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Behind the Numbers: State Capitalism and Executive Compensation in China

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**Behind the Numbers:
State Capitalism and Executive Compensation in China**

Li-Wen Lin*

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Abstract

The rapid rise of Chinese companies in the global economy has attracted great scholarly attention to Chinese corporate governance. Among the various areas of Chinese corporate governance, executive compensation is an important yet difficult part to research. The common research method of Chinese executive pay literature relies on pay figures disclosed in listed companies' annual reports and tends to take the disclosed numbers at face value. This Article discusses three informal pay practices that constrain the usefulness and reliability of executive pay data formally disclosed in annual reports of Chinese listed companies, especially those owned by the state. A valid reading of formal pay figures entails an understanding of the network structure and the political environment in which Chinese companies operate. An investigation of the practices behind formal compensation numbers sheds light on many issues for scholars and policymakers, the salience of which escalates as the international interaction with Chinese companies expands. For example, it stresses the important role of political institutions in shaping executive compensation; it raises questions about the extent to which international cross-listing improves transparency of Chinese companies; it critically evaluates whether China's latest reform policy deals with the real problems of its state-owned enterprises; it spotlights the lacuna of extant scholarship on Chinese executive compensation.

Keywords: executive pay, state-owned enterprise, business group, disclosure

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Introduction

China now ranks second behind the United States in number of the world's largest 2,000 public corporations on the *Forbes* list.¹ The rapid rise of Chinese companies in the global economy has drawn great scholarly attention to Chinese corporate governance. Scholars of comparative corporate governance however often observe significant limits of using standard theories or Western experience to understand Chinese companies. Among the various areas of Chinese corporate governance, executive compensation is an important yet difficult part to research. As the *Economist* aptly noted years ago, "How executives are rewarded is one of the many mysteries of China's increasingly powerful companies. Unravelling it is important, not least because it should help to explain corporate China's transformation from a state-controlled to a consumer-driven creature."²

In the past decade a growing body of literature has tried to bring Chinese executive pay practices to light. Most studies of Chinese executive pay follow the conventional approach of Western compensation literature: taking the publicly-listed firm as the unit of observation, focusing on the listed firm's pay figures disclosed in the annual report, and regressing the dependent variable of the disclosed pay amount on a set of independent variables such as revenues, profits, ownership type, etc.³ This typical approach produces useful insights, to be sure, yet it is an under-contextualized approach to studying Chinese companies, particularly the state-controlled firms. It overlooks the fact that a Chinese listed firm often is a member of a corporate group in which there are frequent intra-group transactions and personnel overlaps among

¹ The Forbes Global 2000 is an annual ranking of the world's top 2,000 public companies by Forbes Magazine. The ranking is based on a combination of four metrics: sales, profit, assets and market value. In 2016, the U.S. leads the list with 579 companies, followed by China (mainland and Hong Kong) with 232. Chinese companies own the top four spots and split the top ten spots with U.S companies. For the full list, see <http://www.forbes.com/global2000/list/#tab:overall>.

² *Executive Compensation in China: False Options*, THE ECONOMIST, September 4, 2008 <http://www.economist.com/node/12070705>.

³ See Section II for the review of this empirical literature.

member companies. The incentive systems of group-affiliated firms may be different from those of typical stand-alone firms considered in the Western executive pay literature.⁴ Moreover, this common approach relying on corporate annual reports assumes that China has effective enforcement of securities regulations and Chinese companies have a culture of compliance and truthful disclosure. This assumption should be accepted with caution. Chinese public companies and even the government itself have a notorious reputation of data manipulation.⁵ Big accounting firms in China have been embroiled in the scandals of accounting frauds.⁶ As Professor Donald Clarke notes, “the reality of corporate governance practices in China remains very different from what appears in the statute books, and indeed so opaque that it is difficult to measure reliably where it is, let alone in what direction it is moving.”⁷ It suggests nontrivial limits of using the standard methodology to capture the true picture of executive compensation in China.

This Article focuses on three common practices that constrain the usefulness and reliability of executive pay data disclosed in Chinese listed companies’ annual reports: on-duty consumption, zero compensation, and nominal *versus* actual pay. In particular, this Article collects data to show the striking yet overlooked zero-pay puzzle presented in Chinese listed companies’ annual reports, where a considerably large proportion of board members of Chinese

⁴ For literature on Chinese corporate groups showing how group affiliation affects affiliated firm’s financial performance and behavior, see Lisa Keister, CHINESE BUSINESS GROUPS: THE STRUCTURE AND IMPACT OF INTERFIRM RELATIONS DURING ECONOMIC DEVELOPMENT (2000); Michael Carney et al., *Business Group Performance in China: Ownership and Temporal Considerations*, 5 MGMT.& ORG. REV. 167 (2009).

⁵ Nina Xiang, *Accounting Fraud Is Still Widespread Among Chinese Companies*, FORBES, April 16, 2014, <http://www.forbes.com/sites/ninaxiang/2014/04/16/accounting-fraud-is-still-widespread-among-chinese-companies/#2eb89f88723e>. After China Fraud Boom, Nasdaq Steps Up Scrutiny Of Shady Listings, MARKET WATCH, June 20, 2016 (reporting that “more than 50 U.S. listed Chinese companies were either delisted or halted from trading in 2011 and 2012 based on claims of fraud and other violations of U.S. securities laws”). *Whether to Believe China’s GDP Figures*, THE ECONOMIST, July 15, 2015, <http://www.economist.com/blogs/freeexchange/2015/07/chinese-economy>; Johnathan Chew, *China Officials Admit They Fake Economic Figures*, FORTUNE Dec. 14, 2015, <http://fortune.com/2015/12/14/china-fake-economic-data/>.

⁶ Securities and Exchange Commission (SEC), *SEC Imposes Sanctions Against China-Based Members of Big Four Accounting Networks for Refusing to Produce Documents*, press release of Feb. 6, 2015, <https://www.sec.gov/news/pressrelease/2015-25.html>.

⁷ Donald Clarke, “Nothing but WIND”?: *The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75, 101-02 (2010).

listed firms are reported to earn no compensation paid by the listed companies that they serve. To the best of author's knowledge, this is the first systematic analysis of the zero-pay puzzle in extant scholarship. These three compensation practices lurking behind the formal numbers must be understood against a backdrop of regulatory slacks and corporate group structures being used to support the interests of the Chinese state-owner. China's current securities regulations give listed companies freedom to mystify their top management compensation practices through the pervasive personnel linkages in a corporate group; and the mystification particularly serves the interests of the state-owner, who have been unwilling to relinquish control over the personnel of state-owned enterprises (SOEs).

These three compensation practices raise concerns about data comparability and reliability of Chinese listed companies' annual reports. As shown in this Article, the data problems are not alleviated by cross-listing in better disclosure regimes such as the stock exchanges of the United States and Hong Kong. These informal pay practices also raise questions about whether executives of China's listed firms are capable to discharge their fiduciary duties to the listed firms they serve.

Furthermore, observing the pay practices behind the formal numbers published in corporate annual reports offers a nuanced view on the perennial scholarly debate about the trajectory of national corporate governance systems in the age of globalization. It suggests that politics play an important role in the formal rules and actual practices of executive compensation. It also offers an insightful perspective to evaluate China's recent SOE reform agenda.

In China, the term "executives" or "top managers" (*gaoguan*) usually includes directors, supervisors, the general manager (CEO), deputy general managers (vice CEOs), the financial officer, the corporate secretary and others described in the articles of incorporation. This

common usage considers the fact that directors and supervisors are usually corporate senior managers.⁸ To be consistent with China's common usage, "executive compensation" referred in this Article includes compensation for directors, supervisors, and other top managers.

This Article is organized as follows. Section I will set out the existing regulatory framework of executive compensation China. It helps explain how the formal regulatory rules make the mystification of executive pay possible. Section II will review existing scholarly studies of Chinese executive compensation to show what sorts of pay information are typically examined in existing literature. Section III will discuss three informal pay practices that render compensation information disclosed in the corporate annual report significantly incomplete or misleading. Finally, Section IV discusses theoretical and policy implications as well as questions for future research.

I. The Formal Rules of Executive Compensation

Executive compensation in China is regulated by four legal sources: the company law, securities regulations for listed companies, special rules for financial institutions and rules for state-controlled firms. An overview of the legal sources provides a backdrop to understand how actual compensation practices deviate from the formal rules and how the formal rules play a role in concealing actual practices.

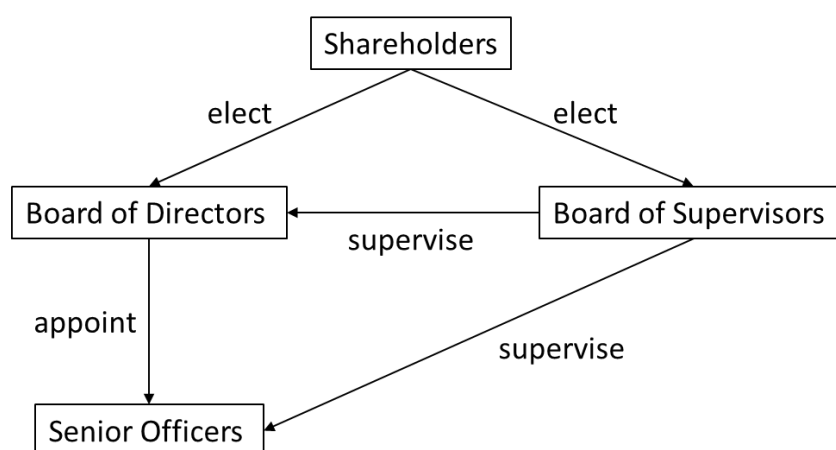
A. The Company Law

China's 2006 Company Law is the fundamental legal source of Chinese corporate governance. A major governance feature under China's corporate law is the dual board structure, which consists of the board of directors and the board of supervisors. Figure 1 below shows the

⁸ Lin Lin, *Regulating Executive Compensation in China: Problems and Solutions*, 32 J. L. & COMM. 207, 212 (adopting the same definition of "executives" in the Chinese context).

governance structure under China's corporate law. The function of the board of directors is similar to the board in the Anglo-American corporate system. The board of directors is responsible for managing the corporation's business and affairs, including the appointment of senior officers and the determination of their compensation. The board of supervisors is responsible for supervising directors and senior officers in performing their duties. Both boards are elected by shareholders, who are entitled to receive periodic disclosure of executive compensation paid by the company and have the authority to approve the compensation of directors and supervisors at the general shareholder meeting.⁹

Figure 1. Governance Structure under China's Company Law



B. Securities Regulations for Listed Companies

The China Securities and Regulatory Commission (CSRC) is the main government agency overseeing listed companies in China. CSRC's Code of Corporate Governance for Listed Companies (2002) suggests that a listed company may establish the compensation committee to study and review the company's remuneration policies for directors and senior officers.¹⁰ It also suggests that the board of directors should disclose compensation information to shareholders.

⁹ The Company Act of China (2006), §§ 38 & 47.

¹⁰ The Company Act of China (2006), §§ 52 & 56; Code of Corporate Governance for Listed Companies in China, (Zhengjianfa No.1 of 2002), available at http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69223.html.

While in the early 1990s China's securities regulations already required listed companies to disclose executive compensation in their annual reports, most listed companies in fact did not comply with the rules.¹¹ In 1999, CSRC promulgated a new rule which required the listed company to disclose in its annual report the lump sum of compensation paid to its directors, supervisors and senior officers; and the company was required to list all the directors, supervisors and senior officers who did not receive compensation from the company.¹² While this disclosure rule had no compliance problems, the lump sum approach provided very limited information to understand each individual executive's compensation.

The compensation disclosure rules were amended in 2001.¹³ The 2001 amendment required disclosure of executive pay policies. Moreover, instead of lumping directors', supervisors' and senior officers' compensation all altogether, the rules required the listed company to disclose the sum of the top three paid directors and the sum of the top three paid officers respectively. Independent directors' compensation should be disclosed on an individual basis. The listed company was required to list executives who did not receive any compensation from the company and indicated whether or not they received any pay from its shareholders or subsidiaries. This disclosure rule implied that top managers were allowed to be paid by the listed company's shareholders or affiliates rather than by the listed company itself. Yet how much compensation paid by the listed company's affiliates was not subject to disclosure.

¹¹ Gupiao Faxing yu Jiaoyi Guanli Zanzheng Tiaoli [Provisional Administrative Regulations on Stock Issuance and Trading] (1993), §59.

¹² Gongkai Faxing Gupiao Gongsi Xinxi Pilu de Neirong yu Geshi Zhunze Dierhao <Niandu Baogao de Neirong yu Geshi> [Public Companies' Disclosure Content and Format Rules No. 2 <Content and Format of Annual Reports>] (1999).

¹³ Gongkai Faxing Gupiao Gongsi Xinxi Pilu de Neirong yu Geshi Zhunze Dierhao <Niandu Baogao de Neirong yu Geshi> [Public Companies' Disclosure Content and Format Rules No. 2 <Content and Format of Annual Reports>] (2001) § 26.

In 2005, CSRC amended the disclosure rules resulting in mandatory disclosure of each executive's compensation.¹⁴ The disclosure scheme included two parts: the total compensation and the current equity holdings. The total compensation is the sum of base salary, bonuses, subsidies, employee benefits, insurance and other forms of compensation paid by the company. The rules maintained the position that the listed company should list executives who did not receive any pay from the company and should indicate whether or not they received compensation from the company's shareholders or subsidiaries. Still, how much compensation paid by the company's affiliates remained undisclosed. The most current disclosure rules (released in 2016) are virtually the same as the rules of 2005.¹⁵

C. Rules for Financial Institutions

In the aftermath of the 2008 global financial crisis, the Chinese government tightened its control over executive compensation of the financial sector, which has been dominated by SOEs. In 2009, the Ministry of Finance placed an annual pay cap at RMB 2.8 million (approximately \$410 thousand in USD)¹⁶ for executives at state-controlled financial institutions; moreover, it promulgated rules to strengthen the link between pay and performance. The China Banking Regulatory Commission (CBRC) also published guidelines to regulate executive pay practices of China's financial institutions (including policy banks, commercial banks, financial assets management companies, financial cooperatives, and finance companies, etc.), whether state-

¹⁴Gongkai Faxing Gupiao Gongsi Xinxi Pilu de Neirong yu Geshi Zhunze Dierhao <Niandu Baogao de Neirong yu Geshi> [Public Companies' Disclosure Content and Format Rules No. 2 <Content and Format of Annual Reports>] (2005) § 26.

¹⁵Gongkai Faxing Gupiao Gongsi Xinxi Pilu de Neirong yu Geshi Zhunze Dierhao <Niandu Baogao de Neirong yu Geshi> [Public Companies' Disclosure Content and Format Rules No. 2 <Content and Format of Annual Reports>] (2016) §53, available at <http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/xxpl/xxplnr/201701/P020170111425807651253.pdf>.

¹⁶The official historical average exchange rate of USD to Renminbi for the year of 2009 is 1:6.831.

owned or not.¹⁷ According to the guidelines, the structure of executive compensation should include fixed salary, variable pay (i.e., performance-oriented compensation and short-term and long-term incentives) and benefits (e.g. housing subsidies). The guidelines set out details of executive compensation management. For instance, the base salary should be no more than 35% of the total compensation and 40% of performance bonus should be paid on a deferral basis with the deferral period not less than three years. Financial institutions that fail to comply with the guidelines would be subject to sanctions imposed by CBRC.

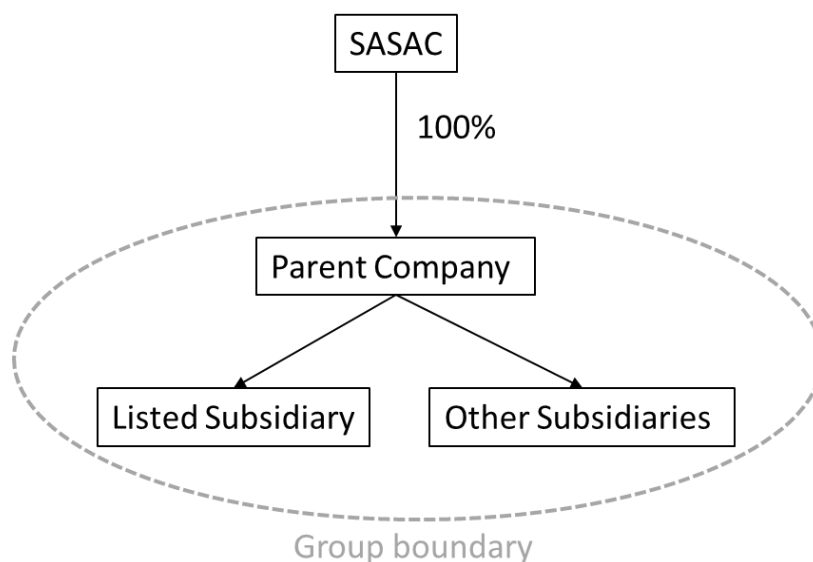
D. Rules for Non-Financial SOEs

At present, China's largest non-financial SOEs are controlled by the central or local government's ownership agency, known as the State-Owned Assets Supervision and Administration Commission (SASAC). The large non-financial SOEs under SASAC's control are typically organized as vertically-integrated business groups. Figure 2 illustrates the organizational structure of a typical business group under SASAC's control.¹⁸ The parent company typically is 100 per cent owned by SASAC. Beneath the parent company are a large number of subsidiaries including listed firms, finance companies, research institutes and many other related firms along the production chain. Often there are frequent business transactions and personnel overlaps among member firms in a group.

¹⁷ Shangye Yinhang Wenjian Xinchou Jianguan Zhiyin [Supervision Guidelines on Healthy Compensation of Commercial Banks], CBRC [2010] No. 14 (Feb. 21, 2010).

¹⁸ For a detailed discussion on the organization and governance of the business groups under SASAC's control, see Li-Wen Lin and Curtis J. Milhaupt, *We are the (National Champions): Understanding the Mechanisms of State Capitalism in China*, 65 STANFORD L. REV. 697 (2013).

Figure 2. Typical Structure of a Non-Financial State-Owned Group



SASAC is authorized by the State-Owned Enterprise Assets Act (a special law outside the company law) to determine managerial compensation of the company under its *direct* control, i.e. the *parent* company in Figure 2.¹⁹ Since its establishment in 2003, SASAC in cooperation with relevant government and party organs has introduced a series of measures to reform the parent company's executive compensation.²⁰ Some important measures include: managerial compensation structure consist of base salary, bonus, and mid-term and long-term incentives which are linked with corporate performance; executive pay pegged to the average worker's pay at certain fixed rate;²¹ using sophisticated formula to determine the pay level based on a set of economic, social, environmental and political indicators.²²

¹⁹ Qiye Guoyou Zichan Fa [State-Owned Enterprise Assets Act] (2008), Chapter 4.

²⁰ The regulations usually were promulgated jointly with the Organization Department of the Chinese Communist Party (i.e., the Party's human resources department), the Ministry of Human Resources and Social Security, the Ministry of Finance, National Audit Office, the Ministry of Inspection and SASAC.

²¹ According to SASAC's 2009 guidelines, base salaries should not be more than 5 times of SOEs' average worker's pay in prior year and performance bonuses should not be more than 3 times of base salaries; in other words, the total compensation including base salaries and performance bonuses should be no more than 20 times of SOEs' average worker's pay. The original text of the guidelines (Guanyu Jinyibu Guifan Zhongyang Qiye Fuzeren Xinchou Guanli de Zhidao Yijian [Guidelines Concerning Further Regulating Executive Compensation of the Central State-Owned Enterprises]) was never unpublished to the public; but a summary and inside information is available in People's Daily, an official newspaper of the Chinese Communist Party. See *Pay for Senior SOE*

Recently, the government's anti-corruption campaign has escalated the SOE pay reform. In 2014, the Political Bureau of the Chinese Communist Party's Central Committee, presided by President Xi Jinping, passed a set of rules to reform SOE executive pay.²³ Top managers (including directors, supervisors, CEOs and vice CEOs) of the SOEs directly owned by SASAC (i.e. the parent company in Figure 2) are subject to the new rules.²⁴ The government's reform statement reaffirms the use of performance-oriented pay and prohibits illegal financial income.²⁵

E. Evaluation

The brief overview of China's executive compensation rules shows that government intervention is quite direct and pervasive. Mandatory disclosure, a common form of government intervention in executive compensation, indeed exists in China. But the depth of information disclosure is relatively limited compared to the disclosure standards in advanced capital markets such as the United States. Disclosure of each executive's compensation was not required until 2005. Still, the scope of executive compensation remains vague and it does not require disclosure of a breakdown of compensation composition. It raises questions about comparability of compensation data across companies in China.

Executives Capped at 20 Times Average Employee Pay, People's Daily, September 25, 2009, at <http://finance.people.com.cn/GB/10113071.html>.

²² SASAC, Zhongyang Qiye Fuzeren Jingying Yeji Kaohe Zanxing Banfa [Provisional Measures on the Comprehensive Evaluation of Top Managers of the Central State-Owned Enterprises], December 29, 2012, available at <http://www.sasac.gov.cn/n1180/n1566/n257060/n257203/15124088.html>.

²³ Zhongyang Guanli Qiye Fuzeren Xinchou Zhidu Gaige Fangan [Reform Scheme on Executive Compensation of the Central State-Owned Enterprises]; Guanyu Heli Queding bing Yange Guifan Zhongyang Qiye Fuzeren Luzhi Daiyu , Yewu Zhichu de Yijian [Opinions on Rationalizing and Strictly Regulating Position-Related Treatments and Business-Related Expenses of Top Managers of the Central State-Owned Enterprises], passed by the Central Political Bureau of the Communist Party of China on August 29, 2014. A summary of the rules is available on the website of the Ministry of Human Resources and Social Security of China, http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/buneyaowen/201409/t20140903_139627.htm.

²⁴ While the rules are applicable to the SOEs under SASAC's control, the government explicitly encouraged all central and local SOEs adopt similar rules. As a result, many local governments recently have taken similar steps to curb executive pay at their SOEs.

²⁵ While a brief summary of the pay reform policy has been released by the government, until today the full text of the rules remains unpublished to the public.

Another problem involves the permissibility that executives may receive no compensation from the listed company but from its shareholders or subsidiaries. The regulations only require the listed company to disclose “whether or not” executives receive pay from its affiliates. The amount of compensation actually paid by the listed company’s affiliates is not subject to disclosure. Section III will empirically show that the business group structure coupled with this regulatory slack lead to the zero-pay phenomenon, significantly masking the actual compensation practices in China.

The most silent government intervention is that the state itself directly determines the pay level in SOEs. As discussed above, the government has imposed a maximum amount of executive compensation on SOEs. Moreover, by virtue of the State-Owned Enterprise Assets Act, the state-owner authorizes itself the power to determine not only directors’ compensation but also compensation of senior officers such as CEOs and vice CEOs. In other words, the state-owner has a super control right that is unavailable under the corporate law where shareholders have authority to determine director remuneration yet the board of directors approves compensation for senior officers.

In fact, the state-owner not only legitimates its intervention through the special law, its involvement is more penetrating than what the law appears to be. As Section III will show, SASAC’s compensation power effectively reaches down to the listed subsidiaries, rather than restricted to the parent company as proclaimed in the law. By leveraging the complex corporate group structure and complementary disclosure rules, the state-owner effectively conceals actual SOE compensation practices notwithstanding mandatory disclosure of each executive’s compensation paid by the listed firm.

II. The Numbers Scrutinized in the Spotlight

Empirical analysis is essential in understanding executive compensation. Without compensation data, it is impossible to systematically observe the pay level, composition and the relationship between pay and performance. Using empirical methods to analyze executive remuneration data is the main approach both in Western and Chinese executive pay literature. As discussed in Section I, starting in 1999, China's listed companies began to disclose the sum of top three paid directors and the sum of top three paid senior officers; and starting in 2005, they should disclose in the annual report the compensation of each director, supervisor and senior officer. These disclosure rules triggered the takeoff of Chinese executive pay research.

Existing Chinese executive pay literature, both in Chinese and English, typically concerns two related empirical questions: whether there is a positive relationship between pay and firm performance; and if yes, what the determinants of pay-performance sensitivity are. The extant studies tend to find a positive relationship between executive pay and performance, while significance and magnitude of the positive linkage vary with performance measures and sample periods. Often studies investigate how corporate governance attributes such as ownership concentration, ownership identity (e.g., state-owned or not), and board structure (e.g. board size, number of independent directors) affect pay-performance sensitivity, and the results seem inconclusive.

Regardless of their research questions, all the studies need to measure executive compensation. Because of general quality concerns about Chinese academic journals, this Article will focus on the studies published in English scholarly journals. A summary of pay variables and data periods in major English studies of Chinese executive compensation is

provided in Appendix. The summary is not intended to serve as a comprehensive literature review but to show existing studies' common approaches to measuring executive compensation.

As shown in Appendix, early studies relied on survey data to examine Chinese SOEs' executive compensation practices in the 1980s. The sample companies in these early studies were non-listed companies because China's stock exchanges had not been established until the early 1990s. All the other studies focus on listed firms, and their study periods start from 1999 or thereafter due to data availability made by mandatory compensation disclosure rules. Most of the existing studies focus on cash compensation (i.e. salary and bonus) rather than equity as Chinese listed firms rarely use equity incentives. The pay variable of studies covering the years prior to 2005 is typically measured as the sum or the average of the three highest-paid senior officers or directors; the pay variable of studies that focus on 2005 or after use individual executive pay. This measurement pattern reflects data availability under the disclosure rules.

Clearly, most studies focus on cash compensation while only few studies examine perquisites. Perquisites typically include housing subsidies, travel reimbursement, entertainment expenses, etc. The limited investigation of perquisites is due to the fact that Chinese listed companies are not required to disclose such information.

No matter how scholars measure executive compensation (cash, equity or perks), they typically take the listed firm as a stand-alone unit of analysis. Executive compensation is analyzed as an outcome of the listed firm's internal governance such as the percentage of independent directors on the board, chairman-CEO duality, the existence of compensation committee, or shareholder identity (e.g. state or non-state).

Overall, extent empirical studies focus on cash compensation disclosed in the corporate annual report. While this approach produces insights, there remain great limitations of

understanding actual managerial compensation practices of Chinese listed companies. As Section III will show, there are simultaneously under-, over- and non-reporting problems in Chinese listed firms' executive compensation disclosure. The numbers disclosed in the corporate annual report should be taken cautiously rather at their face value.

III. The Practices Hidden in the Shadow

This section analyzes three disclosure practices peculiar to China's ownership structure and compensation regulations that mask actual executive pay of Chinese listed companies, particularly state-controlled firms. The first practice is the non-disclosure of perks or so-called "on-duty consumption." Because some existing studies have recognized on-duty consumption, it will simply give a brief discussion of its institutional causes. Attention will be focused on the other two practices that are overlooked in the extant literature. The second practice is the zero-compensation phenomenon where a large number of directors and supervisors do not receive any compensation from the listed company they serve. The third practice concerns the gap between actual and nominal pay.

A. On-Duty Consumption

On-duty consumption (*zaizhi xiaofei*) is an important source of income for Chinese SOE executives. It involves various benefits enjoyed as a result of one's position. Typical benefits include housing allowance, personal use of corporate cars, shopping vouchers, travel expenses, and entertainment expenditures. The true amount of perk consumption is difficult to estimate because China's listed companies are not required to disclose such information. Even if disclosed at all, perk consumption is likely underreported or significantly obscured. A conservative estimate suggested that perks could range between 15 and 32 percent of the total executive

compensation in China.²⁶ Another study suggested that the average managerial perks could be as high as eight times of the average cash pay.²⁷

Despite the significance of perks in Chinese executive compensation, very few studies focus on perks because of data unavailability. Chinese listed companies are not required to disclose information on executive perks. Less than 50 percent of the listed firms voluntarily disclosed such expenses; and even if they did, the disclosed information was in a lump-sum format where shareholders could not distinguish legitimate corporate operating expenses from managerial personal benefits.²⁸ Therefore, most scholars focus on the observable data (i.e. salary and bonus) rather than the unobservable (i.e. perks).

The use of on-duty compensation in SOEs traces back to the traditional compensation system. Before the economic reform starting in the 1980s, all enterprises were state-owned and managers' compensation was subject to the civil service pay system. The system was based on egalitarianism in which there were little salary differentials between ordinary workers and high-rank employees.²⁹ Yet government employees above a certain rank could receive considerable rank-specific perks. While in 1985 the SOE pay system separated from the government pay system, no-duty consumption remains as a significant hidden pay component for SOE executives. Because on-duty consumption is off-sheet income and subject to little monitoring, it has been criticized as a major source of corruption in the SOE system. The Chinese government very recently in the anti-corruption campaign made high-profile regulations to restrain the abuse of

²⁶ Takao Kato and Cheryl Long, *Executive Compensation, Firm Performance and Corporate Governance in China: Evidence from Firms Listed in the Shanghai and Shenzhen Stock Exchanges*, 54 *Economic Development and Cultural Change* 945, 961 (2006).

²⁷ Donghua Chen et al. *Do Managers Perform for Perks?*, <http://ssrn.com/abstract=1562003> (March 1, 2010).

²⁸ Martin J. Conyon et al., *Organizational Slack, CEO Turnover and the Horizon Problem in China*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2355744 (March 10 2016) at p.20, fn 3 (arguing the limits of using voluntarily disclosed perk-related expenditures to estimate the true amount of perks).

²⁹ For detailed discussion on China's civil pay system, see Hon S. Chan, *How Are They Paid? A Study Of Civil Service Pay In China*, 77 *INT'L REV. ADMIN. SCI.* 294 (2011).

on-duty consumption in the SOEs. The regulatory rules limit the scope of on-duty consumption to certain qualified expenditures.³⁰ The effects of the recent rules are in question given that similar regulatory rules have already been in place for a decade.³¹

Critically speaking, the government's existing reform on on-duty consumption has only scratched the surface of the problem. The fundamental problem of on-duty consumption lies not in extravagant expenditures, but in the government's (precisely the Chinese Communist Party's) unwillingness to let go its control over SOE personnel. My previous work has shown that the Chinese government frequently rotates people between government bureaus and SOEs as an important way to control the management of SOEs.³² The common personnel linkages inevitably make government officials a group of peers for SOE executives. As a result, a SOE executive's pay is implicitly benchmarked against the pay of a government official of equivalent rank, whose pay structure has a very low salary but considerable perks.³³ As mentioned above, the amount of on-duty consumption is rank-specific, depending on one's administrative rank (*xinzheng jibei*) in the government system. For example, ministers enjoy the perks of the ministerial level. Since 1999 the Chinese government has made several regulatory attempts to abandon administrative rank for SOEs, but the rules have been effectively disregarded.³⁴ The largest five state-owned

³⁰ Guanyu Heli Queding bing Yange Guifan Zhongyang Qiye Fuzeren Luzhi Daiyu , Yewu Zhichu de Yijian [Opinions on Rationalizing and Strictly Regulating Position-Related Treatments and Business-Related Expenses of Top Managers of the Central State-Owned Enterprises], passed by the Central Political Bureau of the Communist Party of China on August 29, 2014. In the Opinions, position-related treatments include the use of corporate vehicles, corporate housing, and training (including training at the Chinese Communist Party School and administrative academy but explicitly excluding MBA or EMBA tuitions). Business-related expenses include expenses for customer entertainment, travel, and telecommunication.

³¹ SASAC, Guanyu Guifan Zhongyang Qiye Fuzeren Zhiwu Xiaofei de Zhidao Yijian [Guidelines on On-Duty Consumption of Top Managers of the Central State-Owned Enterprises](2006).

³² Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 2013 COLUM. BUS. L. REV. 743 (2013) (investigating the CEO career paths of Chinese SOEs and finding that generally more than 20% of the CEOs spent some time in government bureaus before their CEO appointments).

³³ Chan, *supra* note 29.

³⁴ The 15th National Congress of the Chinese Communist Party passed a resolution (*Guanyu Guoyou Qiye Gaige he Fazhan Ruogan Zhongda Wenti de Jueding [Resolution on Several Important Questions Concerning SOE Reform and Development]*) to abandon administrative ranks for enterprises and their top managers. In 2000, the

banks and the largest three state-owned oil companies, for example, hold vice-ministerial rank in the government system. The use of administrative rank in SOEs allows a unified career platform for government officials and SOE managers. It efficiently interprets the meaning of a transfer (promotion, lateral move or demotion) and associated benefits for a rotation between SOEs and other government units. While the legal pay of an SOE executive is higher than that of an equivalent-rank official, it is significantly lower than that of executives of privately-owned or foreign enterprises, another peer group for compensation determination. This sharp pay gap instigates a feeling of unfairness and adds fire to SOE executives' unscrupulous extraction from covert on-duty consumption. (As opposed to the clandestine nature of on-duty consumption, salary offers relatively limited room to maneuver because salary is formally budgeted and for public companies it is disclosed to the public). Any pay reform short of actual delinking of the SOE personnel from the civil service system is ineffective to cure the endemic problem of on-duty consumption in China's SOEs.

B. The Zero-Pay Puzzle

In China, like the United States, the public discourse on executive compensation is focused on excessive pay. While Chinese executives are paid only a fraction of compensation

State Council also issued a notice to abandon administrative ranks for SOEs. However, the government decisions were not actually implemented. This was also true for listed SOEs. In 2006, the Shanghai Stock Exchange conducted a survey of the SOEs listed on the stock exchange to investigate whether the executives retained any administrative rank. The result showed that about 60% of executives of the listed central SOEs retained administrative rank. See Shanghai Stock Exchange Research Center, *China Corporate Governance Report (2006): The Corporate Governance of State Holding Listed Companies*. Very recent news reports also suggest that administrative rank remains a living institution in SOEs. See Huihau Nie, *Zhongguo Guanyuan Jibie de Zhengzhi Luoji [The Political Logic of Chinese Government Officials' Administrative Rank]*, FINANCIAL TIMES (Chinese), September 8, 2015, <http://www.ftchinese.com/story/001063796?full=y>; Xingjie Chen, *Feichu Guoqi Lingdao Xingzheng Jibie? Dou Ni Wan er [Abandoning Administrative Rank in SOEs? Just Kidding You]*, Sohu Finance, News New Perspectives Vol. 785, Oct. 10, 28, 2013, <http://business.sohu.com/s2013/others786/>; Henshue Suo, *Guozi Gaoguan Diaoyan: Chao 99% Buyuan Fangqi Xingzheng Jibie Huan Gaoxin [A Survey on SOE Executives Shows 99% Unwilling to Give Up Administrative Rank for Higher Compensation]*, China Business Journal, Issue 2075, September 1, 2014, http://news.cb.com.cn/html/economy_9_19746_1.html (reporting a survey result by the Ministry of Human Resources and Social Security of China).

earned by their Western counterparts,³⁵ the public outcry over high executive pay is by no means less furious in China. As discussed in Section I, the Chinese government recently has taken measures to slash executive compensation in SOEs. High executive compensation is ill-tolerated in China not simply because of the weak connection between pay and performance, but more importantly, the worsening of social inequality and corruption. A handsome pay becomes something not for an executive to be proud of, but to be questioned. High-paid executives now may even stand in the spotlight of shame.

In contrast to eye-catching high compensation, pay as low as zero has been largely unnoticed in extant literature. A perusal of the compensation data in the corporate annual reports reveals that a significant number of top managers particularly directors and supervisors report their compensation as zero. These zero-pay executives do not receive any compensation in cash or equity from the listed company that they serve. This section first presents the data on the scale of the zero-pay phenomenon and then it explains the underlying causes and implications.

i. The Scale of the Zero-Pay Phenomenon

This Article collects executive compensation data and relevant information from the 2014 annual reports of the companies listed on China's two stock exchanges, the Shanghai Stock Exchange and the Shenzhen Stock Exchange.³⁶ The dataset includes 2,621 listed companies.

Table 1 shows compensation and shareholding data by ownership type and management position.

³⁵ In 2014, the average CEO pay of the listed firms in China was 2.03 million RMB (approximately 326 thousand USD) according to Forbes (China Edition). See *Top 10 Mainland Ceos With Best Pay*, CHINA DAILY, July 28, 2015, http://www.chinadaily.com.cn/bizchina/2015-07/28/content_21424926.htm. The average CEO pay of S&P 500 firms in the United States was \$13.5 million. See AFL-CIO, *Executive Pay Watch*, <http://www.aflcio.org/Corporate-Watch/Paywatch-2015>.

³⁶ The raw data were mainly collected from Taiwan Economic Journal (TEJ), a commercial database that contains comprehensive information about ownership and executive compensation of China's listed companies. Moreover, this Article directly extracted information from corporate annual reports to confirm data accuracy. In China, there are many free online financial databases that provide comprehensive information of Chinese listed companies. The Article downloaded annual reports from Sina.com and Stockstar.com. The data were compiled and analyzed with the assistance of computer programs. The listed companies published their 2014 annual reports sometime in 2015. This Article completed the data collection in January 2016.

The zero-pay phenomenon exists mainly for directors and supervisors, rather than CEOs. Still note that six percent of the CEOs of the SOEs controlled by the central government do not earn any compensation paid by the listed companies they serve. In contrast to CEOs, zero-pay directors and supervisors are strikingly prevalent. Table 1 shows that 65.3% (61.2%+4.1%) of the central SOE chairmen, 40.6% (36.2%+4.4%) of the local SOE chairmen, and 12.1% (8.8%+3.3%) of the non-SOE chairmen are unpaid by the listed companies they serve.

[Table 1] Compensation and Shareholding by Ownership Type and Management Position

	Central SOEs	Local SOEs	Non-SOEs
CEOs			
Pay + Shareholding	84 (25.3%)	148 (24.1%)	872 (57.1%)
Pay + No Shareholding	228 (68.7%)	443 (72.1%)	615 (40.3%)
No Pay + Shareholding	0 (0%)	2 (0.3%)	3 (0.2%)
No Pay + No Shareholding	20 (6.0%)	21 (3.4%)	35 (2.3%)
Total	332(100%)	606(100%)	1525(100%)
Chairmen			
Pay + Shareholding	28 (8.2%)	123 (18.9%)	953(59.9%)
Pay + No Shareholding	90 (26.5%)	264 (40.5%)	444 (27.9%)
No Pay + Shareholding	14 (4.1%)	29 (4.4%)	53 (3.3%)
No Pay + No Shareholding	208 (61.2%)	236 (36.2%)	140 (8.8%)
Total	340 (100%)	652 (100%)	1590 (100%)
Independent Directors			
Pay + Shareholding	4 (0.3%)	7 (0.3%)	14 (0.3%)
Pay + No Shareholding	1032 (87.5%)	1963 (88.5%)	4430 (90.1%)
No Pay + Shareholding	0 (0%)	2 (.01%)	1 (.02%)
No Pay + No Shareholding	144 (12.2%)	246 (11.1%)	441 (9.0%)
Total	1180 (100%)	2218 (100%)	4886 (100%)
Other Directors (Excluding Chairmen and Independent Directors)			
Pay + Shareholding	169 (9.8%)	373 (11.4%)	2626 (39.3%)
Pay + No Shareholding	573 (33.3%)	1485 (43.6%)	2522 (37.7%)
No Pay + Shareholding	55 (3.2%)	87 (2.7%)	274 (4.1%)
No Pay + No Shareholding	922 (53.6%)	1325 (40.6%)	1268 (19.0%)
Total	1719 (100%)	3260(100%)	6690 (100%)
Supervisors			
Pay + Shareholding	100 (6.8%)	230 (8.2%)	940 (18.1%)
Pay + No Shareholding	721 (48.9%)	1513 (54.2%)	3299 (63.6%)
No Pay + Shareholding	24(1.6%)	62(2.2%)	93(1.8%)
No Pay + No Shareholding	629 (42.7%)	988(35.7%)	854(16.5%)
Total	1474 (100%)	2793 (100%)	5186 (100%)

The zero-pay phenomenon is much less applicable to independent directors. Among the independent directors of the central SOEs, only 12.2% of them receive no compensation. A slightly lower percentage is shown among the local SOE chairmen (11.2%) and among the non-SOE chairmen (9.2%). The compensation of independent directors has been fairly standardized in which independent directors typically receive a fixed amount of cash payment, with an average (excluding zero-pay independent directors) of about \$72,000 RMB a year.³⁷ The zero-pay phenomenon is not a result of independent directors as unpaid volunteers.

For other directors (i.e. directors excluding chairmen and independent directors), the zero-pay phenomenon is evident in the data. More than 56% of such directors in the central SOEs, 43% in the local SOEs, and 23% in the non-SOEs receive no compensation. Similar to directors, 44.3% of the central SOE supervisors, 37.9% of the local SOE supervisors, and 18.3% of the non-SOE supervisors earn no compensation.

Overall, Table 1 shows that a significant percentage of directors and supervisors of the listed SOEs particularly those controlled by the central government, report zero in compensation. Moreover, most of the zero-pay managers (including directors, supervisors and CEOs) do not have any shareholding, which suggests that the zero-pay phenomenon is not a result of shareholdings as a substitute for compensation.

Table 2 further shows the distribution of zero-pay boards of directors by ownership type. A significant portion of listed companies, particularly those controlled by the central government, demonstrate the board composed of a majority of zero-pay directors. For example, among the 343 central SOEs, 60 companies (17%) have a board in which between 51 and 60 per cent of the directors on the board do not earn any remuneration (no pay and no shareholding) in the listed company. Table 2 shows that approximately 27% of the listed companies controlled by the

³⁷ The average amount is calculated on 7,488 paid independent directors in the author's dataset.

central government have a board dominated a majority of zero-pay directors;³⁸ 15% for local SOEs and only 3% for non-SOEs.

[Table 2] Structure of the Board of Directors, by Ownership Type

	Central SOE Boards	Local SOE Boards	Non-SOE Boards
Percentage of No-Pay Directors on the Board			
0-10%	31 (9%)	133 (20%)	781(49%)
11-20%	32 (9%)	104 (16%)	370 (23%)
21-30%	48 (14%)	112 (17%)	186 (12%)
31-40%	66 (19%)	100 (15%)	116 (7%)
41-50%	68 (20%)	111 (17%)	77 (5%)
51-60%	60 (17%)	63 (9%)	40 (2%)
61-70%	22 (6%)	25 (4%)	13 (1%)
71-80%	10 (3%)	12 (2%)	4 (0%)
81-90%	5 (1%)	3 (0%)	8 (0%)
91-100%	1 (0%)	1 (0%)	6 (0%)
Total	343 (100%)	664 (100%)	1601 (100%)

Similarly, Table 3 shows the distribution of the pay structures of the supervisory boards. Again, it clearly shows that the zero-pay boards are mainly concentrated in the state-controlled firms – 47% of the central SOEs and 30% of the local SOEs have a supervisory board whose majority are zero-pay supervisors.

[Table 3] Structure of the Board of Supervisors, by Ownership Type

	Central SOE Boards	Local SOE Boards	Non-SOE Boards
Percentage of No-Pay Supervisors on the Board			
0-10%	57 (17%)	167 (25%)	1049 (66%)
11-20%	23 (7%)	50 (8%)	37 (2%)
21-30%	5 (1%)	14 (2%)	8 (0%)
31-40%	80 (23%)	195 (29%)	286 (18%)
41-50%	16 (5%)	32 (5%)	10 (1%)
51-60%	62 (18%)	76 (11%)	23 (1%)
61-70%	88 (26%)	113 (17%)	172 (11%)
71-80%	5 (1%)	7 (1%)	4 (0%)
81-90%	0 (0%)	2 (0%)	0 (0%)
91-100%	7 (2%)	8 (1%)	12 (1%)
Total	343 (100%)	664 (100%)	1601 (100%)

³⁸ In Table 2, 27%=17%+6%+3%+1%

ii. Causes and Implications

The large number of zero-pay directors and supervisors, as shown above, warrants an exploration of underlying reasons and implications. Why are there so many no-pay directors and supervisors? Is their compensation really zero as reported in the annual report?

The zero-pay phenomenon cannot be adequately explained without looking into the network in which the listed firm is embedded. While ostensibly a large number of directors and supervisors are unpaid by the listed companies they serve, they are actually paid by the controlling shareholders or other corporate affiliates. As I have noted in previous work, the typical approach to the study of Chinese corporate governance takes the listed firm as a stand-alone unit of analysis.³⁹ This approach certainly generates insights, but it ignores the important fact that business groups are pervasive in China and the listed firm is just a subsidiary embedded in a web of corporate entities, as earlier illustrated in Figure 2.

One feature of Chinese business groups is that there are frequent personnel interlocks among member firms in a group. Top managers of a member firm such as a listed firm often occupy top management positions of other member firms (often non-listed firms) in the same group. Such personnel interlocks complicate executive compensation within the group. China's securities regulations require the listed company to explicitly state in its annual report whether or not each of the top managers receives any compensation paid by its shareholders or other affiliates.⁴⁰ Table 4 summarizes the number and percentage of top managers who are not paid by the listed company but instead paid by the listed firm's shareholders or subsidiaries, according to the data disclosed in the 2014 annual reports.

³⁹ Lin and Milhaupt, *supra* note 18.

⁴⁰ See Section I.B.

[Table 4] Whether or Not Zero-Pay Managers Paid by Shareholders or Subsidiaries

	Central SOEs	Local SOEs	Non-SOEs	Total
Zero-Pay CEOs				
Paid by Shareholders or Subsidiaries	7 (35%)	6 (26%)	4 (11%)	17(21%)
<i>Not</i> Paid by Shareholders or Subsidiaries	13 (65%)	17 (74%)	34 (89%)	64(79%)
Total	20 (100%)	23 (100%)	38 (100%)	81(100%)
Zero-Pay Chairmen				
Paid by Shareholders or Subsidiaries	112 (50%)	157 (59%)	97 (50%)	366 (54%)
<i>Not</i> Paid by Shareholders or Subsidiaries	110 (50%)	108 (41%)	96 (50%)	314 (46%)
Total	222 (100%)	265 (100%)	193 (100%)	680 (100%)
Zero-Pay Directors (excluding Chairmen)				
Paid by Shareholders or Subsidiaries	473 (42%)	779 (47%)	587 (30%)	1839 (39%)
<i>Not</i> Paid by Shareholders or Subsidiaries	648 (58%)	871 (53%)	1397 (70%)	2916 (61%)
Total	1121 (100%)	1650 (100%)	1984 (100%)	4755 (100%)
Zero-Pay Supervisors				
Paid by Shareholders or Subsidiaries	309 (47%)	594 (57%)	429 (45%)	1332 (50%)
<i>Not</i> Paid by Shareholders or Subsidiaries	344 (53%)	456 (43%)	518 (55%)	1318 (50%)
Total	653 (100%)	1050 (100%)	947 (100%)	2650 (100%)

Table 4 suggests that many of the zero-pay top managers are paid by the listed companies' affiliates. It shows that 21% of the zero-pay CEOs, 54% of the zero-pay chairmen, 39% of the zero-pay directors (excluding chairs) and 50% of the zero-pay supervisors are paid by the listed company's affiliates, instead of the listed company itself. Still, these numbers based on the annual reports are significantly underestimated. The concept of "affiliates" is broadly defined in China's company law, yet in practice Chinese companies improperly narrow the scope of the definition and thus underreport compensation by affiliates.⁴¹ The paying affiliates usually are

⁴¹ According to Section 217 of China's Company Law, affiliate relationships include the company's relationships with the controlling shareholder, the actual controller, directors, supervisors or senior officers; or any direct or indirect control relationship with the company; any other relations that may transfer the company's interests; state-controlled companies are not affiliates simply because they are owned by the state. The controlling shareholder is any shareholder who owns more than 50% of the company's shares or any shareholder who owns less than 50% but holds enough votes to influence the decisions of the shareholder meeting. The actual controller is anyone who is not a shareholder but holds enough influence through equity or contractual relations with the company to influence the company's behavior. Despite this board legal definition, companies in practice limit affiliates to the direct controlling shareholder (i.e. the parent company) when reporting whether executives are paid by affiliates. Thus, if an executive is a senior manager of and paid by the parent's controlling shareholder or affiliates controlled by the same parent company, it would go unreported.

controlling shareholders (i.e. parent companies). A typical example is as this: The chairman (ZHOU Jiping) of PetroChina, a SOE listed on the Shanghai and the New York Stock Exchanges, earned no compensation paid by the listed company itself but rather by the parent company which is wholly-owned by SASAC. ZHOU simultaneously as the chairman of the parent company was subject to SASAC's pay decision. His compensation was decided behind closed doors by SASAC, rather than by the governance institutions (i.e. the board of directors and shareholder meetings) of the listed company. This pay arrangement is unobservable from the annual report, unless one understands the corporate network and how SASAC wields its control over executive compensation. But even if the listed company honestly discloses whether or not each of its top managers earns compensation paid by its affiliates, the compensation remains a myth to the public as the regulations do not require any disclosure of the amount paid by the corporate affiliates.

The corporate group structure and the disclosure rules together nicely serve the interests of the state-owner. Chinese SOE executive compensation, often riddled with corruption, is a politically sensitive issue that the state-owner has been trying to keep it in secrecy. However, it is becoming difficult to maintain secrecy for listed companies because of the increasing transparency demand in the corporate governance world. It is fair to say that the zero-pay phenomenon is a temporary balance between the state-owner's (or the ruling elite's) secrecy interests and the demand of convergence on internationally-accepted disclosure rules. While the Chinese regulators adopt the rule requiring disclosure of each top manager's compensation paid

A prominent example is the chairman (CHANG, Xiabing) of China United Network Communications Ltd. has been reported since 2004 in the annual reports that he earned no compensation paid by the listed firm or its affiliates. However, CHANG was reported in the annual reports of China Unicom that he was paid by China Unicom, an affiliate listed on the New York Stock Exchange. China United Network and China Unicom belong to the same business group and owned by the same parent company; China United Network is an indirect controlling shareholder of China Unicom. Moreover, there are overlaps in their top management personnel. This is just one example. In my data collection process, I noticed that it is fairly common that companies fail to report compensation by affiliates.

by the listed company, they allow the listed company to hide compensation in its corporate affiliates without violating the disclosure rule.

This information hiding strategy permitted by China's domestic securities rules is not effectively mitigated by cross-listing to international capital markets. Table 5 shows the number and percentage of zero-pay managers of the 88 Chinese companies with shares listed both on domestic and international stock exchanges. It shows that 8% of the CEOs, 41% of the chairmen, 31% of the directors (excluding chairmen) and 34% of the supervisors of the Chinese cross-listed companies report zero in compensation paid by the listed firm they serve. As previously discussed, these zero-pay managers are actually paid in a publicly-unknown amount by the listed company's affiliates. Most of these zero-pay companies are state-owned, including high-profile firms such as PetroChina, Sinopec, Chalco and many others simultaneously listed on the Shanghai and the New York Stock Exchanges. The Chinese state-owner's interest in mystifying executive compensation remains unharmed despite internationalization of the listed firms. The limited role of international cross-listing in bringing transparency to executive compensation of Chinese cross-listed firms partly relates to the regulatory fact that foreign issuers often enjoy lots of disclosure exemptions and often compliance with the listed company's domestic rules would be deemed sufficient. The zero-pay phenomenon persistent in cross-listed Chinese companies offers another piece of evidence to question whether cross-listing delivers any real positive effects on Chinese firms.⁴²

⁴² Donald Clarke, *The Bonding Effect in Cross-Listed Chinese Companies: Is it Real?*, GWU Law School Public Law Research Paper No. 2015-55, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710717.

[Table 5] The Zero-Pay Situation among Firms with Shares Listed Overseas

	Total Number of Managers (a)	Number of Zero-Pay Managers (b)	Percentage of Zero-Pay Managers (b)/(a)
CEOs	87	7	8%
Chairmen	85	35	41%
Directors (Excluding Chairmen)	863	270	31%
Supervisors	409	138	34%

A practical implication of the zero-pay phenomenon is that any measures of top management compensation of Chinese listed companies should be taken with great caution. For example, as shown in Table 6 below, the average compensation varies significantly with the inclusion or exclusion of the zero-pay managers. Unfortunately, existing literature on Chinese executive compensation does not make it clear whether the sample includes or excludes zero-pay managers.⁴³

[Table 6] Average Pay Differences if Zero-Pay Managers Included or Excluded

	Including Zero-Pay [a]	Excluding Zero-Pay [b]	Difference (RMB) [b-a]	Difference (%) [(b-a)/a]
Chairmen	545,249 (2,596)	739,635 (1,914)	194,386	35.7%
Directors (Excluding Chair)	217,179 (20,061)	285,286 (15,272)	68,107	31.4%
Supervisors	185,681 (9,499)	258,100 (6,834)	72,419	39%

Note: Number of managers in brackets.

Fundamentally, the zero-pay phenomenon raises doubt over top managers' ability to act in the best interest of the listed company. The standard approach to the study of executive compensation views pay as a solution to the agency problem. Compensation schemes are to provide directors and officers with efficient incentives to loyally pursue the interests of the

⁴³ None of the studies reviewed in Appendix articulates whether it includes or excludes the zero-pay executives in data analysis.

company that they serve. But the loyalty to the listed company may be in jeopardy when directors and officers are not compensated by the listed company itself but by its controlling shareholder; what's worse is that the amount of compensation is a black box to the public. This hidden pay arrangement may exacerbate the central governance problem in concentrated ownership structure – controlling shareholders exploit minority shareholders. As I recently noted in a co-authored work on China's state capitalism, the state-owner “seeks to maximize a range of benefits extending from state revenues to technology prowess and from soft power aboard to regime survival at home.”⁴⁴ In the eye of the state-owner, the individual listed firm's financial interests are subordinate to the country's interests as defined by the ruling elite. Pay by the controlling shareholder rather than the listed firm itself reinforces this interest preference.

Finally, the zero-pay phenomenon calls for rethinking the meaning of executive compensation in the Chinese context. The compensation disclosed in the annual report is the amount legally approved by the board of directors and/or the shareholder meeting. It is a legitimate financial incentive given to executives. However, are Chinese SOE managers really motivated by the legitimate pay or more by something else?⁴⁵ China's SOE system is full of rent seeking opportunities for top managers. Financial gains are not necessarily in the form of legal compensation but illegal payments such as bribes.⁴⁶ Political career advancements may be

⁴⁴ Lin and Milhaupt, supra note 18 at 746.

⁴⁵ This question is vividly illustrated by the recent comment by the former chairman (WANG, Jianzhou) of China Mobile, a SOE listed on the Hong Kong and New York Stock Exchanges. In the Summer Annual Meeting (known as Summer Davos) of the World Economic Forum, held in September 2015, WANG as the chairman of the Association of China's Listed Companies commented on executive pay cuts and stated that “To be honest, top managers of large SOEs and large enterprises consider a lot of things everyday as they manage tens of thousands of employees and they do not really care about the level of personal executive pay.”
<http://economy.caijing.com.cn/20150909/3964095.shtml>.

⁴⁶ It was reported that SOE executives accounted for 76% of the 605 cases of entrepreneurs as criminals for the year of 2015 alone. The top three crimes for SOE executives were bribery (278 cases), corruption (66) and embezzlement (21). The cases have been increasing over the past years. See *The 2015 Criminal Report of China's Entrepreneurs*, available at http://www.legaldaily.com.cn/index_article/content/2016-04/05/content_6551886.htm?node=5955. The report is an annual publication starting in 2009 by Legal Daly, Legal Weekly, and China Youth Daily to track criminal records of Chinese entrepreneurs.

another form of incentives.⁴⁷ If they are motivated by executive compensation, companies should fill in the blank spaces of compensation tables in the annual report. But if they are actually not motivated by executive compensation, then the disclosed pay in the annual report, regardless of the amount, does not matter much and it leaves a black hole of what to be disclosed to investors.

C. Nominal *versus* Actual Pay

Reporting zero in executive pay is rather intuitively suspicious and should be subject to close scrutiny. Still, ostensibly reasonable compensation figures disclosed in the corporate annual report can be misleading, particularly for Chinese SOEs. The pay disclosed in the annual report sometimes may be a nominal rather than actual amount paid to SOE managers; and the gap between the nominal pay and the actual pay can be very large.

The nominal *versus* actual pay practice traces back to the overseas listing wave among Chinese SOEs in the 1990s. It was created as an expedient solution to the disparity between the pay level allowed in China's state-owned sector and the pay level demanded in the international capital market. On the one hand, executive compensation of Chinese SOEs traditionally was shockingly low by international standards. The low pay could raise a red flag on Chinese firms' governance quality and could negatively affect their initial public offering (IPO) price and subsequent corporate value in the international capital market. On the other hand, international pay practices, especially stock options that often drive compensation high, were incompatible with the traditional pay system of Chinese SOEs, whose top managers were often government officials and their pay was benchmarked against civil service pay. In the face of the institutional

⁴⁷ Jerry Cao et al., *Political Promotion, CEO Compensation and Their Effect on Firm Performance*, AFA 2011 Denver Meetings Paper, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1512142 (showing that "both monetary and political incentives are positively related to firm performance" and moreover "the monetary compensation-based incentive is weaker when CEO incentives are heavily driven by political career concerns").

clashes, Chinese SOEs contrived the appearance of adopting Western-style compensation schemes to alleviate the market concerns while at the same time clandestinely making informal arrangements with their top managers to maintain the state's control over compensation. A recent study suggests that stock options granted to executives of Chinese SOEs listed on the Hong Kong Stock Exchange, many of which are also on the New York Stock Exchange, are merely window dressing to satisfy the taste of foreign investors.⁴⁸ Executives of Chinese listed SOEs are never allowed to freely exercise stock options shown in corporate annual reports; and even if exercised, they are expected or required to surrender the gain to the parent company.⁴⁹

The nominal *versus* actual pay practice is further institutionalized by SASAC's compensation management beyond its legal authority. SASAC is legally authorized to manage executive compensation of the company under its direct ownership (i.e., the parent company rather than the listed subsidiary in Figure 2). In reality, SASAC's compensation management power effectively reaches down to the listed subsidiary. Top managers of the listed subsidiary who are also executives of the parent company are in fact subject to SASAC's pay decisions, which effectively override the pay approved by the board of the listed company. Available information indicates that the actual compensation approved by SASAC and paid to the executives can be very different from (usually considerably less than) the nominal pay disclosed in the annual report.⁵⁰ This important fact that many SOEs do not receive the pay disclosed in

⁴⁸ Zhihong Chen et al., *Are Stock Option Grants to Directors of State-Controlled Chinese Firms Listed in Hong Kong Genuine Compensation?*, 88 ACCOUNTING REV. 1547 (2013).

⁴⁹ *Id.*

⁵⁰ The actual and nominal pay disparity sometimes may be observed in an inconspicuous footnote of an annual report. For example, Poly Real Estate (a listed central SOE) disclosed in a footnote of its 2012 annual report that "according to the compensation system approved by the board of directors, the chairman (SONG, Guangju)'s total compensation for the fiscal year of 2012 should be 2.8 million; however, according to SASAC's decision, the pre-tax actual pay is 605 thousand dollars." The company's 2013, 2014, and 2015 annual reports stated in a footnote that "the chairman's compensation was unavailable for disclosure because SASAC had not yet completed the annual performance review for the chairman."

the annual report but rather a pay internally determined by SASAC is sometimes downplayed as a footnote in the annual report or buried in obscure corporate documents, and more often it is entirely unstated.

How SASAC determines SOE executive compensation is opaque, though it has published some rules regarding its compensation policy. According to the published rules, the basic structure of managerial compensation includes three parts: base salaries, performance bonuses, and mid-/long-term incentive compensation. Briefly speaking, the base salary is a function of the size of the enterprise, the difficulty level of managing the enterprise, the responsibilities undertaken, and the average worker's pay of the given enterprise, the given industry and the given city where the enterprise is located.⁵¹ Managers receive base salaries monthly. The structure and payment of performance bonuses are based on much more complicated formula in

For central SOEs, CNOOC Ltd, one of the largest state-owned oil companies in China and listed on the Hong Kong and New York Stock Exchanges, is the most representative case. CNOOC's annual reports disclosed that several of its top managers were paid multi million dollars (RMB) annually, which aroused public anger in 2009. In response, CNOOC clarified that since the first day of the listings in 2001, all the top managers had agreed to donate the pay approved by the board of directors to the parent company and they actually received the amount determined by SASAC rather than the amount published to the public. According to CNOOC, the difference between the actual pay and the nominal pay was like "the sky and the earth." See *CNOOC Reply to Ten Million Annual Pay: Actual and Nominal Pay like Sky and the Earth*, XINHUA NEWS, April 14, 2009 (reporting the public explanation made by CNOOC's spokesman) at http://news.xinhuanet.com/fortune/2009-04/13/content_11180853.htm; CNOOC's statements were consistent with information given by SASAC's officials in interviews. See *SASAC Experts: Annual Executive Pay at Central SOEs often 400 Thousand Dollars, No One Over One Million*, CHINA ECONOMIC WEEKLY, Volume 37, Sep. 21 2009.

For local SOEs, Huayuan Property is the case widely reported in news media. Since 2008, the company had disclosed in its annual reports that its chairmen (REN, Jiqiang) earned more than \$7 million RMB. In the face of the public outcry over the excessive compensation, the company released a formal statement in 2010 explaining Ren's compensation composition and it flagged the fact that Ren's compensation was determined by SASAC and for the fiscal year of 2009, the amount approved by SASAC was less than 700 thousand, only one tenth of the disclosed amount in the annual report. See Huanyan Property's Announcement on Feb. 4, 2010, available for downloads from the website of the Shanghai Stock Exchange <http://www.sse.com.cn/disclosure/listedinfo/announcement/>.

⁵¹ SASAC published the formula explaining how to calculate managerial compensation, see Zhongyang Qiye Fuzeren Xinchou Guanli Zanxing Banfa Shixing Xize [Implementation Detailed Rules for Provisional Measures on Compensation Administration of Top Managers of the Central State-Owned Enterprises], promulgated in 2004. For the CEO or chairman of the enterprise, the function of base salary is: $W = W_0 * L * R$. W indicates the base salary. W_0 indicates 5 times of the average worker's pay in state-owned enterprises nationwide in the past year. L indicates a combination index including the assets size, industry, profits, etc. R indicates a value between 1 and 1.4 determined by SASAC.

which political loyalty to the Chinese Communist Party is a factor.⁵² The performance bonus is contingent on the annual performance evaluation and the three-year term review.⁵³ However, how the SOE executives are actually evaluated and paid under these formal rules remains unclear.

IV. Implications and Questions for Future Research

A. Implications for Comparative Corporate Governance Scholarship

The central theme of comparative corporate governance scholarship seeks to explain the variance of governance systems around the world. Among various factors, politics has been recognized as a key explanation for different national governance regimes.⁵⁴ Nevertheless, the mainstream approach to executive compensation pays limited attention to politics. Most recent studies of executive compensation have relied on optimal contracting theory or managerial power theory, both of which are developed with a focus on the U.S. experience.⁵⁵ Optimal contracting theory assumes that boards are able to bargain with managers and get optimal contracts for shareholders' interests. Managerial power theory, however, argues that the level and structure of executive compensation are not shaped by efficient contracting but rather distorted by rent-seeking managers who are able to capture board members to set their own compensation. However, as leading executive pay scholar Kevin Murphy critically commented on the U.S. executive pay literature,

⁵² See Zhongyang Qiye Lingdao Banzi he Lingdao Renyuan Zonghe Kaohe Pingjia Banfa [Measures on the Comprehensive Performance Evaluation of Top Management Teams and Top Managers of the Central State-Owned Enterprises], Dec. 30, 2009; Zhongyang Qiye Fuzeren Jingying Yeji Kaohe Zanxing Banfa [Provisional Measures on Performance Evaluation of Top Managers of the Central State-Owned Enterprises], SASAC No. [30], promulgated on Dec. 29, 2012.

⁵³ *Id.*

⁵⁴ Mark Roe has been a leading advocate for the importance of politics in shaping corporate governance systems. See Mark Roe, *THE POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT* (New York: Oxford University Press, 2003).

⁵⁵ Lucian Bebchuk and Jesse Fried, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* (2006). Bebchuk and Fried criticize optimal contracting theory and offer an alternative view, managerial power theory.

Most recent analyses of executive compensation have focused on efficient-contracting or managerial-power rationales for pay, while ignoring or downplaying the causes and consequences of disclosure requirements, tax policies, accounting rules, legislation, and the general political climate. A central theme of this study is that government intervention has been both a response to and a major driver of time trends in executive compensation over the past century, and that any explanation for pay that ignores political factors is critically incomplete.⁵⁶

This observation actually is even truer in the Chinese context. Scholars of Chinese executive compensation, like their U.S. counterparts, follow the two prevailing theories. But meanwhile they are certainly aware of the important role of government intervention given that the most important enterprises in China are state-owned. More often than not, the scholars treat government intervention equivalent to binary variables of state ownership (i.e., whether or not the firm is owned by the state) or top managers' political connections (i.e., whether or not the firm's top managers are former or incumbent government officers). This Article adds a new dimension of government influence through the lens of disclosure rules. China's disclosure regulations give controlling shareholders great latitude in maneuvering executive compensation reporting and ultimately mask the true numbers of executive pay of publicly listed companies. The ruling elite's interest in limiting public scrutiny over its SOE personnel management remains largely unharmed despite ostensibly mandatory disclosure of each individual executive's compensation under the securities regulations. The disclosure regime well serves the interests of the state-owner (or the ruling elite).

⁵⁶ Kevin Murphy, *Executive Compensation: Where We are, and How We Got There*, HANDBOOK OF THE ECONOMICS OF FINANCE Volume 2, Part A, Chapter 4, Pages 211-356 (2013) Edited by George M. Constantinides, Milton Harris and Rene M. Stulz.

Another issue relates to comparative corporate governance scholarship is the perennial debate about the future trajectory of national corporate governance systems in the era of globalization. Will they converge on a universal model or will they continue to retain their national characteristics? For executive compensation, its convergence question essentially asks whether there is “Americanization” of executive pay – the prevalent use of performance-oriented pay and lucrative compensation.⁵⁷ On its face, China seems to present “formal convergence”⁵⁸ in the sense that China’s recent regulations explicitly advocate for performance-oriented pay (such as cash bonuses and stock options), a key feature of the U.S. pay paradigm. Moreover, empirical evidence based on the formal numbers disclosed in the annual reports of China’s listed companies show that while executives earn only a fraction of compensation paid to American executives, their compensation has been rising very swiftly.⁵⁹ While the recent formal rules and formal pay figures show some changes toward to the U.S. standards, the informal practices (including on-duty consumption, the zero-pay practice, and the nominal-actual pay divide) place a cautionary note on the substantive meaning of the converging formal rules and formal pay figures.

Related to the convergence debate, the informal pay practices offer an illustration of pay reform and “institutional complementarity”⁶⁰, a concept used by scholars of comparative corporate governance to describe that institutions are resistant to change due to institutional

⁵⁷ Brian Cheffins and Randall S. Thomas, *The Globalization (Americanization?) of Executive Pay*, 1 BERKELEY BUS. L. J. 233 (2004).

⁵⁸ Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (defining “formal convergence” as convergence of rules on the books).

⁵⁹ Alex Bryson et al., *Same or Different? The CEO Labour Market in China's Public Listed Companies*, 124 THE ECON. J. 90-108 (2014) (finding that the average total cash and bonus compensation for a top executive in 2010 was equivalent to US\$129,399; and the pay has doubled between 2005 and 2010).

⁶⁰ The leading scholarship of using “institutional complementarities” to compare political economies is Peter A. Hall and David Soskice, *An Introduction to Varieties of Capitalism*, in VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 1-70 (Peter A. Hall and David Soskice eds. 2001). Their idea is that any political economy is composed of several institutions such as corporate governance, labor markets, and more. The institutions become functionally complement over time; as a result, the institutions are stable and difficult to change.

interdependence. As previously discussed in Section III, the informal pay practices are important institutions complementary to the government's peculiar personnel management in which there are frequent rotations between the government bureaus and SOEs. The personnel linkages across the government and the SOE sector facilitate the formation and implementation of national economic policy and promote coalition among the ruling elite. Because SOE executive pay is inextricably tied to personnel appointments, any significant change to the pay institution requires a functional adjustment of its interconnected appointment institution. The government's recent SOE reform policy, as discussed below in detail, suggests that the complementarity of executive pay and personnel appointment institutions makes pay reform more challenging.

B. Implications for Reform Policy

In recent years, executive compensation has become high on the Chinese SOE reform agenda. The Chinese government has promulgated many rules to curb excessive executive pay at SOEs. In the wake of the global financial crisis, China's Ministry of Finance imposed a policy where the maximum pre-tax pay at state-controlled financial institutions would be 2.8 million RMB.⁶¹ More recently, amid of the ongoing anti-corruption campaign, the government declared that the base salary for central SOE executives is equal to twice of the average worker's pay; annual performance bonus should be no more than twice of the base salary; and on-duty consumption should be constrained.⁶² Local SOEs are subject to similar policies as well.⁶³

⁶¹ Ministry of Finance, Jinrong lei Guoyou ji Guoyou Konggu Qiye Fuzeren Xinchou Guanli Banfa [Administrative Measures on Top Managerial Compensation of State-Owned and State-Controlled Financial Enterprises], Jan. 13, 2009, a summary of the measures available at http://www.mof.gov.cn/zhengwuxinxi/caizhengwengao/2009niancaizhengbuwengao/caizhengwengao2009dierqi/200904/t20090413_132166.html; for inside information about the rules, see <http://finance.people.com.cn/GB/1040/8771812.html>.

⁶² *Supra* note 23.

Overall, the pay reform to date has been focused on the substantive components of compensation rather than the decision-making process and transparency.⁶⁴ Indeed, transparency is particularly challenging in China's political environment. Disclosure of SOE executive pay may intensify the public's outrage against economic inequality and political corruption. It touches a nerve with China's ruling elite who are dreadful of any threat to social and political stability. Furthermore, as shown in this Article, even though mandatory disclosure rules of executive compensation are in place, it does not necessarily lead to transparency when misrepresentation is actually orchestrated by the government out of its own political interests, and gatekeepers including lawyers and auditors give way to this political reality. The transparency reform of executive compensation in China requires not just releasing numbers to the public but information credibility verification and truthful disclosure culture.⁶⁵ Otherwise, the disclosed numbers would be just whatever the company (or the state-owner) wants them to appear to the public.

In the late December 2016, SASAC for the first time disclosed executive compensation of the 111 SOEs under its control.⁶⁶ As noted, many zero-pay managers of the listed companies are actually paid by the parent companies under SASAC's control. This disclosure initiative fills some information gaps in the zero-pay puzzle. According to the released data, the highest pre-tax pay in 2015 was \$1.2 million RMB and the executive pay was often between \$500,000 and

⁶³ *Id.*

⁶⁴ Tellingly, even the reform rules themselves have no transparency. The government has never published the text of the rules but only publicly disclosed a brief summary of the reform policies. While rumors in news suggest that the government will soon disclose SOE executive compensation in detail, no progress in this regard has been detected.

⁶⁵ SASAC officials sometimes informally in news interviews disclosed fragmented information about SOE executive compensation. However, this informal way of disclosure has no comparability and reliability.

⁶⁶ SASAC, Guowuyuan Guoziwei Guanli Qiye Fuzeren 2015 Niandu Xinchou inxi Pilu (国务院国资委管理企业负责人 2015 年度薪酬信息披露), <http://www.sasac.gov.cn/n85463/n327265/n327406/n327425/c2513588/content.html>.

\$800,000 RMB.⁶⁷ Although this recent disclosure initiative is an encouraging move towards transparency, such disclosure suffers a significant time lag and faces credibility challenges.⁶⁸

It is fair to say that all the “behind the numbers” problems are essentially rooted in China’s peculiar personnel management. The Chinese Communist Party as the visible hand governs the SOE executive labor market. Top managers of important SOEs, like government officials, are evaluated and appointed by the Party. In this personnel system, SOE (formal) executive pay is benchmarked against civil servant pay and significantly lower than the market rates for corporate executives. As a result, SOE executives have incentives to lavishly use on-duty consumption as a way to compensate for the sense of unfairness. The state-owner (ultimately the Party) has interests to maintain its personnel control and secrecy by practicing the zero-pay reporting and the nominal-actual pay gap. The Party’s retreat from SOE personnel management is the key to successful compensation reform of Chinese SOEs. Unfortunately, until today the Party remains unwilling to relinquish this power. While in recent years the government has experimented with the idea of recruiting top managers from outside the state sector, my recent empirical research shows that the executive labor market of China’s SOEs remains virtually closed to those who are outside the state system.⁶⁹ Part of the reason for the absence of professionals recruited outside the state system is that the pay is too low compared to the prevailing market rate. To handle this problem, the Chinese government is experimenting with a dual pay system for SOEs. Under the system, the compensation of executives whose careers develop within the state system is unilaterally set by SASAC’s evaluation, while those recruited from outside are paid based on market rates through contract negotiation. The latter

⁶⁷ Id. The chairman and CEO of the China Merchants Group received the highest pay.

⁶⁸ SASAC disclosed the 2015 pay at the end of 2016. Its disclosure time is no contemporaneous with annual reporting of listed companies. Moreover, the low executive pay reinforces the common belief that Chinese SOE executives do not rely on formal pay but other sources of income (“gray income”).

⁶⁹ Lin, *supra* note 32.

compensation is usually much higher than the former. It is unclear whether such dualism will work well because anecdotal evidence indicates that it can brew resentment among those whose pay is subject to SASAC's relatively low pay policy.⁷⁰

C. Questions for Future Research

The primary research methodology of executive compensation literature is quantitative analysis of compensation data disclosed in formal corporate reports. The validity of this research approach is built on the premise that the numbers published on paper fairly reflect the compensation practices in effect. This premise is apt when corporate governance institutions are competent and efficient. However, it should be taken with great caution in China's context where the capital market remains relatively immature. Also as scholars of Chinese law commonly note, the gap between the law on the books and the law in action is often considerably large in China. To be sure, it is unwarranted to entirely deny the credibility of information disclosed in the annual reports of China's listed companies, yet it does reasonably suggest the limitation of statistically crunching numbers to understand the true practices of Chinese corporate governance including executive compensation. Future empirical research should conduct surveys and interviews to get deeper insights in order to fully understand the operation of executive compensation in the Chinese context.

The findings in this Article suggest another lacuna of existing empirical research on Chinese executive compensation: business groups as a missing variable. A Chinese listed firm is often part of a business group and some studies have investigated how the business group

⁷⁰ See Beijing News, *Forty Percent of the Central SOE Executives Recruited Worldwide are from Inside the System*, May 2011 (interviewing a SOE CEO who was offered to pay at market rate but declined the offer and accepted the lower pay policy because of the potential resentment concern).

structure may influence a Chinese firm's financial performance and accounting behavior.⁷¹ Yet most existing studies of Chinese executive compensation lack the variable of business group and tend to treat the listed firm as a stand-alone unit. How the business group structure may influence Chinese executive compensation is an important topic to be explored. A very recent study found that executive compensation of a Chinese listed subsidiary is correlated with the performance and compensation of another listed subsidiary in the same business group.⁷²

Furthermore, the zero-pay phenomenon raises some specific questions to be investigated in the future. For instance, does the lack of financial compensation really impair managers' capability to satisfy their fiduciary duties? Empirically, do companies with a higher percentage of zero-pay directors or supervisors on the board demonstrate inferior financial performance, more frequent related-party transactions, more sanctions by securities regulators, or any other undesirable behavior? Positive answers lend some support to the concerns about fiduciary duties while negative answers lead to further inquiries about any other mechanisms that may effectively align board members' interests with the listed company even when they are not paid by the company at all.

Conclusion

In recent years, Chinese executive compensation has received considerable media and scholarly attention. News media have annually broadcasted answers to the questions like who are

⁷¹ See e.g., Jia He et al., *Business Groups in China*, 22 J. CORP. FIN. 166 (2013); Lisa A. Keister, *Engineering Growth: Business Group Structure and Firm Performance in China's Transition Economy*, 104 AM. J. SOC. 404 (1998); Lisa A. Keister, *Interfirm Relations in China: Group Structure and Firm Performance in Business Groups*, 52 AM. BEHAV. SCIENTIST 1709 (2009).

⁷² Guilong Cai and Guojian Zheng, *Executive Compensation in Business Groups: Evidence From China*, 9 CHINA J. ACCOUNT. RES. 25 (2016) (specifically finding that "when the change in performance of one subsidiary is lower than that of the other subsidiaries, the change in its executive compensation is significantly lower. Further, when the business group is private and the level of marketization is high, the subsidiary's executive compensation is more likely to be influenced by the performance of the other subsidiaries").

the highest paid CEOs; scholarship has heatedly debated whether there is an excessive pay problem; and the government has taken high-profile measures to slash SOE executive compensation. Yet, a more than two-decade-old comment on American executive compensation in the Harvard Business Review seems apt for the current situation in China – “The relentless focus on *how much* CEOs are paid diverts public attention from the real problem—*how* CEOs are paid.”⁷³ The “how” indeed has Chinese characteristics, rather than merely an issue of compensation composition like in the United States and elsewhere. Understanding how Chinese executives are paid is a challenging task because it is not a matter simply by crunching the numbers released in public companies’ annual reports. A valid reading of formal compensation figures entails an understanding of the network structure and the political environment in which Chinese companies operate.

⁷³ Michael C. Jensen and Kevin J. Murphy, *CEO Incentives—It’s Not How Much You Pay, But How*, THE MAY–JUNE 1990 ISSUE, <https://hbr.org/1990/05/ceo-incentives-its-not-how-much-you-pay-but-how>.

Appendix

Authors	Data Years	Sample	Compensation Data
Mengistae and Xu .2004. Agency Theory and Executive Compensation of Chinese State-Owned Enterprises, <i>Journal of Labor Economics</i> 22:615-637.	1980s	Survey data on about 400 non-listed Chinese SOEs	Annual CEO salary and bonuses
Chong-En Bai and Lixin Colin Xu. 2005. Incentives for CEOs with Multitasks: Evidence from Chinese State-Owned Enterprises, <i>Journal of Comparative Economics</i> 33(3):517-539.	Late 1980s	Survey data on more than 300 non-listed Chinese SOEs	Annual CEO salary and bonuses
Takao Kato and Cheryl Long. 2006. Executive Compensation, Firm Performance, and Corporate Governance in China: Evidence from Firms Listed in the Shanghai Shenzhen Stock Exchanges, <i>Economic Development and Cultural Change</i> . 54(4):945-983.	1998-2002	937 listed companies	Average of the three highest-paid senior managers' cash compensation
Michael Firth, Tak Yan Leung, Oliver M. Rui. 2006. Corporate Performance and CEO Compensation in China, <i>Journal of Corporate Finance</i> 12(4):693-714.	1998-2000	549 non-financial listed companies	Assuming the highest-paid executive's pay as CEO pay
Michael Firth, Tak Yan Leung, Oliver M. Rui. 2007. How Ownership and Corporate Governance Influence Chief Executive Pay in China's Listed Firms, <i>Journal of Business Research</i> 60: 776-785.	1998-2000	549 non-financial listed companies	Assuming the highest-paid executive's pay as CEO pay
Trevor Buck, Xiaohui Liu and Rodion Skovoroda. 2008. Top Executive Pay and Firm Performance in China, <i>Journal of International Business Studies</i> 39, 833-850.	2000-2003	601 listed companies in 2000	Average of the three highest-paid senior managers' cash compensation
Ruilong Yang and Jidong Yang. 2009. Why Has Top Executive Compensation Increased So Much In China: An Explanation of Peer-Effects. <i>Pacific Economic Review</i> . 14(5): 705-716.	2001-2007	994 listed firms	Sum of the three highest-paid senior managers' cash compensation (change in the sum between years)
Michael Firth, Tak Yan Leung, Oliver M. Rui. 2010. Justifying Top Management Pay in A Transitional Economy. <i>Journal of Empirical Finance</i> 15(7)852-866.	2000-2005	Non-financial listed companies	Average of the three highest-paid executive directors' cash compensation
Shujun Ding et al. 2010. Executive Compensation, Supervisory Board, and China's Governance Reform: A Legal Approach Perspective. <i>Review of Quantitative Financial Accounting</i> 35:445-471.	2005-2006	Listed firms (1,345 observations in 2005 and 1,410 in 2006)	Average and sum of the three highest-paid executive directors' cash compensation
Jean Chen et al. 2010. The Effect of Insider Control and Global Benchmarks on Chinese Executive Compensation. <i>Corporate Governance: An International Review</i> 18(2):107-123.	2001-2006	502 listed companies	Sum of the three highest-paid senior managers' cash compensation
Marin J. Conyon and Lerong He. 2011. Executive Compensation and Corporate Governance in China, <i>Journal of Corporate Finance</i> , 17(4):1158-1175.	2001-2005	Almost all listed firms (in both Shanghai and Shenzhen Stock Exchanges)	Sum of the three highest-paid senior managers' cash compensation

Tajao Kato and Cheryl Long. 2011. Tournaments and Managerial Incentives In China's Listed Firms: New Evidence, <i>China Economic Review</i> 22(1):1-10.	1998-2002		Tier 1 executives: average of the three highest-paid senior managers' cash compensation Tier 2 executives: average of all other executives including <i>all directors</i> , supervisors, and high-level executives.
Pattarin Adithipyangkul et al.. 2011. Executive Perks: Compensation and Corporate Performance in China. <i>Asia Pacific Journal of Management</i> 28:402-425.	1999-2004	3,706 year-firm observations	Assuming disclosed expenses on eating, traveling, company cars, communication, socializing, and entertaining spent for management's personal consumption
Wei Luo et al. 2011. Bank Ownership and Executive Perquisites: New Evidence from an Emerging Market. <i>Journal of Corporate Finance</i> 17(2):352-370.	1996-2006	All listed firms (excluding financial industries)	Perk 1: Regress Mexpense (i.e. Total administrative expenses minus bad debt expenses, unrealized holding gain or loss for inventory if any, and direct compensation for directors and top executives) on several firm characteristics, and use the residual values as the abnormal administrative expenses of a company Perk 2: Sum of disclosed travel, eat, drink, entertainment and vehicle expenses, medical allowances and medical expenses, pension expenses, housing allowance, moving and relocation expenses, educational expenses; office expenses, board meeting fees, communication expenses, conference fees, and insurance expenses.
Hongbin Cai et al. 2011. Eat, Drink, Firms, Government: An Investigation of Corruption from the Entertainment and Travel Costs of Chinese Firms. <i>Journal of Law and Economics</i> 54(1): 55-78.	2000-2002; 2001-2003; 2005	Three firm-level surveys conducted jointly by the World Bank and the Enterprise Survey Organization of the National Bureau of Statistics of China (i.e. including non-listed firms)	Executive perks measured as voluntarily disclosed entertainment and travel costs expenditures

Kun Wang and Xing Xiao. 2011 Controlling Shareholders' Tunneling and Executive Compensation: Evidence from China, <i>Journal of Accounting and Public Policy</i> . 30(1):89-100.	1999-2005	6670 firm-year observations with executive compensation and 5150 firm-year observations with changes in executive compensation.	Sum of the three highest-paid senior managers' cash compensation
Jerry Cao et al. 2011. Political Promotion, CEO Incentives, and the Relationship Between Pay and Performance. Wharton Financial Institute Working Paper #11-53.	2005-2009	756 listed firms	Sum of the three highest-paid senior managers' cash compensation
Dongwei Su. 2011. State Ownership, Corporate Tournament and Executive Compensation: Evidence from Public Listed Firms in China. <i>Singapore Economic Review</i> . 56(3): 307-332.	1999-2006	1,386 listed firms	Cash pay gap between different tiers of managers Tier 1: CEO, President and the Chair of the Board of Directors Tier 2: Vice Chief Manager, Vice President, Vice Board Chair and the Chair of the Supervisory Committee Tier 3: Executive Board Director and members of the Supervisory Committee and other senior officers
Ningyue Liu et al. 2012. Government Intervention And Executive Compensation Contracts of State-Owned Enterprises: Empirical Evidence From China. <i>Journal of Chinese Economic and Business Studies</i> 10(4):391-411.	1999-2008	8269 firm-year observations	Average of the three highest-paid directors' cash compensation
Bin Ke, Oliver Rui, Wei Yu. 2012. Hong Kong Stock Listing and the Sensitivity of Managerial Compensation to Firm Performance in State-Controlled Chinese Firms, <i>Review of Accountings Studies</i> 17:166-188.	2003-2004	266 A shares, 124 H shares, 71 Red Chip shares	Average of the three highest-paid senior managers' cash compensation
Marin J. Conyon and Lerong He. 2012. CEO Compensation and Corporate Governance in China, <i>Corporate Governance: An International Review</i> , 20(6):575-592.	2005-2010	Almost all listed firms	CEO pay: Individual CEO's cash sum (salary, bonus, stipends. excluding equity) CEO equity: Individual CEO's shareholding and equity grants
Yongli Luo and Dave O. Jackson. 2012. Executive Compensation, Ownership Structure and Firm Performance in Chinese Financial Corporations, <i>Global Business and Finance Review</i> 2012: 56-74.	2001-2009	142 financial firms	Average of the three highest-paid executive directors' cash compensation

Alex Bryson et al. 2013. Same or Different? The CEO Labour Market in China's Public Listed Companies. <i>The Economic Journal</i> . 124 (574):90-108	2001-2010	2197 listed firms	Average of the three highest-paid executives' cash compensation
Hao Liang, Luc Rennebooga, Sunny Li Sun. 2015. The Political Determinants of Executive Compensation: Evidence from an Emerging Economy. <i>Emerging Markets Review</i> , 25, 69-91.	2001-2011	More than 92% of all the listed firms	Sum of the three highest-paid senior managers' cash compensation
Lars Helge Hab et al. 2015. Equity Incentives and Corporate Fraud in China. <i>Journal of Business Ethics</i> . 1-20.	2000-2010	Listed firms	Shareholding the measure of equity incentives: (1) supervisors' shares (the number of shares held by the board of supervisors); (2) management's shares (the number of shares held by directors and senior managers)
Zhigang Zheng et al. 2016. Executive Compensation and Legal Investor Protection: Evidence from China's Listed Firms. <i>Review of Development Economics</i> 20(1):39-47	2002-2008	Listed firms	Industry-mean adjusted average of the three highest-paid senior managers' cash compensation
Guilong Cai and Guojian Zheng. 2015. Executive Compensation in Business Groups: Evidence From China. China. <i>Journal of Accounting Research</i> 9(1): 25-39	2003-2012	271 listed business groups	Sum of the three highest-paid senior managers' cash compensation