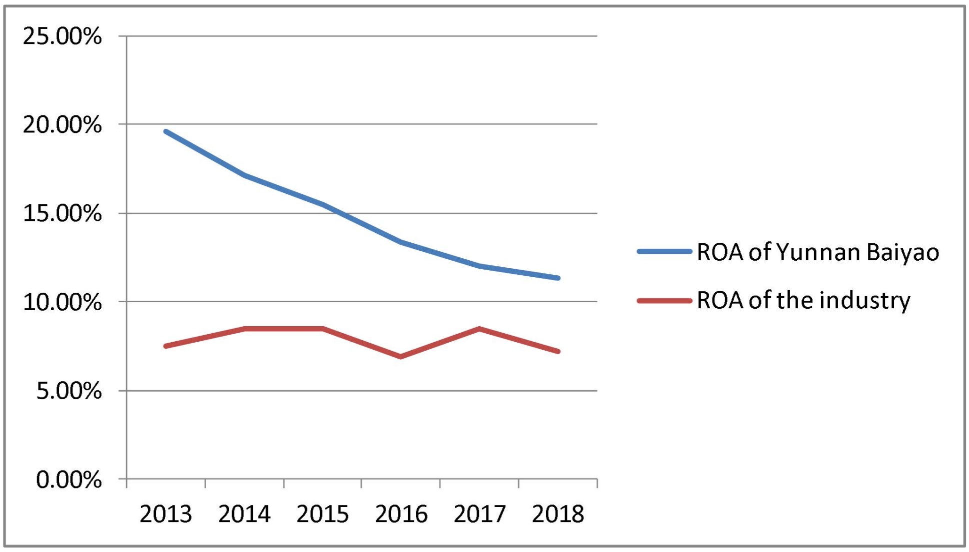

Figure 5-4 Comparison of total return on assets between Yunnan Baiyao and comparable companies in the industry

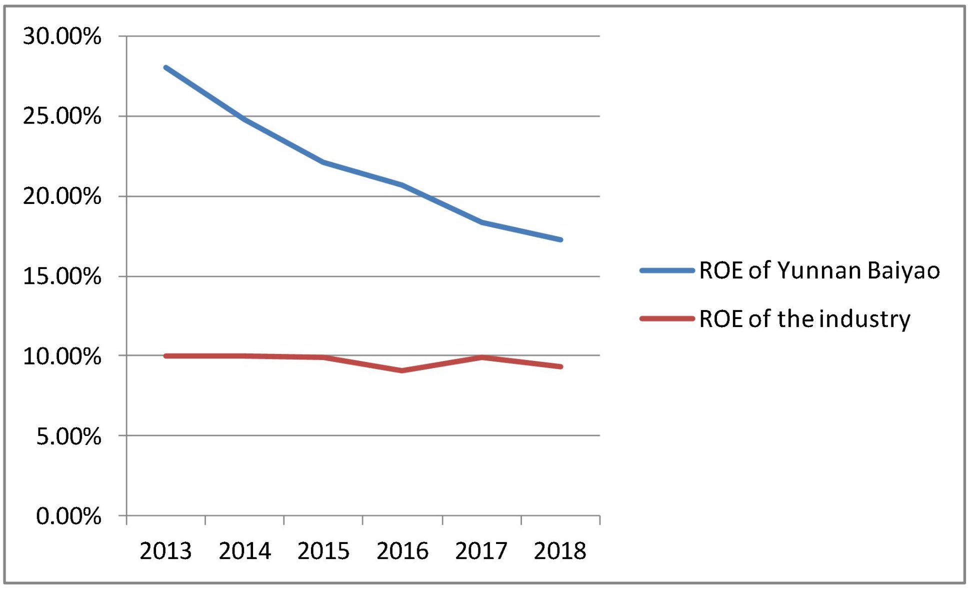

Figure 5-5 Comparison of return on total assets between Yunnan Baiyao and comparable companies in the industry

(3) Analysis of operational capacity

Operational capacity refers to the ability to keep an enterprise in operation. This paper measures the changes in the operating capacity of Yunnan Baiyao before and after the mixed reform with indicators like the total asset turnover rate, the receivables turnover ratio and the investment utilization rate. As indicated in Figures 5-6 and 5-7, the turnover of each asset was not significantly improved over the time frame. In respect of the total asset turnover rate, Yunnan Baiyao was in a declining trend. The industry average was stabilized at around 0.5 from 2013 to 2017, which was lower than Yunnan Baiyao. However, the industry average doubled in 2018 to be slightly higher than Yunnan Baiyao. As to the receivables turnover ratio, the average value was relatively stable, contrasted by the downward trend of Yunnan Baiyao. A sharp drop was perceived from 2014 to 2016, but the trend slowed down after the mixed reform. Overall, Yunnan Baiyao's receivables turnover ratio was higher than the industry data. Thus, it can be concluded that Yunnan Baiyao had outstanding management ability in terms of accounts receivable and total assets.

Table5-16 Operational Capacity Index

		2013	2014	2015	2016	2017	2018
Total asset turnover	Yunnan Baiyao	1.34	1.29	1.16	1.02	0.93	0.92
	Industry Average	0.50	0.50	0.50	0.50	0.50	1.00
Accounts receivable turnover	Yunnan Baiyao	31.13	34.46	25.73	21.65	21.65	17.31
	Industry Average	5.50	5.70	5.60	5.00	5.60	5.00

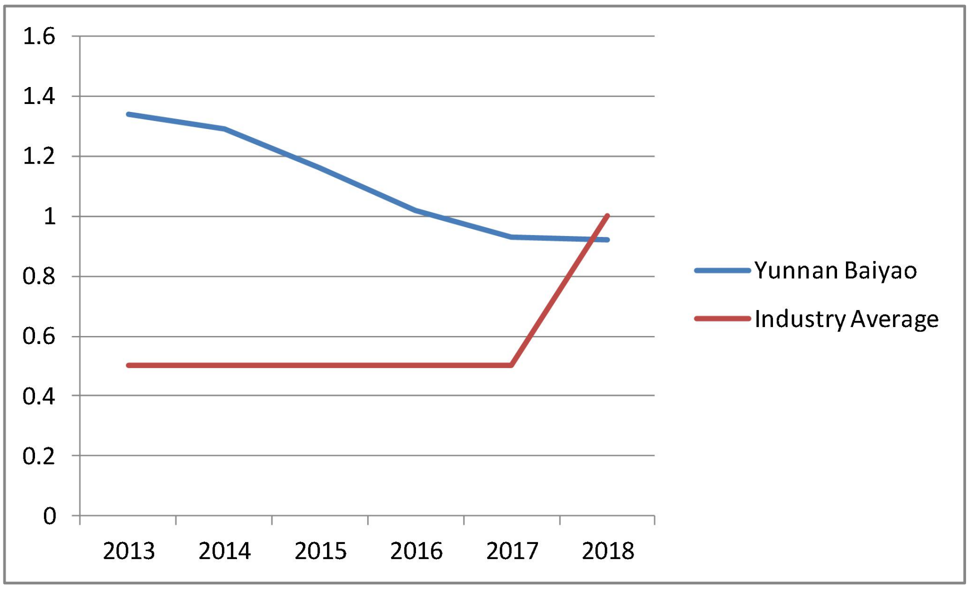

Figure 5-6 Chart of total asset turnover

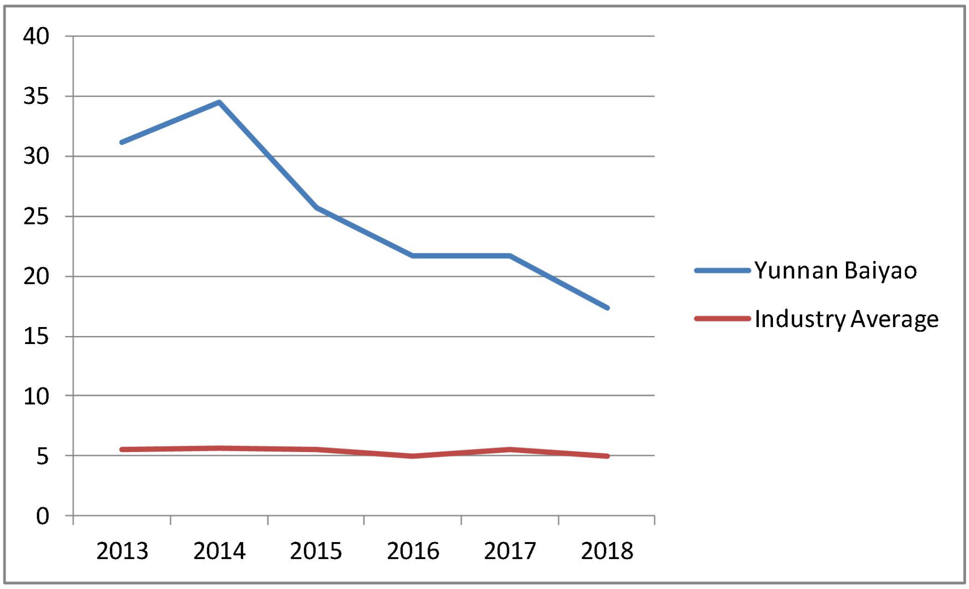

Figure 5-7 Chart of accounts receivable turnover

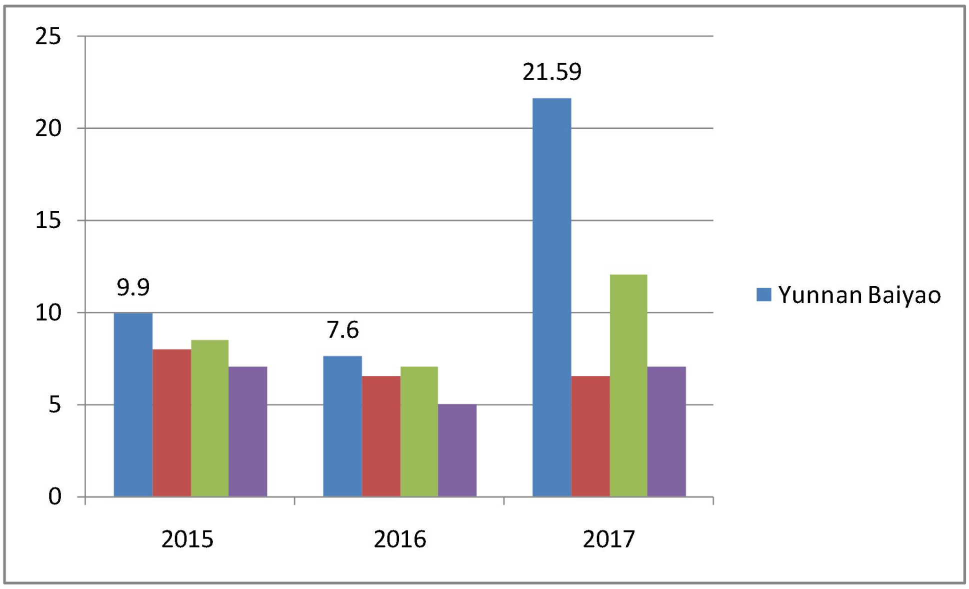

Figure 5-8 Comparison of investment utilization rate

As we can see from Figure 5-8, there were significant changes in the investment utilization rate of Yunnan Baiyao before and after the mixed reform. The company kept its utilization rate of new operating assets almost the same as that of other companies in the same industry before the reform. But the rate boomed after the reform: from 7.6 in 2016 to 21.59 in 2017. The data indicated that the investment utilization rate of Yunnan Baiyao was largely improved, although the scale of new investments was hardly changed.

Combining the analysis of financial indicators in the above three dimensions, it can be told that the mixed reform did not fundamentally change the solvency, profitability and operational capacity of Yunnan Baiyao Holding Co., Ltd., but its overall development was consistent with the industry level and better than the industry average. Combining the analysis of financial indicators in the above three dimensions, it can be told that the mixed reform did not fundamentally change the solvency, profitability and operational capacity of Yunnan Baiyao Holding Co., Ltd., but its overall development was

consistent with the industry level and better than the industry average. The reform did not have an impact on the operation and management of Baiyao Holdings during the research timeframe but we can predict its operational capacity to be improved to a certain degree, given the optimization of corporate governance in the medium- and long-term and the continuous adjustment of Yunnan Baiyao's product advantages and industrial structure.

5.2.5 Conclusions and enlightenments

(1) That Baiyao Holdings introduced strategic investors in the reform of mixed ownership has diversified its ownership structure, changed the enterprise nature of Baiyao Holdings and Yunnan Baiyao, and contributed to their governance.

(2) Based on the long-term restrained demand to revolutionize "the mixed functions of government and enterprise; unapparent rewards and punishments" among the management team, Baiyao Holdings offered buyout packages to the existing core management before market-oriented recruitment, improved salary incentives, and reduced the "principal-agent cost", so that the company's management rights and ownership was well coordinated to earn support from the management headed by the former chairman of the board of directors—this was an important guarantee for the success of the reform. In the case of Baiyao Holdings, we suggest clearly implementing the long-term incentive of management, introducing the employee stock ownership plan (ESOP) and long-term incentives to avoid short-term speculative behaviors,

and rationally determining the proportion of ESOP, the sum of shareholders, the requirements for shareholding and the withdrawal mechanism, thus improving the development efficiency of the enterprise and maximize its value.

(3) After the reform, Baiyao, the Yunnan SASAC, New Hua Du and its concerted action person were listed as the first largest shareholders but did not gain control over the listed company. There were no actual controllers, either before or after this transaction, and its ownership structure would remain stable for a long time. In the view of insiders, unlike most cases of state-owned enterprise reform where private capital accounted for a minority share in financial investment, the mixed ownership reform of Baiyao Holdings maintained the shareholding balance between state-owned capital and private capital. The balance fully stimulated the vitality of private capital and ensured state-owned shareholders to perform their duties and responsibilities as usual. In this case, private capital gained the right to speak in the reform and equal seats with state-owned capital in the board of directors as the property right of state-owned capital was cut to less than 50%. Besides, the mixed reform guaranteed a locked-in period for capital entering Yunnan Baiyao to ensure the safety of state-owned assets and avoid the loss of state-owned assets and benefits, encouraging the stable development of the company in the future. In addition, the ownership reform did promise the goal of introducing modern management system at the level of corporate governance. In Baiyao Holdings,

the changes from “one-share dominant” to “three-legged tripartite” that shaped the diversified structure of stock ownership after the mixed reform achieved effective check and balance among shareholders. To conclude, the mixed ownership reform, a mixture of state-owned and civilian capital at the equity level, can adjust the proportion of two different kinds of capital, rationalize the ownership structure, solve the phenomenon of absent owner in state-owned enterprises, and at a certain level deal with the contradiction between state-owned and civilian capital, between the progress of the state and the retreat of the people. At a deeper layer, the mixed ownership reform is to improve the modern enterprise system, to better tap into the role of entrepreneurs, to redistribute the responsibilities of all the stakeholders in an enterprise, to make resource allocation market-oriented.

(4) The case of Yunnan Baiyao had its shortcomings, which could shed light on the mixed ownership reform of state-owned enterprises. According to Hart’s theory, only when there is a highly complementary relationship between the specific assets involved in different businesses of different enterprises, the merger (integration) of enterprises becomes an objective requirement for the efficiency of property rights allocation. In the reform, New Hua Du as a mainly introduced strategic investor was not related to Yunnan Baiyao in terms of key business. Therefore, New Hua Du neither established a high degree of complementary relationship with Yunnan Baiyao nor significantly improved the efficiency of property rights allocation. It was

of limited help to Baiyao's development. Through comprehensive analysis of short-term financial indicators, along with the existing status of Yunnan Baiyao, it could be realized that the gene of the mixed ownership reform was cultural integration which consequently led to business integration and channel integration. Baiyao, New Hua Du and Jiangsu Yuwell, all of different enterprise natures, failed to well integrate their high-quality resources. In the short-term effect, the effect of the mixed ownership reform was not obviously identified.

(5) As the mixed reform was completed in Baiyao Holdings, a new executive compensation management proposal was honored by Yunnan Baiyao—a first-time adjustment taken after 2002 when the original executive compensation evaluation methods were adopted. The new compensation management system fully referred to the salary levels of the industry and companies of the same size. By optimization and adjustment, the compensation level of the company's top management became more market-oriented and effectively drove their work enthusiasm and expectations on improving corporate performance. However, in the matter of management incentives and restraint mechanisms, Baiyao Holdings was yet to implement management share incentives and form a state of balance among state-owned assets, social capital and employee shares. Managers may lack sufficient motivation to promote the company's sustainable and healthy development. If Baiyao Holdings implements management shareholding incentives in the

years to come, we believe the enthusiasm and stability of the management team will be further enhanced to be more conducive to Baiyao's long-term development. At the same time, the equivalence of private capital and state-owned capital rights will be a potential danger for corporate governance in the future to a certain extent.

5.3 Analysis of Greenland Holdings' mixed ownership reform

5.3.1 Background of Greenland and introduction of related parties

(1) Greenland Holdings Corp., Ltd.

Greenland Holdings Corp., Ltd. known as Greenland Group is a comprehensive enterprise that specializes in real estate. Its predecessor, Shanghai Greenland Development Corporation, founded in 1992, was initiated by Shanghai state-owned Agricultural Industry and Commerce Group. With more than 20 years of developing both industries and capital, Greenland Group have carved out an industrial layout where "real estate, energy and finance" advance side by side, complemented by flourishing industries, construction, consumption and other related. As of 2012 when restructuring was yet to be in place, Greenland Group, as a global leader of the Chinese real estate industry, successfully deployed overseas business in the United Kingdom, Germany, the United States, Canada, South Korea and other countries. Domestically, Greenland branched out its real estate projects in more than 80 cities of 29 provinces (including municipalities directly under the Central Government and autonomous regions) and exceeded Vanke by over 200 billion yuan in annual contracting volume. As its share in the domestic and foreign markets expanded year by year, Greenland grew into a global diversified enterprise with total assets of more than 300 billion yuan. Guided by “publicization, capitalization and internationalization”, Greenland, being supported by Shanghai SASAC, initiated the restructuring in 2013 for better long-term development, taking the “bring in” and “go global” strategy, with industrial operation and capital operation being its dual power engine. That year, Shanghai Greenland Development Corporation absorbed and merged the ESOP Association of Greenland Group to become the largest shareholder. The following year, strategic investors were introduced to further enhance capital scale and operational strength. On August 18, 2015, Greenland officially landed in the A-share capital market by backdoor listing. Being one of the largest enterprises under the Shanghai SASAC, Greenbelt Holdings Group was viewed as the benchmark of this round of state-owned enterprise reform in Shanghai.

(2) Shanghai Jinfeng Investment

Shanghai Jinfeng Investment Co., Ltd. was established in 1992 from its predecessor, Shanghai Jiafeng Co., Ltd. It was listed on the Shanghai Stock Exchange on March 27, 1992 with business focusing on real estate—real estate investment and development, circulation services, entrusted management, and financial services, to be more detailed. Since its establishment, the company continuously expanded its business in accordance with national policy and market conditions and achieved initial results. However, a significant lack of growth appeared recently after a period of relatively rapid development.

5.3.2 Mixed Reform "Trilogy" in Greenland

(1) Restructure the ESOP Association

The ESOP Association under Greenland Group was established in March 1997. With several adjustments to its ownership structure, the ESOP Association owned a total of 982 members before the reform, and the total amount of capital held of Greenland Group was 3,766,552,000 yuan, accounting for 29.09% of the group's shares. As regulators made it clear that they would not accept the application of ESOP Association as a shareholder or initiator for public issuance of shares. That is to say, it needs to liquidate the shares held by its employees, if the company goes public. As the ESOP Association represented all the senior and core employees of Greenland Group, its restructuring became the key to the mixed ownership reform and listing.

In this case, Greenland established Shanghai Greenland as a new partnership, which converted the ESOP Association into a limited partnership after inheriting all its assets, claims, liabilities, and obligations. On April 5, 2014, Greenland Group issued the "Information Note on the Restructuring Plan of the ESOP Association of Greenland Group" to detail the basic principles of the restructuring plan, the specific methods of the restructuring, the agreement of absorption and merger, and the agreement of shareholders' meeting, etc. The scheme for restructuring the ESOP Association was shown in Figure 5-9 below. At the price of 0.01 yuan per share, all the members of the ESOP Association contributed 37,665,520.81 yuan to set up Shanghai Greenland (grand partnership). Then Shanghai Greenland matched the total contribution with the total number of shares held by the association members, and the contribution of all partners corresponded to the proportion of shares held by the association members. After the restructuring completed, Shanghai Greenland absorbed and merged the ESOP Association and transferred its 29.09% stake of Greenland Group to the name of Shanghai Greenland.

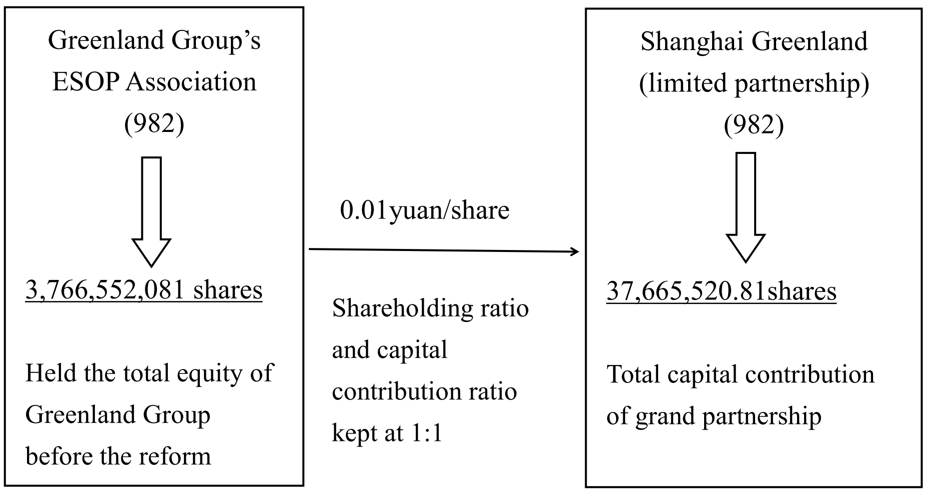

Figure 5-9 Proportion of partners' capital contributions and their shares in the ESOP Association

The management of Greenland Group invested 100,000 yuan to create Greenland Investment, a management company, with Yuliang Zhang, the chairman of Greenland Group, assigned as its legal representative. At that time, the core management of Greenland Group totaled 43 members. All members of the ESOP Association acted as limited partners (LP) and

Greenland Investment as general partners (GP), establishing 32 limited partnerships (hereinafter referred to as "small partnerships"): Shanghai Greenland No.1 Investment Management Center to Shanghai Greenland No.32 Investment Management Center (hereinafter referred to as "1-32 small partnerships"). Moreover, Greenland joined hands with the 32 small partnerships to fund the establishment of Shanghai Greenland—a limited partnership (hereinafter referred to as "grand partnership"). After the establishment of the grand partnership, Shanghai Greenland inherited all the assets, claims, liabilities and obligations of the ESOP Association by absorbing and merging it. The large and small partnerships and all their partners authorized Greenland to invest. Its Investment Management Committee was on full behalf of Greenland to participate in the formulation and implementation of specific capital operation schemes (listings) and undertake related work. As the ESOP Association was regulated, its shareholding structure in Greenland Group was outlined in Figure 5-10 below.

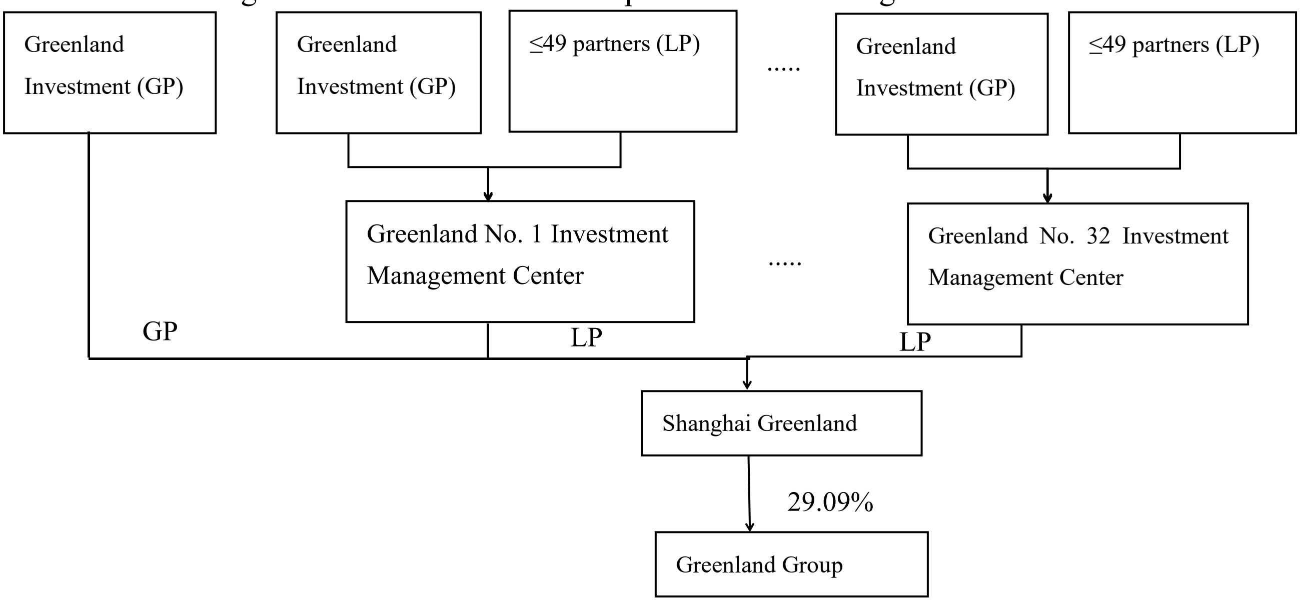

Figure 5-10 The shareholding structure of the ESOP Association in Greenland Group

(2) Attract strategic investment and optimize the equity structure to pave the way for going public

Before the reform of mixed ownership took off, Shanghai SASAC was the controlling shareholder of the joint stock company, locking 60% of Greenland Group's shares via Shanghai Real Estate Group and its wholly-owned subsidiaries. In early 2014, Greenland Group introduced strategic investors vigorously through the open market bidding mechanism. Five strategic investors, Ping An Ventures, Shanghai CDH Jiaxi Equity Investment Partnership, Ningbo Hui Sheng Juzhi Investment Partnership Enterprise, Zhuhai Providence Equity Investment Fund and Shanghai SDIC Xieli Equity Investment Fund Partnership, jointly invested 11.729 billion yuan in Greenland, holding 9.91%, 4.25%, 3.82%, 1.00% and 0.96% respectively. Together with 2.60% of other public shares, the total public shares of Greenland Group exceeded 20%. The proportion of state-owned shares represented by Shanghai Real Estate Group and Shanghai Municipal Investment (Group) Corporation decreased to 18.20% and 20.55%, and the proportion of the ESOP Association rose to 28.79% to make it a single major shareholder. Since then, Greenland Group has formally changed from a state-owned holding to a mixed ownership enterprise. Introducing investment has further consolidated the capital strength and diversified the ownership structure of Greenland, thus achieving mutual checks and balances among shareholders and exhibited a positive impact on improving the corporate governance structure and the operation effect.

Table 5-17 Changes to the equity structure of Greenland Group

Changes to the equity structure of Greenland Group			
Before the mixed reform (2013)		**After the mixed reform (introducing strategic investment and merging Shanghai Greenland)**	
Neway Group Holdings Limited	9.65%	Neway Group Holdings Limited	7.62%
Shanghai Real Estate Group	25.03%	Shanghai Real Estate Group	18.20%
Shanghai Tianchen Co., Ltd	2.89%	Shanghai Tianchen Co., Ltd	2.29%
Shanghai Municipal Investment (Group) Corporation	26.00%	Shanghai Municipal Investment (Group) Corporation	20.55%
ESOP Association	36.43%	Shanghai Greenland	28.79%
		Shanghai SDIC Xieli Equity Investment Fund Partnership	0.96%
		Zhuhai Providence Equity Investment Fund	1.00%
		Shanghai CDH Jiaxi Equity Investment Partnership	4.25%
		Ningbo Hui Sheng Juzhi Investment Partnership Enterprise	3.82%
		Ping An Ventures	9.91%
		Others	2.60%

(3) A reverse takeover of Jinfeng Investment to go public

The plan adopted by Greenland Group for backdoor listing was a combination of asset replacement and directional issuance of shares. Specific process was as follows:

Asset replacement was the first move. Shanghai Real Estate Group exchanged all assets and liabilities of Jinfeng Investment in equal value with its equity of Greenland Group. The proposed exchange-out assets of Jinfeng Investment were taken over by Shanghai Real Estate Group or other designated third parties. The assets were estimated at 2.213 billion yuan, which was 26 million yuan higher than the net asset value of the financial statements, representing an appreciation rate of 1.18%. Taking into account that Jinfeng Investment would pay 21 million yuan in dividends after December 31, 2013, the proposed exchange-out assets were adjusted to 2.192 billion yuan. The essence of the asset placement was equivalent to Jinfeng Investment's purchase of the shares of Greenland Group held by Shanghai Real Estate Group at 2.192 billion yuan. The payment method was the appraised value of the company's own net assets. At the end of the asset placement, Jinfeng Investment, a listed company, became a clean "shell" company, waiting for the placement of high-quality assets.

Issuing additional shares and purchase assets came as the second step. As soon as the asset placement was completed in Jinfeng Investment, it issued shares to all shareholders of Greenland Group to purchase their shares. Jinfeng proposed to buy in the 100% equity of Greenland Group estimated at 66.732 billion yuan and sell its own assets estimated at 2.192 billion yuan. The stock issue price was set at 5.54 yuan per share, and the number of private placement shares was 11.65 billion. The estimated value of the proposed exchange-in assets was 66.732 billion yuan, an increase of 24.655 billion yuan from the book value of the attributable equity in the statements, representing an appreciation rate of 58.60%.

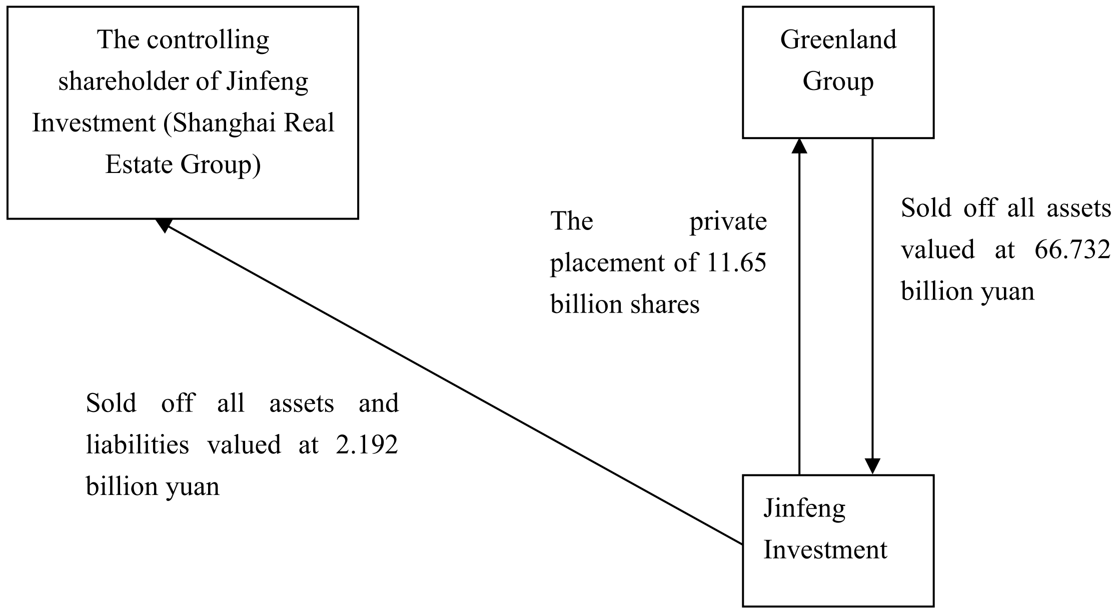

Figure 5-11 Transaction plan between Greenland Group and Jinfeng Investment

Greenland Holdings attained its wish of going public by backdoor listing after the restructuring in 2015. As the listing was done, Shanghai Greenland became its largest shareholder, and its two major state-owned shareholders—Shanghai Real Estate Group and Shanghai Municipal Investment (Group) Corporation—held no more than 30% of its shares and should not act as an independent controller of Greenland. There were no nominal controlling shareholders and actual controllers in the listed Greenland Group. State-owned shares dropped from 60.68% to 48.45%, and the SASAC was no longer the controlling shareholder of Greenland Group nor interfered in specific business activities. The business of Greenland was independent of the main shareholders, and no competition would exist between the company and its main shareholders in the same industry. In words, the overall listing of Greenland Group played a good demonstration role in reducing and eliminating the competition between listed companies and major shareholders in the same industry.

5.3.3 Changes to governance mechanism

5.3.3.1 Establish a modern enterprise management system

For long, state-owned enterprises were subject to the supervision and management of state-owned regulatory authorities to a large extent, run in a regulatory model of managing people, affairs and assets. The operation and major investment decisions of state-owned enterprises, the appointment of senior executives, and performance indicators were all deeply influenced by the SASAC. The state of mixing government with enterprise dampened the independent initiative of the enterprise and was not conducive to the enhancement of its comprehensive competitiveness. Before the mixed reform, Greenland Group followed this pattern. Through the mixed reform, state-owned shareholders were cut in their shareholding ratio and removed from business management, providing a relatively loose mechanism for Greenland Group's independent operation and development. To achieve more systematic and standardized business operations, the company has continuously improved its corporate governance structure after the mixed reform.

A modern corporate governance structure consists of the general meeting of shareholders, the board of directors, and the board of supervisors. Each performs its own functions: the general meeting of shareholders for the distribution of rights and interests, the directory board for development strategies, and the advisory committee for execution. To create a win-win situation in the distribution of benefits, Greenland Holdings has established a corporate governance structure with effective checks and balances and equal protection, a shareholder-board of directors-supervisory board-management structure, perfected the “three meetings and one layer” agency structure, and shaped a standardized governance structure. It has also fully realized mixed ownership via involving private companies in equity participation and going public, with its corporate governance consummated in the direction of mixed ownership. In Greenland Holdings, its general meeting of shareholders, board of directors, board of supervisors, and managers are independent of controlling shareholders.

(1) The newly established board of directors in Greenland consists of thirteen members, including five members appointed by the ESOP Association (including the chairman), four members appointed by Shanghai SASAC (vice-chairmen), three members recommended by social capital and two independent directors (independent directors later increase to five members and the board of directors to fifteen members). The board structure represents the different interests of state-owned capital, strategic investors, management and employees, featuring the checks and balances of power. Such a layout

ensures that a single stakeholder would not be able to directly control the board of directors, thus guaranteeing fair and just decision-makings by the board of directors and the interests of all board members to be reflected. Independent directors are put in place to play a supervisory role, and the division of labor between departments is made more reasonable.

Table 5-18 Changes to the Board of Directors in Greenland Group

Changes to the Board of Directors in Greenland Group					
2011			After the mixed reform		
Yuliang Zhang	ESOP Association	Chairman & President	Yuliang Zhang	ESOP Association	Chairman
Xiaoping Chen	Shanghai Real Estate Group	Vice Chairman	Xiaoping Chen	Shanghai Real Estate Group	Vice Chairman
Jiancheng Lu	Shanghai Municipal Investment (Group) Corporation	Vice Chairman	Jiancheng Lu	Shanghai Municipal Investment (Group) Corporation	Vice Chairman
Kemin Hu	Neway Group Holdings Limited	Vice Chairman	Xianqiang Zhou	Neway Group Holdings Limited	Vice Chairman
Xinshe Lu	ESOP Association	Director & Vice President	Chengli Song	Ping An Ventures	Director
Yun Zhang	ESOP Association	Director & Vice President	Jing Xu	ESOP Association	Director
Weidong Wu	ESOP Association	Director & Assistant to the President	Yun Zhang	ESOP Association	Director
Bo Tian	ESOP Association	Director	Jing Hu	ESOP Association	Director
Hongwen Lu	ESOP Association	Director	Bo Tian	ESOP Association	Director
Qiju He	Shanghai Real Estate Group	Director	Jialiang Wang	Shanghai Municipal Investment (Group) Corporation	Director
Qiang	Shanghai Municipal	Director	Qiju He	Shanghai Real Estate	Director

Wu	Investment (Group) Corporation			Group	
Xuyu Xu	Shanghai Tianchen Co., Ltd	Director	Xuyu Xu	Shanghai Tianchen Co., Ltd	Director
			Min Hua	Nominated by Shanghai SASAC	Independent Director

(2) The board of supervisors in Greenland has been enriched with the intervention of strategic investors. Five members in the initial stage (later increased to eight) involve in different business areas, including statistics, law, economy, finance, strategy and management—such breadth and depth is a shield for the operation and management of enterprises.

Table 5-19 Changes to the List of Board of Supervisors

Changes to the List of Board of Supervisors					
Before the reform			After the reform		
Jian Huang		Chairman of the Board of Supervisors	Kangwen Ji	Greenland Group Party Committee & Shanghai SASAC	Chairman of the Board of Supervisors
Lan Wang	Shanghai Municipal Investment (Group) Corporation	Non-Employee Supervisor	Daguang Chang	Shanghai Municipal Investment (Group) Corporation	Non-Employee Supervisor
Yan Zhang	Neway Group Holdings Limited	Non-Employee Supervisor	Yan Zhang	Neway Group Holdings Limited	Non-Employee Supervisor
Minkang Huang		Employee Supervisor	Shufeng Sun	Ping An Ventures	Non-Employee Supervisor

Jiayu Wu		Employee Supervisor	Wei Ying	Shanghai CDH Jiaxi Equity Investment Partnership	Non-Employee Supervisor
			Lijun Lin	Ningbo Hui Sheng Juzhi Investment Partnership Enterprise	Non-Employee Supervisor
			Minkang Huang		Employee Supervisor
			Jiayu Wu		Employee Supervisor

(3) The "Advisory Professional Committee", nominated by the board of directors and the board of supervisors, covers four professional directions: the Strategic Committee, the Audit Committee, the Nomination Committee and the Compensation and Assessment Committee. These special committees play an important role in the corporate governance structure. The "three meetings" serves to help managers make more scientific and efficient decisions, take advantage of state-owned capital (Shanghai Real Estate Group and Shanghai Municipal Investment (Group) Corporation declare to be both independent, to attend the shareholders' meeting of Greenland Group as financial investors, and will not substantively intervene in the group's management decisions), and at the same time avoid the disadvantages of state-owned capital in operation and management, enabling enterprises to take profit as the goal and the driving factor of enterprise development.

5.3.3.2 Changes to incentive mechanisms

Under the protection of the "three meetings", the management team, appointed by the board of directors and shareholders' meeting according to the

Company Law, cancelled the hierarchy system of state-owned enterprises right away to ensure a clearer platform for the execution of control rights. The "Compensation Proposal" was immediately adopted as personnel power was delegated. It evaluates the performance of the company according to the principle of objectivity, truthfulness, fairness and impartiality, and assesses individuals by focusing on the company's annual business plan and the completion of work/performance. This reflects "the consistency of responsibility and interests, the matching of ability and value, and the linkage between performance and earnings" and effectively exerts the incentive and restraint effect of performance compensation, thus establishing a flexible and effective personnel training and development mechanism for Greenland Holdings.

The operating incentive system of Greenland Group has been significantly improved after the mixed reform, in which the advantages of the integration and complementary hybridization of state-owned capital and private capital are reflected over time. In the past few years of focusing on promoting the mixed reform, the market-oriented mechanism, winning strong support from supervisors, has activated the role of incentives. Greenland Group is capable of making more accurate investment decisions, becomes more flexible in recruitment policies, more effective in implementing incentives and constraints, internal management and control, and embraces more transparent competitions for internal job opportunities. As to employment, the previously policy of re-employment at the administrative level was cancelled to emphasize the rule of replacing underperformers with able men, thus soothing and clearing channels for the promotion of ordinary employees. In terms of the incentive mechanisms, the basic salary and compensation system has been upgraded with emphasis on the increase of shareholding in the company's equity to the management and outstanding employees. In this way, the personal interests of employees and corporate benefits are closely tied, short-sighted behaviors among employees reduced, and the source of the company's sustainable development increased. Besides, the incentive mechanisms help to avoid the loss of core employees and backbone talents, provides a unique business model and intellectual support for the group to achieve strategic goals, and plays the role of cornerstone for the healthy and sustainable development of the company.

Table 5-20 Incentive measures for Greenland Group staff

General staff	Monetary	Monetary incentives mainly include basic salary, job-related allowances, monetary benefits, etc. They play an obvious role. For the performance appraisal of employees, to closely integrate monetary incentives with employees' work performance will produce lasting and effective motivation.
	Employee stock ownership	Employee stock ownership transforms corporate employees to corporate owners, and the spirit of ownership can stimulate work enthusiasm and improve performance.
	Promotion opportunities	Personal development and promotion opportunities provided by an enterprise are one of the most effective means of motivation and will greatly stimulate the morale of employees.
	Paid vacation	Paid leave can effectively enrich employees' spare time and improve job satisfaction. It is particularly attractive to employees and serves as a company's gratitude and feedback to employees.

	Recognition and appreciation	In actual management practice, it is found that recognition and appreciation can enhance personal honor, collective cohesion, and play an incentive role imperceptibly from a psychological perspective. It acts as an important means and method of rewards.
Management staff	Basic pay	Managers' requirements for basic compensation are basically the same as those of general staff.
	Long-term rewards	The main forms of long-term rewards include company stocks, stock options, etc. In general, managers have a greater impact on the company's operation and development, which is continuous and long-term. Compensation incentives for managers should focus on guiding their long-term behaviors and overcoming short- and medium-term behaviors, therefore ensuring the sustainable and healthy development of the group.
	Special benefits	Special benefits are benefits that can only be enjoyed by senior managers in certain positions. Such benefits are not fixed and may vary in different companies. They mainly include the provision of special vehicles, free tours, and welfare housing. Special benefits, of certain effective, can drive management staff to work hard.
	On-the-job consumption	The management staff generally holds certain positions within the group or organization, and involves on-the-job consumption to some extent. This type of consumption is mainly reflected in non-monetary consumption, including the provision of high-end offices, high-quality secretaries, free commercial travels, and the additional hiring of auxiliary staff. For certain, on-the-job consumption can improve the subjective initiative of managers, but it should also be controlled within a certain reasonable range to prevent excessive expenditure and drag down financial performance.

5.3.4 Analysis of restructuring benefits

To sum up, the mixed reform of Greenland Group has indeed boosted its financial performance and brought about interim results. Take the total asset. Greenland Group had a total asset of 360 billion in 2013, but it soared to over 800 billion in 2018. The overall strength of the company was substantially reinforced, and its profitability and development capabilities showed a significant improvement. Most of the indicators gradually went out of the low, and their later performance was better than the industry-related indicators in the same period.

5.3.4.1 Sustainability analysis

Development ability can be interpreted as the growth of a company in the future cycle, emphasizing development potential and stamina. Being an essential indicator to evaluate enterprise performance, it pays attention to the development potential of an enterprise to continuously accumulate capital, expand production and increase scale through daily production and operation activities. This paper screens out such indicators as the growth rate of total assets, the growth rate of fixed assets, and the growth rate of net profits to reflect the development capability of Greenland Group.

Table 5-21 Analysis of indicators for development capability (2012-2018)

The Development Capability of Greenland Group between 2012-2018			
Year	The Growth Rate of Net Profits	The Growth Rate of Total Assets	The Growth Rate of Fixed Assets
2012	8.11%	27.20%	-3.68%
2013	23.55%	54.01%	37.92%
2014	-35.02%	38.43%	26.81%
2015	36.74%	17.97%	27.56%
2016	21.54%	14.97%	7.40%
2017	25.40%	15.74%	36.86%
2018	25.86%	22.16%	27.81%

As shown in Table 5-21, leaving aside -35% in 2014, large fluctuations could be seen in the growth rate of net profits, which were mainly resulted from the shrinking of non-business sections. However, after the backdoor listing in 2015, the rate immediately jumped to 36.74%, and good performance was achieved from 2016 to 2018, in spite of adjustments in the overall real estate market. As the reform started in 2014, the introduction of external strategic investors as part of strategic capital resulted in a sharp decrease in the growth rate of total assets and the growth rate of fixed assets, but a good momentum of development was maintained after the mixed ownership reform. The total assets of Greenland Group in 2019 exceeded 1.04 trillion yuan to make it a carrier-class enterprise in the field of mixed ownership. In the face of macroeconomic and national macro regulations on real estate, it still maintained a continuous growth of about 20% and created huge absolute growth every year. It is true that the mixed ownership reform played a role in the sustained and stable development of Greenland.

5.3.4.2 Profitability analysis

The paper sorts out two indicators—return on total assets and return on net assets—to analyze the profitability of Greenland Group. The return on net assets is to measure the efficiency of a company's use of its own capital to obtain profits, reflecting the level of return on shareholder equity. The return on total assets fully reflects the role of all assets in the capture of profits, and determines whether a company can borrow. The indicator tells the development prospects and competitive advantages of a company.

As we can see from Tables 5-22 and 5-23 that the return on total assets and the return on net assets of Greenland Group declined in 2013 and reached the lowest level in 2014 but they gradually picked up again. This shows that Greenland Group has revamped the efficiency of capital utilization and corporate profitability through the mixed reforms. A look at Figures 5-12 and 5-13, we can tell that when Greenland Group started to carry out the mixed reform, there was a clear gap between its profitability indicators and the industry level, if compared with other businesses in the same industry. The indicators were improved significantly after Greenland was listed, with the return on net assets even exceeding the industry mean.

Table 5-22 Return on total assets of Greenland Holdings

ROA	2013	2014	2015	2016	2017	2018
Greenland Group	1.12%	2.10%	1.33%	1.41%	1.72%	1.70%
Vanke A-Share	4.27%	3.91%	4.46%	3.93%	3.73%	3.66%
Poly Real Estate	4.20%	4.19%	4.37%	3.92%	3.38%	3.39%

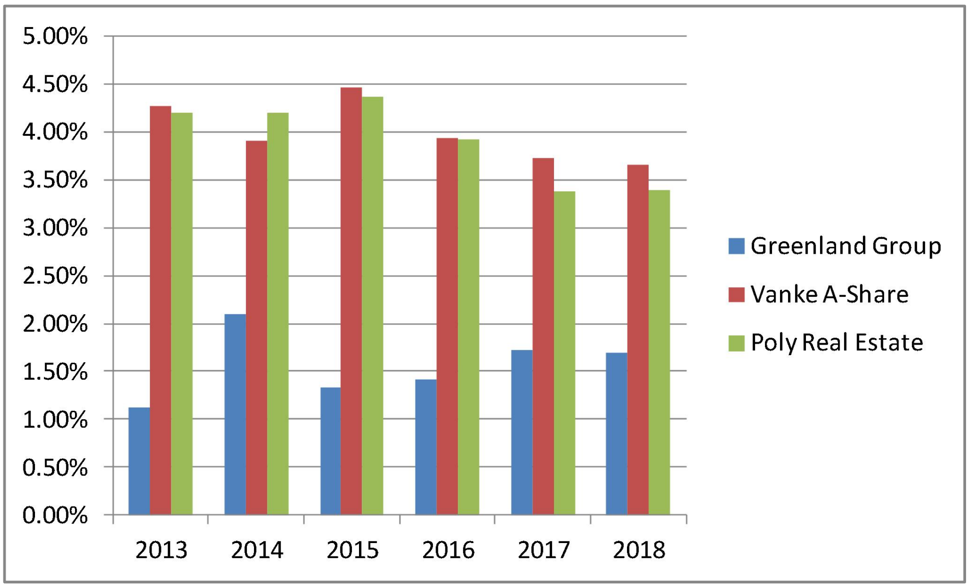

Figure 5-12 Return on total assets

Table 5-23 Return on net assets of Greenland Holdings

Return on net assets (weighted)	2013	2014	2015	2016	2017	2018
Greenland Holdings	28.24%	12.62%	14.12%	13.01%	15.21%	17.14%
Vanke A-Share	21.54%	19.17%	19.14%	19.68%	22.80%	23.24%
Poly Real Estate	22.95%	21.65%	18.63%	15.53%	16.34%	16.63%
Industry Average	10.21%	8.57%	4.26%	8.56%	9.64%	10.32%

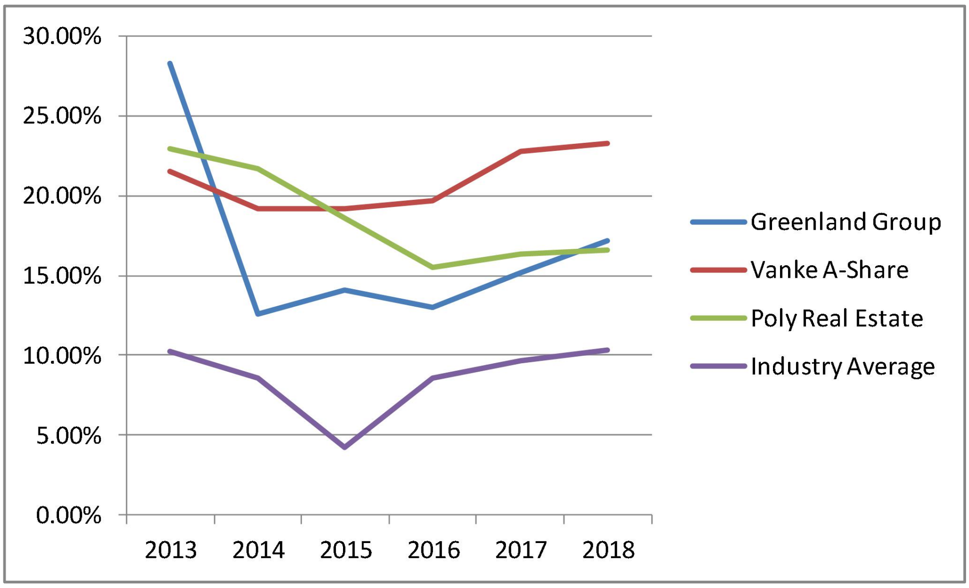

Figure 5-13 Analysis of return on net assets

5.3.4.3 Solvency analysis

Debt solvency exhibits an enterprise's ability to repay debts. Generally speaking, the better the solvency, the better the risk resistance capacity. This paper measures the solvency of Greenland Group with debt to asset ratio and quick ratio.

From Table 5-24 and Figure 5-14, it can be conceived that the debt to asset ratio of Greenland Group has always been kept at a relatively high value. This should be attributed to the nature of the industry in which Greenland Group is located. In the real estate industry, long project construction cycle and slow sales return put the debt to asset ratio at a generally high level. In the overall trend, Greenland's debt to asset ratio is in downward, while the industry average witnesses a slight increase. The contrast manifests that the mixed reform has brought positive effects and the debt to asset ratio has been improved.

Table 5-24 Debt to asset ratio

Debt to asset ratio	2013	2014	2015	2016	2017	2018
Greenland Holdings	88.75%	87.97%	88.04%	89.43%	88.99%	89.49%
Vanke A-Share	78.00%	77.20%	77.70%	80.54%	83.98%	84.59%
Poly Real Estate	77.97%	77.89%	75.95%	74.76%	77.33%	77.97%
Industry Average	74.05%	73.20%	75.00%	76.10%	78.30%	77.80%

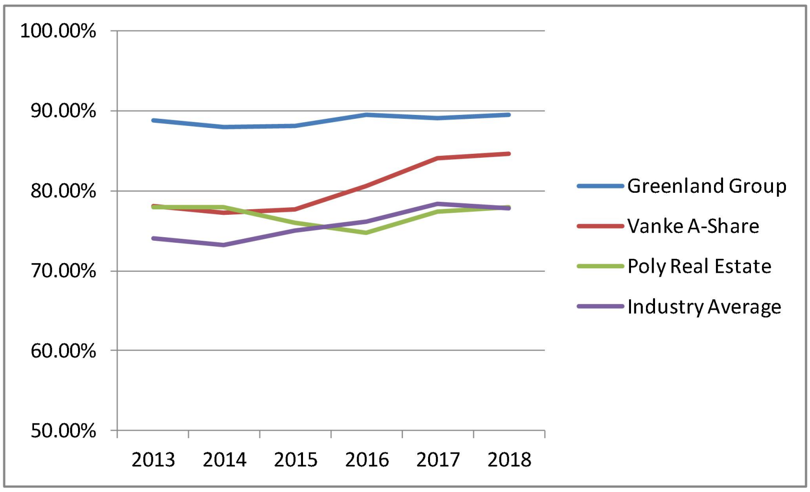

Figure 5-14 Debt to asset ratio

As illustrated in Table 5-25 and Figure 5-15, the quick ratio of Greenland Group is in an upward trend. Although it moves down after the mixed reform, the overall trend is better than that at the beginning of the reform. This is a sign of improved solvency in Greenland Group after the mixed reform. It can also be noticed that the industry average is relatively stable and sees small fluctuations. There is still a certain gap in the quick ratio between Greenland Group and the industry level but it reflects that Greenland's fluctuations in this indicator is not an industry factor, but more a result of the company's development.

Table 5-25 Quick ratio

Quick ratio	2013	2014	2015	2016	2017	2018
Greenland Holdings	0.34	0.38	0.41	0.4	0.43	0.44
Vanke A-Share	0.34	0.43	0.43	0.44	0.50	0.49
Poly Real Estate	0.38	0.45	0.43	0.53	0.57	0.66
Industry Average	0.50	0.54	0.52	0.55	0.49	0.53

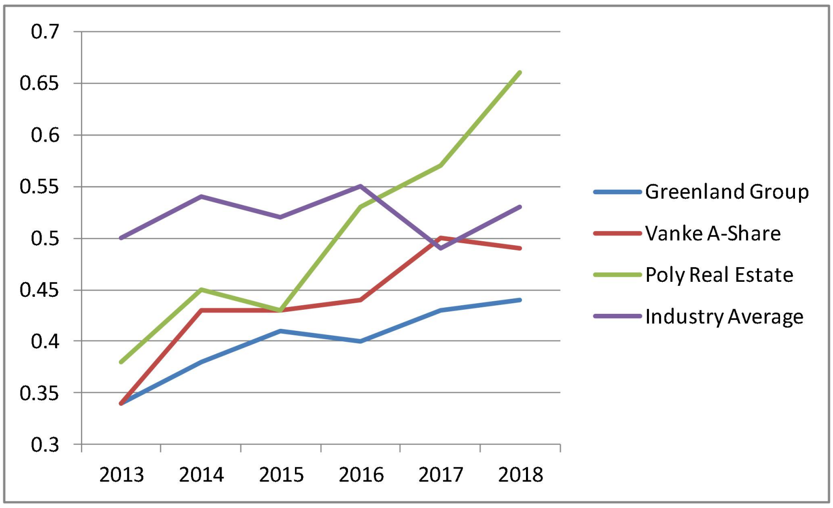

Figure 5-15 Quick ratio

5.3.4.4 Analysis of operational capability

Operational capability can be interpreted as the allocation and use efficiency of economic resources by an enterprise. Generally speaking, the higher the rate of asset turnover, the stronger the liquidity and the higher the efficiency of economic resource allocation. In other words, the company has sufficient funds for turnover and a good debt solvency. It also indicates that the company is able to bring growth in profits and value at a faster rate. In this sense, this paper measures the company's operational capability with total asset turnover, inventory turnover and accounts receivable turnover.

As detailed in Table 5-26, 5-27 and Figure 5-16, Greenland Holdings' total asset turnover, inventory turnover and accounts receivable turnover fell sharply from 2013 to 2015. The key reason should be Greenland's excessive pursuit of scale expansion, which led to a substantial increase in accounts receivable and inventory, followed by increasing asset scale. This implies deteriorating operational capability and asset utilization efficiency. As

Greenland completed the mixed reform in 2015, its total asset turnover stabled at 0.37 during 2016-2018, and the inventory turnover increased at a steady pace. It increased by 0.05 in 2018 from that in 2015. In addition, the accounts receivable turnover is in a relatively stable downward trend, but it has not been improved. The data point to the fact that Greenland's efficiency of asset utilization has declined, asset turnover slowed down, and operational capability impaired.

A comparative study also highlights the downward trend of Greenland Holdings' inventory turnover and total asset turnover before the mixed reform, as well as the industry average. However, the former saw a bigger decline, indicating weakening ability to operate and manage assets. After the mixed reform, the total asset turnover of Greenland stabilized at 0.37, which was higher than the industry average. Compared with the data before the reform, the ratio was actually a bigger drop due to Greenland's actively expanding its business after the reform. Its asset scaled up rapidly and the inventory turnover rebounded and rose year by year. At the same time, the inventory turnover rate of the real estate industry was mildly decreasing. The contrast proves that the mixed reform has been a positive impact on the inventory management level of Greenland and accelerated the inventory turnover. In view of accounts receivable turnover, the average value of the real estate industry is in a relatively stable state, contrasted by Greenland Group's data which went higher than the industry average in 2013 but dropped to be lower year by year. All the data pinpoint the fact that the scale and number of Greenland Group's projects during the mixed reform and listing further expanded, that the income realized by real estate business was not recovered quickly, which in return enlarged the scale of accounts receivable to a certain extent.

Table 5-26 Inventory turnover and total asset turnover

	2013	2014	2015	2016	2017	2018
Greenland Group Inventory Turnover Ratio	1.1	0.78	0.48	0.48	0.5	0.53
Industry Average Inventory Turnover Ratio	0.48	0.36	0.28	0.32	0.31	0.3
Greenland Group Total Asset Turnover Ratio	0.82	0.59	0.37	0.37	0.37	0.37
Industry Average Total Asset Turnover Ratio	0.27	0.25	0.23	0.24	0.23	0.24

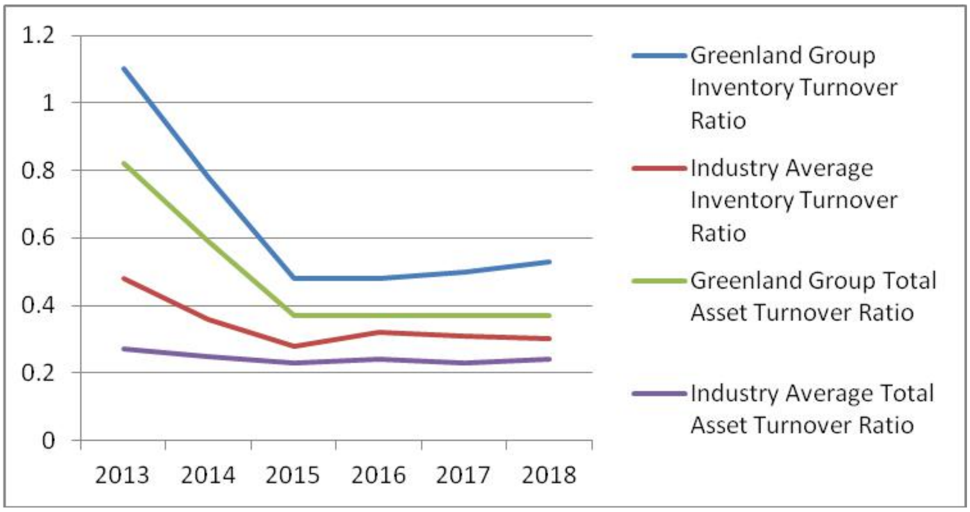

Figure 5-16 Inventory turnover and total asset turnover

Table 5-27 Accounts receivable turnover

Accounts receivable turnover	2013	2014	2015	2016	2017
Greenland Group	32	18.33	12.99	12.71	8.95

Average of Real Estate Industry	22.13	22.26	22.49	22.03	22.16

5.3.5 Conclusions and enlightenments

(1) To exploit the capital operation platform for listed companies, Greenland Holdings made rational use of its prime time to develop, adopted a comprehensive merger and reorganization plan that strengthened its core competitiveness, introduced PE strategic investors via restructuring the ESOP association to broaden financing channels, and relied on the capital market with the aim of fulfilling its strategic development goals. As a result, the business managers, also the enterprise's owners authorized by the board of directors, had their rights and interests protected and initiative stimulated.

(2) For the purpose of guarding the rights and interests of small and medium shareholders and strategic investors, and ensuring state-owned capital's right to speak for public and national interests, Greenland Holdings implemented a series of countermeasures: the seats on the directory board shall be allocated reasonably to guarantee effective decision-makings; one vote and special matters shall be established to protect the board of directors with regulations, to ensure that state-owned shareholders have the right to speak in certain specific matters.

(3) A complete performance appraisal system was set up after the reform to standardize Greenland's employee management. Considering the different backgrounds and mechanisms of the two companies before the merger, the compensation system and employee incentive mechanism were optimized to

cultivate and retain talents—this should be of great importance to the success of the mixed reform. In face of problems like difficulty in coordinating between the shareholding demands from the majority of employees and policy restrictions, limited liquidity of equity, low annual salary of employees, and the company's large asset stock, Greenland adopted certain measures that are of reference value. A portion of the excess performance was drawn as a cash incentive for employees not included in the ESOP plan, so that the company's equity structure would not be impacted and more employees would be able to enjoy the benefits of the reform. By communicating with and guiding employees, an open mechanism was emphasized, in which employees were granted access to shareholding if meeting standards. This would prevent employees from misinterpreting the mixed reform and hindering its progress.

(4) Furthermore, the greatest vitality of employee shareholding lies in tapping into employees' functioning in democratic management and supervision in the corporate governance structure, and refining the scientific nature of the governance structure. Once holding a certain amount of shares, employees are granted access to the shareholders' meeting as a shareholder and can fully exercise their own business decision-making power. The shareholding employee representatives on the board of supervisors can directly exercise the right to supervise the company's management. Employees can also be fully aware of company information. As they become a residual claimant, they will effectively supervise the activities of their agents

and reduce the commission-agent costs for the purpose of maximizing their own interests, thereby improving the corporate governance structure and making the company operate in an efficient manner.

As the largest state-owned real estate company in China, Greenland Holdings' success of being listed is a milestone for the continuous deepening of the reform of state-owned enterprises.

Chapter VI Suggestions and Prospects of Incentive Mechanism for the Mixed Reform of State-owned Enterprises

The mixed ownership reform is a foremost measure for China to deepen the reform of enterprises. Building an incentive mechanism that meets the needs of the mixed reform of state-owned enterprises is the key to improving the competitiveness of enterprises and stimulating long-term development. Grounded in the theories related to property rights, principal-agent and incentives, this paper views the incentive mechanisms of mixed-reformed enterprises as the objective of research and conducts a comparative examination of the incentive methodologies in the previous reforms of state-owned enterprises, especially the impact of the problems relevant with incentives faced by the current mixed ownership reform of state-owned enterprises. The author builds a basic theoretical and practical framework for incentives through analyzing the needs of executives, human nature assumptions and behaviors. For the analysis of core elements, this paper sees the optimal salary system as an entry point and compares key points like salary incentives, equity incentives, and spiritual incentives. As a supplement, it also tries to build a complete and practice-oriented incentive system against the background of the mixed property rights reform from the perspective of management systems with Chinese characteristics, including the governance structure of "three meetings and one layer", the disciplinary mechanism of party organization supervision, and the market-centered recruitment of managers.

6.1 Research conclusions and summary of innovations

6.1.1 Systemaltization of incentive elements in mixed reform enterprises

The mixed ownership reform of state-owned enterprises should be implemented from three incentives: institutional, economic, and social. The three incentives are interrelated and complementary to each other to form a complete incentive system. An effectual corporate governance system, a market-based hiring and exit mechanism, and a scientific performance salary system can give rise to efficient resource allocation. Not only are they institutional incentives, but they are a prerequisite for the implementation of economic and social incentives. Contracted salary incentives and the economic incentive system built on equity can meet primary economic needs, while diversified channels for career development and the platform sharing mechanism are the means to fulfill high-level social demands including social interaction, self-esteem, vocational development, and self-realization. From the different attributes of economic man, social man and moral man in state-owned enterprises, this paper discusses the necessity of constructing a multi-dimensional incentive system, which should meet the needs of enterprise reform and guarantee the practice of reform. Building an incentive system that sees a leap from form to contents for the governance structure of the mixed reform is the main contribution of this paper.

6.1.2 Systemaltization of Incentive Models for Executive Managers

As per the theories of principal-agent and key controller, reducing the cost of multi-level principal-agent in state-owned enterprises and establishing a relationship between government and enterprise with Chinese characteristics should be the core goals for this round of reform deepening. How to contractualize and institutionalize the incentive methods for executive managers as the actual controller and SASAC agent is the key point of research proposed by the author. Referring to the practice of quantitative analysis and case analysis, this paper further demonstrates the effectiveness of salary and equity incentives, and presents channels to optimize the incentive mechanisms for managers. First, a scientific institutional environment like market-based recruitment and channels for identity conversion can encourage managers to better perform their duties and meet their desire for vocational growth. Secondly, on the basis of transferring the status of executive managers of state-owned enterprises, the author brings forward the introduction of incentive contracts and policies regarding remuneration incentives and long-term incentives that are compatible with the competitive market environment through the establishment of contractual relationships to reduce administrative intervention, to implement rewards and punishments for managers as a respond to the actual situation of the company’s economic goals. Thirdly, in the case of restricted political promotion channels, platform and spiritual incentives come as an important supplement to all managers since they can satisfy the pursuit of career development and self-realization, and at the same time impose hard constraints from market regulations and soft constraints from a moral sense. These fully embody the principle of "from the market and to the market" for managers and can address their dual identity of "senior executives" and "senior officials"—the institutional conditions for stimulating and implementing efficiency in the mixed ownership reform. At the institutional level, this paper analyzes the incentive problems faced by managers in the mixed ownership reform, broadens traditional economic and social incentives, and extends the incentive paths for executive managers in state-owned enterprises to spur new thinking on their incentive models.

6.1.3 Optimization of governance mechanism for corporate benefits

In China's mixed ownership reform, "mixing" is the means to achieve the goal of "reform". In practice, equity adjustment is the method of reform and serves the ultimate goal of optimizing and upgrading corporate governance. In conformity with the theory of modern enterprise system, only by strengthening the modern enterprise mechanism and perfecting the corporate governance structure can the optimal allocation of enterprise resources be realized in the reform. Fundamentally, there must be three changes. The first is to change the management model and build a corresponding management mechanism that separates "managing assets" and "managing capital". In terms of management, the separation of government, enterprise, and capital, of asset management and operation functions are the basis for vitalizing capital participation and avoiding market risks. The second is to transform the function of supervision and strengthen management from the aspects of corporate performance appraisal and asset evaluation. Innovating supervision methods should be carried out from strengthening the rule of law and social supervision so as to avoid interference in the specific operations of enterprises, stimulate their creativity, and steer their market competitiveness. Following is changing the “old three meetings” in the corporate governance structure to the “new three meetings”, with particular focus given to strengthening the management functions of the board of directors during the reform process. Specific measures include: intensifying the independent selection of senior managers by the board of directors and effective incentives for them; clarifying the proportion of professional directors in the board of directors and a scientific voting mechanism; ensuring the effective participation of employee directors and independent supervisors. This paper can be viewed as an extension of theoretical and practical applications as it levels up research on shareholding system transformation from a mere formality to discussions on the optimization and upgrading of corporate governance after the mixed reform for the creation of a modern management system for state-owned enterprises with Chinese characteristics.

6.1.4 Specialization of discipline and constraint by party organizations

The author creatively puts forward the principle of compatibility between the core disciplinary and restraint functions of “party organizations” and the incentive mechanisms, straightens out the relationship between the party committee and the “old three meetings”, and initiates the concept of compatible “new three meetings”. Emphasis is given to the unity of grassroots and party organizations as we urge to effectively integrate the role of party organizations with the promotion of corporate cohesion and performance. New models of party building that adapt to new situations have also been explored. First, we may start with exploring the leadership system for party building in mixed-ownership enterprises, establish a two-way entry and cross-holding leadership system, optimize the work pattern of party organizations, improve the effectiveness of decision-makings, and define responsible persons. Second, the focus of the party committee’s work should be determined. The party committee should implement ideological and political education on corporate executives from the source and fulfill supervision and management to eliminate corporate corruption. Third, we should organically blend the promotion of party building at grassroots level with ideological and ethical work in an enterprise and the construction of their corporate culture, so as to create new blood for party building work in the new era. Combining the mechanism of punishment and restraint with the aforementioned incentives, this paper asserts that the “incentive and restraint” mechanism is the most eye-catching innovation in researching the performance of state-owned enterprise reforms, also a major measure to adapt to the socialist system with Chinese characteristics.

6.2 Suggestions for improvement of performance mechanisms

6.2.1 The paths of incremental equity and inventory equity determine the efficiency of reform

The reform model of incremental property rights is also called the model of attracting or increasing capital to expand shares. Its main methods include employee shareholding, the introduction of external strategic partners, the creation of a new ownership structure, and diversificating subsidiaries. The restructuring of Yunnan Baiyao is a typical example of incremental equity, which can be convenience to the later stage of core asset divestiture, equity restructuring and listing, the introduction of private capital, and the institutionalization of stock options. The reform model of inventory equity involves complex personnel relations in original state-owned enterprises and a group of administratively appointed managers. How to realize the transformation of identity is a big problem in the reform. For enterprises of newly established mixed-ownership, the “incremental” reform allows the market-based recruitment of managers, which serves as the key to ensuring the effectiveness of the incentive mechanisms. In addition, in Yunnan Baiyao, the entering of private enterprise entrepreneurs into the management team laid the foundation for activating its subjective initiative and implementing market-oriented strategies as well as reflected the effect of incremental restructuring. Studies have shown that the “incremental” reform is mostly about the establishment of new enterprises with different investors, in which the realization of the reform becomes relatively easy and more efficient. However, the “inventory” style requires the adjustments of the existing interest structure, which are usually difficult to be fulfilled. With “increment” in original company capital, state-owned enterprises can achieve restructuring with the assistance of capital increase and share expansion. And the entry of foreign capital can enable the rapid expansion of the original enterprise to fill up capital and build up an innovative development model in a short period of time.

Therefore, increasing capital and shares should be a creative breakthrough in the mixed ownership reform. Pushing the reform of state-owned enterprises through the incremental model will help grow corporate capital (to make a larger company) and enhance corporate vitality (to make a stronger company). In particular, it can effectively promote the governance efficiency of state-owned enterprises during the mixed ownership and formulate a win-win situation.

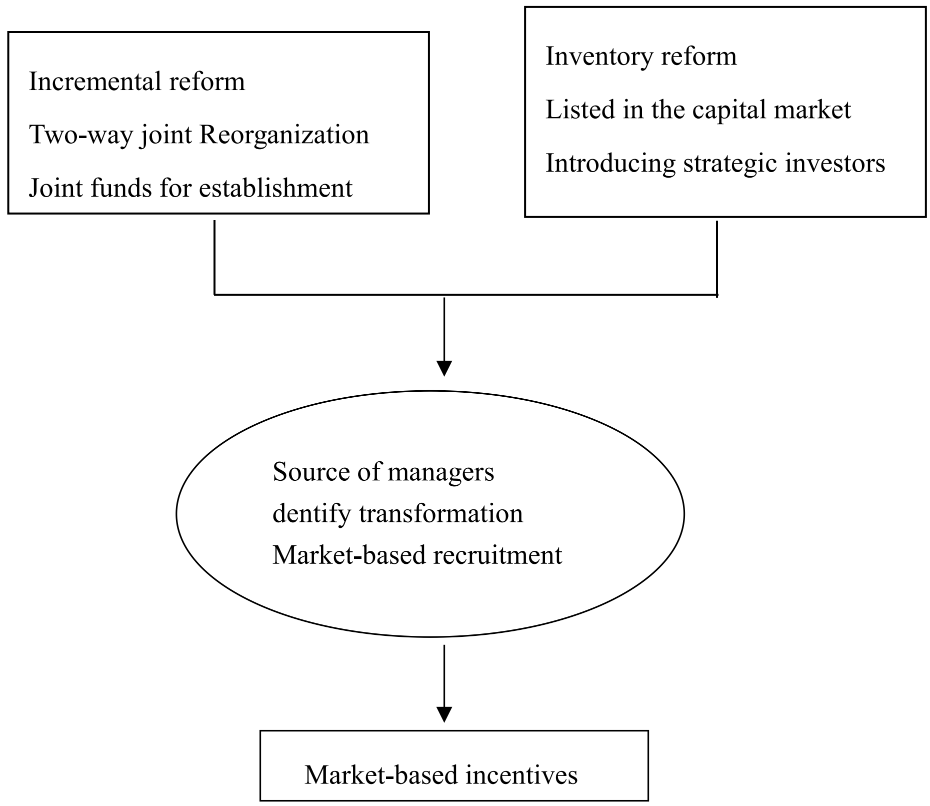

Figure 6-1 Sources of managers in the mixed ownership reform of competitive state-owned enterprises

6.2.2 Virtual equity: a golden handcuff for enterprises to achieve long-term incentives

The author compared the top 500 companies across the world and found that the equity incentives for executives accounted for more than 80% of their total income. It can be interpreted that equity incentives have become a common mode to motivate company performance. However, to avoid “inside control”, the SASAC and the China Securities Regulatory Commission have made clear restrictions on the total amount and individual amount of equity incentives for state-owned enterprise executives. The total amount of equity incentives must not exceed 10% of the total equity and personal equity incentives no more than the limit of 1% of a company's total equity. Besides, the proportion of equity incentives shall be within 30% of its total compensation level (including expected options or equity returns). The "red line setting" fails to reflect the human capital value of executives and severely restricts the release of productivity.

In respect of the substantial equity issues related to the restructuring of state-owned enterprises, the author recommends the incentive model of virtual equity to be extensively used, the greatest value of which lies in mobilizing the enthusiasm of managers to fight for long-term corporate development. It is a simple, easy and effective strategy to retain excellent managers for enterprises. Driven by the model of virtual equity, senior managers can enjoy certain dividends and the rights of share price appreciation, but the state-owned holding status will not be diluted nor the equity structure impaired. Meanwhile, immediate right to earnings will become effective incentives for managers, which will impact current corporate profits—this is particularly prominent for the restructuring of state-owned enterprises from competitive industries. Take Greenland Group. As the real estate industry was put in the environment of fully open market competition, the employee stock ownership meeting could only reflect the sense of responsibility as senior management as no large percentage of increase was seen in annualized income. The "virtual equity" outside of equity incentives, namely benefit commission, covered all employees and witnessed the effect of immediate rewards. Considered as strong motivation, virtual equity was the source of 30% growth in corporate benefits for 7 consecutive years. The incentive of virtual equity is a golden handcuff yet the necessary means to attract outstanding talents. It can well circumvent the red line setting of the supervisory level (state-owned assets preservation) and benefit employees on the basis of asset increments. For companies from an industry in its mature competition, it should be a long-term mechanism.

6.2.3 Status conversion to private enterprises: an effective channel for job transfer and a more appealing incentive than retention in state-owned enterprises

There are three channels for executive transfer to fit in the mixed ownership reform of state-owned enterprises. One is the transfer of former state-owned enterprise managers appointed by administration through tenure. One is the market-based recruitment and hiring of external professional managers. The other is to transfer the identity of private entrepreneurs. The former chairman of Yunnan Baiyao resigned from the company together with the political position as a provincial party committee member as recognition of the restructuring and transfer mechanism. He was then rehired based on a market-oriented identity and appointed as the new president of Yunnan Baiyao by the board of directors. Such standard corporate governance mechanism guarantees the president’s personnel rights and realizes the effective decentralization of management rights. The market-based hiring mechanism, in line with enterprise performance, encourages senior management to create value unanimously.

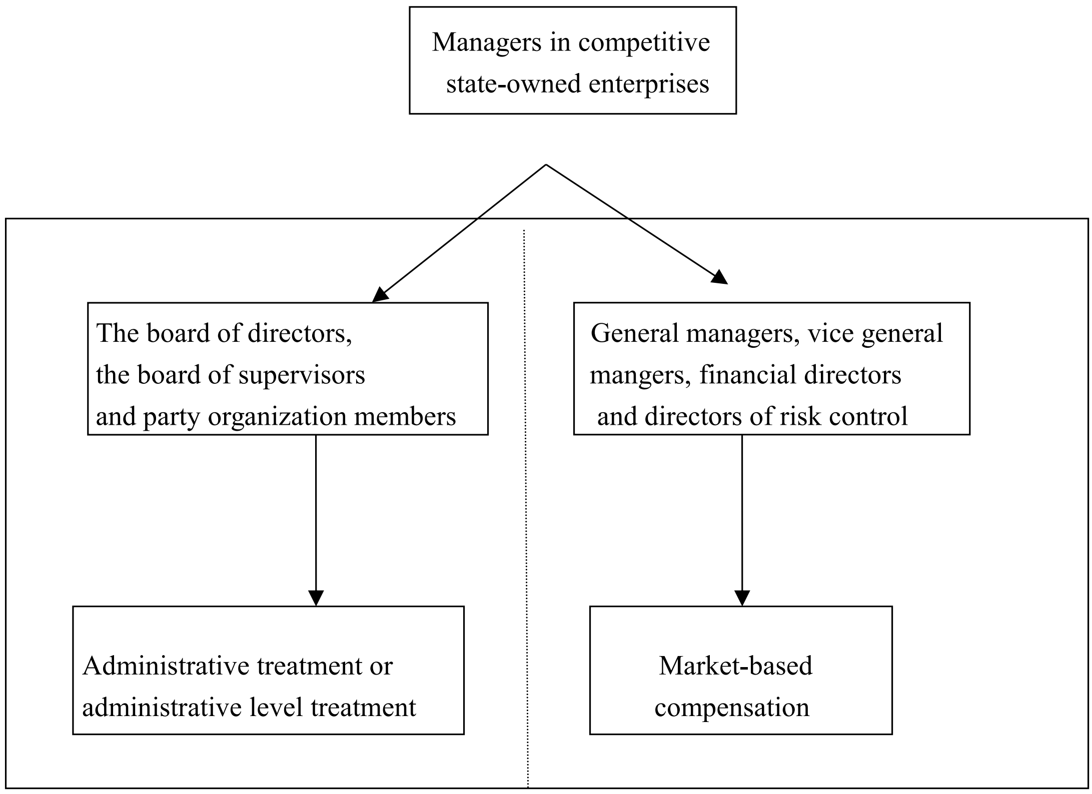

Figure 6-2 Methods for manager identity transfer in competitive state-owned enterprises

6.2.4 Partner sharing mechanism: a more effective incentive than performance distribution

The partnership system breaks the original employment relationship and turns the management into the owner of an enterprise and professional managers into the masters, allowing employees to share the wealth brought about by corporate development. Its distinctive feature resides in the joint contribution of capital and joint operation by partners, the sharing of profits and risks. The mixed ownership reform of state-owned enterprises must bring changes to talent management, redefine the ties between managers and their employers, and treat employees as the “partners of human capital”. There are two options in the organizational structure for the mixed ownership reform of state-owned enterprises: functional and departmental. Mingfu Wang from Hejun Consulting argues that process and control-oriented organizations are dying, while platform-oriented and ecological organizations are emerging. Companies with rigorous processes and run in an orderly and step-by-step procedure are losing their ability to respond quickly. Companies that grow brutally and flexibly and grant talents with enough space to fight for their own interests may win big in chaos. The organizational structure of the business department should encourage managers to display their talents on their career platform, to break away from the ineffective division of labor order and process system, as well as provide them with greater scope of management and powers to maximize their efforts and input. This will be the most effective and productive organizational structure. Besides, all functional activities can be integrated and corporate activities turned into self-managed businesses. They should let talents rush for a blooming life (Wang Mingfu). Meanwhile, given the nature of state-owned enterprises, the business partner sharing system in the course of the mixed reform should not be limited to benefit sharing that covers the sharing of corporate vision, strategic goals and corporate culture, so as to stimulate their internal entrepreneurial dreams.

The modern enterprise system calls for the invention of a sound corporate governance structure, the reasonable set-up of functional departments and management positions, and the clear definition of responsibilities and rights among shareholders, the board of directors and managers. At the right time, it may involve the choosing of new organizational structure models like flat organizations, innovative teams, enterprise alliances, and virtual enterprises to perform decentralized management, human-oriented management and flexible management within the enterprise. Innovations in organizational structure are a realistic demand by the mixed ownership reform and the functioning of incentive mechanisms. Organizational innovation like the partnership system can offer employees a diversified development platform and will inevitably bring about innovative changes to management and mechanism, which is the core of the reform.

6.3 Insufficiency of research and prospects

6.3.1 Insufficiency of research

(1) Due to the diversity of state-owned enterprises, it will be difficult to conduct a holistic research on the reform of China's state-owned enterprises as a whole. This paper attempts to discuss the incentive mechanisms for the mixed ownership reform and explore those that are compatible with the current situation, yet to digs deeper into the incentives for other types of reforms.

(2) The author builds a relatively complete incentive mechanism from

institutional incentives, economic incentives and social incentives, but discussions on incentive elements are not thorough enough. As a main method in Western incentive theories that aim to solve agency and control, equity incentives shape a relatively large system. This paper, however, only puts forward a general framework with targeted opinions.

6.3.2 Theoretical prospects

Since the Third Plenary Session of the Eighteenth Central Committee of the Communist Party of China, the mixed ownership reform of state-owned enterprises has become a hotspot yet challenging topic in the theoretical and business circles. As the mixed ownership reform gradually advances and deepens, discussions on performance incentives will move to a more detailed micro-level.

(1) The reform of state-owned enterprises proposes to explore various employee stock ownership plans. Being an important measure for the mixed ownership reform of state-owned enterprises, executive equity incentives and employee stock ownership plans will become a significant strategy to retain talents. In the future, research on equity incentives can be conducted from the aspects of executive shareholding plans and employee shareholding plans, with emphasis on the analysis of effective paths and methods for equity incentives and employee shareholding in the mixed ownership reform, so as to further improve the theories of incentives.

(2) Since the mixed ownership reform was proposed not long ago, the

cases available for research are limited. Even many state-owned enterprises are still in their exploration stage of reform. As the mixed ownership reform deepens, the implementation effect of corresponding incentive mechanisms can be examined to further study the relationship between company performance and institutional, economic and social incentives.

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