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Development of Corporate Governance Practices and Capital Market Reforms in China

Qidi Zhang[1,2] and Zhijun Lin[1,*]

[1] *School of Business, Macau University of Science and Technology, China*

[2] *School of Digital Economics, Changzhou College of Information Technology, China*

Abstract: We primarily review the historical development of corporate governance in China after the country opened up to the outside world in the early 1980s. Besides the introduction of the major progresses of corporate governance in practice, we illustrate several key policies with distinct Chinese characteristics that have been implemented in more recent years, along with their practical consequences. It is also outlined that the improvement of corporate governance and capital market reforms supplement each other along with the rapid economic growth in China. By analyzing relevant statistical data and representative company cases, we identify several persistent issues in current corporate governance practices, including the impact of corporate environmental, social, and governance performance and the implication of the digital transformation of the business environment. Building on this analysis, we propose future directions for the development of corporate governance, aiming to further the refinement of both corporate governance and capital market reforms in China. We trust that Chinese corporate governance practices can offer valuable insights for other countries toward the continuing improvement of corporate governance on a global scale.

Keywords: corporate governance, regulatory compliance, equity structure reform, information disclosure, ESG performance, digital transformation

1. Introduction

In the last three decades, emerging markets have significantly increased their role in the world economy, leading to a rapid expansion of research on corporate governance, which reflects a growing global recognition of its importance [1]. With the rapid development of the Chinese economy and the continuous advancement of globalization, corporate governance has emerged as a pivotal mechanism in business management in China. It plays an essential role in ensuring the healthy development of enterprises, safeguarding investors' rights, and enhancing the efficient operation of the capital market. The corporate governance practices in China have had a profound impact on the growth and transformation of domestic businesses while contributing unique insights to global corporate governance theory and practice, particularly in emerging markets.

Although many review articles have examined the progress of Chinese corporate governance from different perspectives, such as shareholders, boards of directors, managers, external intermediaries, and social responsibility [2–9], most previous studies are limited to analyzing the state of corporate governance at the time of writing. Recent policy updates that have significantly impacted capital markets have not been included. Even the relatively recent review by Jiang and Kim [9] fails to cover several key policy initiatives. Moreover, the existing literature rarely incorporates recent company cases that vividly illustrate current governance issues. This study aims to fill this gap by addressing the overlooked policy updates and introducing recent company cases, providing a more comprehensive reflection of the current state of corporate governance in China and the challenges it faces.

We address the following core research questions: What historical factors have shaped corporate governance practices in China? How do these practices affect the performance and governance of contemporary companies? And what insights can be drawn for future corporate governance reforms? Through exploring these questions, this study seeks to provide a comprehensive overview of the development of corporate governance in China while examining its achievements and challenges in light of recent capital market reforms and outlining future directions for development.

The primary significance of this study lies in not only enriching the understanding of corporate governance in China but also showcasing its uniqueness and complexity through actual case studies. We employ a qualitative research approach to reveal the distinctive practices of corporate governance in China by analyzing policy changes, company cases, and their broader contexts.

Specifically, we analyze the progression of corporate governance in China from five dimensions: shareholder governance, mixed-ownership reform, board governance, the quality of information disclosure, and sustainable development. Furthermore, we discuss deficiencies in Chinese corporate governance, such as the ineffectiveness of the independent director system; the rationale behind cash dividend payout; the inadequacy of environmental, social, and governance (ESG) disclosure; and weaknesses in external governance mechanisms involving institutional investors, banks, financial institutions, and market intermediaries.

***Corresponding author:** Zhijun Lin, School of Business, Macau University of Science and Technology, China. Email: zlin@must.edu.mo

We further propose future development directions such as deepening governance reforms, enhancing information disclosure quality, and exploring new developments in corporate governance in the context of the digital economy. The study aims to provide guidance for the continuous improvement of Chinese capital market operations and corporate governance practices while offering valuable insights and recommendations for the innovation and enhancement of global corporate governance.

2. Historical Evolution of Corporate Governance in China

Following "opening-up and economic reform" policies in 1978, corporate governance in China has been undergoing an evolutionary process spanning over four decades, characterized by four distinct phases: "Introduction of Corporate Governance Concepts," "Construction of Corporate Governance Structure," "Establishment of Corporate Governance Mechanisms," and "Enhancement of Corporate Governance Effectiveness" [10]. Throughout this evolution, the governance structure of listed companies in China has transitioned from a traditional singular state-owned model to diversified corporate governance models. This transformation not only demonstrates the continuous advancement of corporate governance in China but also reflects the mutual influence and integration of domestic and international governance practices.

2.1. Introduction of corporate governance concepts (1978–1992)

Prior to the economic reform in the late 1970s, China's enterprises and economic system were predominantly characterized by state ownership, with a singular governance structure of direct governmental control and management over enterprise operations. In pace with the economic reforms, China gradually transitioned from a planned economy to a market-oriented economy, leading to the diversification of enterprise systems and the emergence of various business forms, such as shareholding companies, privately run enterprises, and foreign-invested enterprises [11, 3]. State-owned enterprises (SOEs) began to transform, implementing the policies for decentralizing power and allowing for profit retention by enterprises. Measures such as expanding autonomy and implementing economic responsibility systems were adopted to gradually enhance the market competitiveness of business enterprises. In order to better adapt to the development of the market-oriented economy, Chinese enterprises have started to establish more effective and standardized corporate governance structures [12, 13, 6].

At the beginning of 1984, some SOEs initiated pilot reforms of the incorporation system, permitting capital raising through the issuance of stocks and gradually establishing the basic framework of a modern enterprise system. The pilot shareholding reforms facilitate the separation of business ownership and management rights, accumulating experience for the subsequent formulation of the Company Law and new corporate governance structures in China. The enactment of the "Law on Industrial Enterprises Owned by the Whole People (e.g., SOEs)" in 1988 marked the beginning of the legalization of the incorporation system and corporate governance, laying a legal foundation for the reform of SOEs and the establishment of modern corporate governance structures. The 14th National Congress of the Communist Party of China, held in 1992, explicitly proposed the goal of establishing a socialist market-oriented economy system, emphasizing the need to carry out enterprise reforms and enhance the vitality and competitiveness of business enterprises, prompting the subsequent reform of SOEs in alignment with the progress of a market-oriented economy system [14, 15].

2.2. Construction of corporate governance structure (1993–1998)

During this stage, China went through significant advancement in developing a corporate governance structure, primarily evident through the official enactment of the "Company Law" and the "Securities Law." These two legislations provide the necessary legal framework and institutional support for Chinese enterprises to establish modern corporate systems and refine their governance mechanisms.

Implemented in 1993, the "Company Law" set out the legal architecture for corporate governance in China, delineating enterprises should adopt and specifying the roles and operational procedures of main corporate bodies, such as the shareholders' meeting, board of directors, and supervisory board. The enforcement of the "Company Law" is pivotal in regulating corporate organization and conduct, thereby enhancing the transparency and efficiency of corporate operations [8].

In 1998, the introduction of the "Securities Law" signified the establishment of a formal legal system for the capital market to move toward standardized market management in China. This legislation ends the prolonged absence of dedicated legal oversight in the securities market, laying down the legal groundwork for market stability and healthy growth. The "Securities Law" provides explicit guidelines for essential market operations, including securities issuance, trading, and the acquisition of listed companies, thereby setting a standard of conduct for all market participants. This contributes positively to the maintenance of market order and protection of investor rights, bolstering investor confidence and attracting additional capital flows into the market that, in turn, fosters the expansion capital market, offering more efficient financing avenues for the business enterprises [13]. By emphasizing the principles of openness, fairness, and equity, and through measures such as regulating information disclosure and prohibiting insider trading, the "Securities Law" enhances market transparency and credibility in the country [8].

2.3. Establishment of corporate governance mechanisms (1999–2012)

The China Securities Regulatory Commission (CSRC) issued the "Rules of Corporate Governance for Listed Companies" in 2002, which is designed to regulate the governance operations of listed companies, enhance company quality, and protect the rights and interests of investors. It covers various aspects, including the conduct of general meetings of shareholders, boards of directors, supervisory boards, senior management, controlling shareholders and related parties, corporate independence, related-party transactions, information disclosure, internal control, risk management, corporate social responsibility, and environmental protection [6]. The rules aim to promote the establishment of incorporation systems for Chinese enterprises; increase governance transparency and efficiency; safeguard the legitimate rights and interests of investors, especially small and medium-sized investors; foster a fair and transparent capital market; boost market participants' confidence; and provide institutional support for the stable and healthy development of the capital market.

To adapt to the rapid growth of the market-oriented economy and the new requirements following China's accession to the World Trade Organization, the government substantially amended the "Company Law" of 1993 in 2005, which further clarifies the corporate governance structure, strengthens the protection of shareholders' rights, and sets out more detailed provisions on the responsibilities and obligations of directors, supervisors, and senior management [16, 17]. In addition, it introduces regulations on company information disclosure and financial reports in order to enhance the transparency of corporate operation and governance.

The original split share structure, that is, the coexistence of tradable and non-tradable shares, had led to an imbalance in market supply and demand, preventing stock prices from accurately reflecting the value of companies. Non-tradable shares (mainly shares held by state-owned and legal entities) were not circulated in the market, and their value could not be realized through market transactions. The conflict of interest between tradable and non-tradable shareholders has resulted in an overly concentrated company control, which was not conducive to optimize the corporate governance structure and market-oriented operations. To address these issues, the Chinese government implemented the "Split-share reform" in 2005, aiming to achieve full circulation of all shares and eliminate differences in the liquidity of varied types of stocks. This reform has significantly revitalized the stock market, enabling stock prices to reflect the company's value and market supply and demand relationship more accurately. By allowing the circulation of shares held by major shareholders, the market regulation over corporate governance was enhanced, promoting the optimization of corporate governance structures [15, 18]. This significant institutional reform of the Chinese stock market has benefitted minority investors [19]. Concurrently, the reform improves corporate equity structure and strengthens the role of market mechanisms in enterprise reform and resource allocation, providing a solid foundation for the rapid development of the Chinese capital market.

2.4. Enhancement of corporate governance effectiveness (2013–today)

To further deepen the SOEs reform, the Chinese government initiated a new round of mixed-ownership reform in 2015, following the issuance of the "Guiding Opinions on Deepening the Reform of SOEs" by the State Council in August, which allowed non-state capital to participate in the reform of SOEs to affirm the significant role of non-state capital in the business reforms. The State Council also released the "Opinions on the Development of a Mixed-Ownership Economy in SOEs" in September, encouraging non-state capital to engage in the mixed-ownership reform. It also proposed specific measures for a tiered reform process, further clarifying the approaches for SOEs reform, including "introducing non-state capital to participate in the reform of SOEs," "encouraging state-owned capital to take various forms of equity in non-state enterprises," and "exploring the employee stock ownership in mixed-ownership systems."

In 2019, the newly amended "Securities Law" was officially promulgated, with the implementation of the securities issuance registration system, which further expanded the marketization of securities issuance and enhanced market efficiency and transparency [17]. The new "Securities Law" has also increased the penalties for securities violations, tightened the legal restrictions on corporate governance, and prompted companies and their management to place greater emphasis on compliance and fulfillment of information disclosure obligations [9]. These reforms and legal support have collectively propelled the stable and healthy development of the Chinese capital market, setting a more equitable and transparent market environment for businesses and investors.

In short, Chinese corporate governance has undergone an evolutionary path from experimental practices to systematic construction over the past 40 years and eventually approached international common practices. This development not only reflects the transformation and upgrading of the Chinese economy but also demonstrates the efforts of Chinese business enterprises in continuously absorbing international experiences and promoting managerial innovation.

3. Achievements of Corporate Governance Development in China

The governance standards of listed companies in China have been steadily improved, attributable to the refinement of regulatory policies, optimization of market mechanisms, and reforms of internal corporate governance structures. This section analyzes the recent main accomplishments in corporate governance in China, showcasing its notable successes in driving enterprise reforms, enhancing market efficiency, protecting investor rights, and fostering economic stability and growth [20, 21].

3.1. Shareholder governance

The conflict of interests between controlling shareholders and minority shareholders has long been a salient issue in Chinese corporate governance since the early 2010s [3]. The protection of the legitimate rights and interests of minority investors has been further emphasized and positioned at the top priority agenda of the CSRC. This not only reflects the regulatory authority's high regard for the protection of minority shareholders' rights but also sets the direction for future corporate governance reforms in China. In this aspect, the market regulatory authorities have implemented a series of innovative measures. The CSRC has established the China Securities Investor Services Center (ISC) and a representative litigation platform for special representatives. Thus, ISC can act as a more robust protection mechanism for minority investors to mitigate the interest conflicts between controlling and minority shareholders [22]. There are almost no major capital markets in the world that have a similar regulatory institution dedicated to protecting small shareholders [23].

The CSRC established the ISC in 2014, marking a significant institutional innovation in China's securities regulatory framework. The ISC aims to enhance the participation of small and medium-sized shareholders in corporate governance, which is characterized by a dual mechanism that is "semi-public and semi-private[1]." It can act as a "regulatory small shareholder," as per the Securities Law, by holding a minimum of 100 shares in listed companies. The ISC adopts market-based approaches to promote the interests of small shareholders and exercise various shareholder rights either independently or in conjunction with other investors [18, 24]. Active shareholder proposals can play a pivotal role in optimizing corporate governance and improving financial reporting [25]. Moreover, regulatory measures could be more effective if shareholders with regulatory authority are granted the right to exert influence over the company.

The ISC's rights exercise can be categorized into two modalities: first, on-site activism, that is, participating in shareholders' meetings, attending significant corporate restructuring

[1] The "semi-public and semi-private" characteristic of the ISC refers to its dual nature and functions, embodying both the attributes of a public regulatory institution and a private shareholder simultaneously.

consultations, and conducting company visits or inspections, and second, online advocacy, that is to be involved in the process to solicit shareholder opinions and public announcements. As of April 2023, the ISC held shares in a total of 5,164 listed companies nationwide, participated in 3,604 corporate governance activities, and cumulatively exercised shareholder rights 4,624 times. Through resolving 13,000 disputes or illegitimate actions by the controlling shareholders, the ISC has helped other investors recover their losses of approximately RMB 3.132 billion through litigations and an additional RMB 2.52 billion in legal compensations.

The Special Representative Litigation System (SRLS) is a significant complementary policy to the registration-based reform of the Chinese securities market and represents a top-down institutional innovation to the investor protection system, often referred to as the Chinese version of collective litigation. The revised "Securities Law" of 2019 introduces a new Chapter VI of "Investor Protection," which notably establishes the SRLS with distinctive Chinese characteristics, and it draws on the "opt-out, opt-in" principles from group litigation systems in western countries, and it substantially increases the costs associated with illegal and non-compliant activities in the capital market [26].

The first case in China's capital market to apply the SRLS was that of *Kangmei* Pharmaceutical Corp.,[2] which tested the efficacy of SRLS in investor protection. The case, from litigation to judgment enforcement, was completed in a span of less than eight months in 2020, with a compensation of RMB 2.459 billion for its securities investors, and 52,037 affected investors received compensation through cash payments, stocks, and trust benefit rights, among other methods. The percentage of compensation, the amount awarded, and the number of investors compensated were unprecedented, leaving a significant impact on the capital market in China [27].

3.2. Mixed-ownership reform

The mixed-ownership reform for SOEs has made significant progress and yielded notable outcomes, exhibiting a positive development trend in terms of scale, industrial sectors, and restructuring approaches [28].

The scale of mixed-ownership reform has been expanding steadily. In industries and business segments characterized by fierce competition, the reform has been actively and cautiously implemented. By 2020, SOEs run directly by the central government had completed over 4,000 cases of mixed-ownership reform, attracting more than RMB 1.5 trillion in social (mainly private and foreign) capital inflows. Over 70% of SOEs run by the central government have undertaken mixed-ownership restructuring, an increase of nearly 20% since the end of 2012. For SOEs run by local governments, the portion of mixed-ownership entities has reached 54%, with over RMB 700 billion in social capital inflows. Within the total equity of SOEs run by the central government, the minority equity attributable to social capital has increased from RMB 3.1 trillion at the end of 2012 to RMB 9.4 trillion in 2020, rising from 27% to 38%, which indicates a substantial integration of the state and social capital for corporate property rights[3].

Additionally, the scope of industries involved in the mixed-ownership reform is extensive. In the highly competitive industrial sectors such as construction, real estate, manufacturing, and wholesale and retail trade, over 70% of SOEs have completed the transition to a mixed-ownership system, and the reform has also been systematically experimented in pillar business sectors, including electricity, civil aviation, telecommunications and defense, with the orderly inflows of non-state capitals.

Lastly, the mixed-ownership reform has been promoted with varied approaches. In 2020, the Chinese government established the State-owned Enterprise Mixed-Ownership Reform Fund [29], which raised RMB 70.7 billion in its initial phase and has reached a total scale of RMB 200 billion. The fund is designed to facilitate restructuring, transformation, and upgrading of SOEs, as well as to advance the process of mixed-ownership reform through market-oriented means. The SOEs run by the central government are also actively exploring the "reverse mixed-ownership reform," flexibly promoting "two-way mixed-ownership reform" and "second-round mixed-ownership reform." This involves injecting state-owned equity into privately run enterprises and collaborating with the latter to achieve joint growth at critical stages in the business valuation chain [23, 27].

Historically, listed SOEs in China have suffered from problems of absence of effective ownership and severe insider control. The mixed-ownership reform, by introducing non-state capital and diversification of the equity structure, has played an instrumental role in establishing and refining modern enterprise systems for Chinese enterprises. This kind of diversified equity structure enhances the effectiveness of corporate governance. By incorporating the complementary strengths and checks and balances of different ownership forms, a more rational and effective decision-making mechanism can be formed. As a result, the mixed-ownership reform helps to mitigate the risks associated with insider control prevailing in SOEs in China.

3.3. Board governance

Board reforms strengthen corporate governance [30]. Board independency is a key mechanism for effective corporate governance. The independent director system, as a crucial element of the governance structure for listed companies, aims to enhance corporate governance by introducing external independent opinions and oversight, thereby protecting the legitimate rights and interests of investors, especially small and medium-sized investors. Although the Company Law in China has mandated the independent director system, that is, not less than one-third of board members should be independent directors, its effectiveness has long been questioned, since the majority of companies treat the system as a formality to meet regulatory compliance rather than genuinely fulfilling their intended oversight roles in corporate operation and governance. In the major financial fraud of *Kangmei* Pharmaceutical Corp., five independent directors were found to have failed in their supervisory duties and were adjudged to bear partial joint compensation liability, with a total amount of RMB 2.459 billion [31]. This court judgment has reignited market discussions on the role and efficacy of the independent director system and prompted market participants to pay more attention to the issue.

As a response, the CSRC amended the "Administrative Measures for Independent Directors of Listed Companies" in September

[2]During the years 2016 to 2018, *Kangmei* Pharmaceutical Corp. fabricated its financial statements through a variety of means, including inflating operating revenues, interest income, and operating profit, as well as misrepresenting cash and cash equivalents. The cumulative misstatement of cash and cash equivalents reached an astounding scale of RMB 88.68 billion, with an overstatement of operating revenues by RMB 29.128 billion, an exaggeration of operating profit by RMB 4.101 billion, and a surplus of interest income by RMB 510 million.

[3]The data source is from a speech made by Mr. Peng Huagang, Secretary-General and Spokesperson of the State-owned Assets Supervision and Administration Commission (SASAC), during a press conference held by the State Council's Information Office regarding the economic performance of business enterprises run by the central government in 2020.

2023, aiming to improve the performance of independent directors in fulfilling their duties, ensuring their duties in supervision are effectively exercised. This amendment intends to elevate the governance standards of listed companies, safeguard the legitimate rights and interests of investors, and foster the stability and healthy development of the capital market in China [21].

The newly amended "Regulations on Independent Directors" covers various stages of the operation of the independent director system and refines the qualification requirements for independent directors. The main content can be summarized into the following seven key areas:

1) specification of the composition requirements and role for independent directors;
2) more specific qualifications and conditions for appointment;
3) enhancement of the selection and dismissal procedures for independent directors;
4) establishment and improvement of platforms and corresponding mechanisms for the performance of duties by independent directors;
5) specification of special rights for independent directors;
6) clarification of duties for independent directors in operation; and
7) establishment of standards for assessing administrative responsibilities and exemptions for penalties.

Notably, the institution of special meetings by independent directors represents a significant improvement. The changes in the independent director duty performance framework signify a pivotal shift from individual to institutional performance models, which not only allows individual directors to execute their responsibilities with greater comprehensiveness and efficacy but also requires listed companies to set up needed institutions to support and safeguard their independent directors to fulfill their responsibilities. In addition, the new "Regulation" has raised the standards for substantive independence and engagement of independent directors by reducing the maximum number of concurrent appointments of independent directors from five to three listed companies, both domestic and overseas listed companies. Furthermore, an independent director can only continuously serve two terms of six years in total at a listed company to ensure the independency and full engagement of independent directors in corporate governance.

3.4. Quality of information disclosure

The positive impact of corporate governance reforms on the quality of information disclosure has been confirmed in emerging market research [32, 33]. In response to market reforms and the requirements of the new "Securities Law," the CSRC revised the "Administrative Measures for Information Disclosure of Listed Companies" and implemented it on May 1, 2021. The main revisions include the refinement of basic information disclosure requirements, periodic reporting systems, ad hoc reporting standards, and the management system for information disclosure affairs. The revisions aim to enhance the effectiveness of regulatory enforcement and provide more detailed guidance on the voluntary disclosure of information by listed companies.

In 2003, the "Guidelines for Investor Relations Management of Listed Companies" issued by the Shenzhen Stock Exchange first introduced the concept of "voluntary information disclosure." Subsequently, guidelines from both the Shanghai and Shenzhen Stock Exchanges encouraged listed companies toward voluntary disclosure practices. The 2013 "Opinions on Further Strengthening the Protection of the Legitimate Rights and Interests of Small and Medium Investors in the Capital Market" issued by the General Office of the State Council explicitly stipulates the need for rules for voluntary disclosure. The amended "Securities Law" of 2019 formally recognizes voluntary disclosure from the legislative perspective. As stated in Article 84, Paragraph 1, companies may voluntarily disclose information relevant to investors' value judgments and investment decisions beyond what is legally required. As a result, Chinese listed companies have gradually increased voluntary disclosures to the capital market [24].

In terms of the extent of disclosure, the number of Chinese listed companies engaging in voluntary information disclosure on Shanghai, Shenzhen, and Beijing stock exchanges has increased from approximately 1,600 in 2019 to about 3,000 in 2022, according to the annual reports of the listed companies from 2019 to 2022, which represents a rise in the percentage from 64% in 2019 to 73% in 2022.

Regarding the format of disclosure, Chinese listed companies predominantly rely on regular reports, complemented by interim announcements. For example, the number of interim announcements on the Shanghai Stock Exchange (SSE), with "voluntary" in the title issued in 2021 and 2022, were 648 and 1,079, accounting for 0.21% and 0.41% of the total disclosures, respectively. The corresponding figures for the Shenzhen Stock Exchange were 515 and 565, maintaining a consistent percentage of 0.15%. Although there has been an uptick in the number of interim announcements for voluntary disclosure, regular reports remain the primary vehicle for conveying voluntary information by Chinese listed companies at present.

In terms of the information content, voluntary disclosure encompasses a wide range of areas, including progresses in significant project investments, strategic planning, and ESG aspects. Over 80% of companies voluntarily disclose their social responsibility performance, and more than 60% of disclosed information is about customers, suppliers, and related-party relationships, Disclosure of key performance indicators and their calculation assumptions is over 40%, while over 10% of disclosure is about operational and debt repayment capabilities. Current research highlights the role of ESG and carbon disclosure in reducing the cost of capital, enhancing company value, and strengthening investor confidence [34]. These figures indicate that Chinese listed companies are progressively moving toward extensive and more in-depth voluntary information disclosures.

3.5. Sustainable governance

Good internal corporate governance positively influences both corporate social responsibility and environmental responsibility [35]. In 2019, the CSRC issued the revised "Corporate Governance Code for Listed Companies," which includes provisions in Chapter 8 on stakeholders, environmental protection, and social responsibility. Article 86 stipulates that "listed companies should integrate ecological and environmental protection requirements into their development strategies and corporate governance processes, and play a leading role in pollution prevention, resource conservation, and ecological protection." It is explicitly stated in Article 87 that "while maintaining the company's sustainable development and protecting shareholders' interests, listed companies should actively fulfill their social responsibilities in areas such as community welfare, disaster relief, and public service." The new "Corporate Governance Rules for Listed Companies" in China encourages listed companies to participate in ecological civilization construction and the fulfillment of social responsibilities such as poverty alleviation, establishing a basic framework for the disclosure of ESG information.

The CSRC has sequentially issued regulatory rules and guidelines to further clarify the requirements and supervisory measures for corporate ESG practices. For instance, on April 11, 2022, the CSRC published the revised "Guidelines for Investor Relations Management of Listed Companies," which incorporates ESG information as a key component of investor communication by listed companies.

To further regulate the disclosure of information related to the sustainable development of listed companies, on February 8, 2024, the Shanghai, Shenzhen, and Beijing Stock Exchanges each issued, respectively, draft guidelines for corporate sustainability reporting for public consultation. The Draft Guidelines emphasize the "double materiality principle," which requires listed companies to consider both the significant financial impact issues on the enterprise and the broader implications for the economy, society, and environment when disclosing information. The application of the double materiality principle aligns with the European Union's "Sustainability Reporting Standards" and the Global Reporting Initiative standards, which reflects a balanced response to the impact of sustainability issues on corporate value as well as on economic, social, and environmental impact.

4. Existing Issues in Chinese Corporate Governance Practice

Chinese regulatory authorities have introduced numerous distinctive policies to improve corporate governance with notable outcomes. However, Chinese corporate governance faces challenges both internally and externally; each will significantly impact overall corporate performance and sustainability.

4.1. Internal issues

4.1.1. Effectiveness of independent director system

As previously discussed, the role of independent directors in Chinese corporate governance has long been challenged by researchers [3]. First, the median percentage of independent directors on the boards of Chinese listed companies is 33%[4], with an average of 37%, which is in compliance with the minimum legal requirement (e.g., at least 1/3 of the Board composition). However, the appointment of independent directors by listed companies is primarily to meet the legal threshold requirement. In contrast, in the developed economies (e.g., the United States), where the corporate governance system is more mature, independent directors constitute the majority of the board in the vast majority of companies (e.g., approximately 94% in the manufacturing industry), and the average percentage of independent directors in the S&P 500 companies is as high as 85%. In many well-known companies, all board members except the CEO are independent directors. For instance, at Amazon, there are 11 board members, with 10 being independent directors besides the founder, Jeff Bezos. The chairperson of the board in many companies is also an independent director. This comparison illustrates that the proportion of independent directors on the boards of Chinese listed companies is relatively low, which may hinder their ability to provide effective external oversight over controlling shareholders and the management.

The remuneration for independent directors in Chinese listed companies is generally low. According to the 2022 annual reports of listed companies, the median annual salary for independent directors of the CSI 300 composing companies is approximately RMB 150,000. The majority of listed companies in China utilize an "all-inclusive" compensation model for independent directors, which provides the same remuneration irrespective of their actual workload and responsibilities undertaken. Less than 30% of the CSI 300 composing companies have adopted a differentiated compensation model for independent directors, and the variance in individual compensation among independent directors within the same company exceeds 20% in some cases.

Furthermore, the regulatory authority has prohibited independent directors from participating in equity incentive plans to ensure their independence, resulting in their compensation being composed entirely of cash remunerations. The significant penalties imposed on independent directors in the *Kangmei* Pharmaceutical financial fraud case have shown a discrepancy between the risks associated with the independent director's duties and the compensation they receive, leading to a rash of resignations among independent directors and creating negative perceptions in the market [36, 24]. In response, some listed companies have begun to provide liability insurance for their independent directors as a means to alleviate the risks associated with their duties.

Regarding the supervisory role, most independent directors rarely act professionally in respect of their willingness to accept the management proposals, regardless of whether those agenda items are in the best interest of all shareholders. A study examining the voting patterns of independent directors in Chinese listed companies, with at least one independent director abstaining or voting against the management proposals in the sample, including 609 board meetings with 859 proposals being voted on, found that only 6% of independent directors expressed dissent at the board meetings. Despite this, 92% of the management proposals were ultimately approved. This high approval rate is not surprising, given that major shareholders or actual controllers often dictate the board meeting agenda and independent directors have little say in the board meetings [37, 5]. This warrants further actions to enhance the effectiveness of the independent director system within the corporate governance framework.

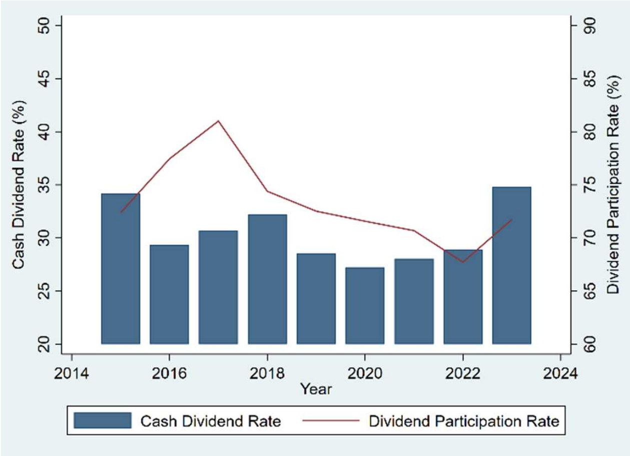
4.1.2. Rationality of cash dividends

As aforementioned, the Chinese market regulatory authorities require listed companies to make dividend distributions to investors. Over the past five years, A-share listed companies have distributed a cumulative total of RMB 8.2 trillion in cash dividends, with the annual dividend payout to exceed the amount of equity financing raised in the same year. In 2022, a total of 3,291 companies from Shanghai and Shenzhen Stock Exchanges declared cash dividends, amounting to RMB 2.1 trillion, of which RMB 1.6 trillion was distributed to domestic investors, marking a year-on-year increase of 22.7%. The proportion of companies with dividend payouts was 67.1%, but the dividend payout ratio is, on average, at 32.5%, and the dividend yield is at 1.97%, matching the middle levels of dividend payout in terms of the main capital markets worldwide. However, compared to more mature markets, there is still room for improvement in the payout ratio and stability of dividend distribution for Chinese listed companies in order to raise investment returns for investors in the capital market in China.

Figure 1 shows the cash dividend ratio and the percentage of companies paying dividends on the A-share listed companies in China from 2015 to 2023. As shown, the cash dividend payout ratio has consistently remained at approximately 30%, a relatively low level of cash dividends. While 75% of participating companies distribute annual cash dividends, there are still some companies that have not done so since going public.

[4] Data source: China Stock Market & Accounting Research Database (CSMAR).

Figure 1
Cash dividend rate and dividend participation rate of Chinese A-share listed companies (2015–2023)



In terms of dividend payout, some companies either do not pay dividends[5] or pay a very low ratio of dividends, which may prevent shareholders from receiving adequate returns on investment. At the same time, a few companies pay dividends at unusually high ratios[6], which could potentially harm their debt repayment capacity and sustainable operating growth.

Regarding the stability of dividend distribution, most companies in the US stock market implement quarterly or semi-annual dividend payouts, whereas the vast majority of Chinese listed companies pay dividends only on an annual basis, with a small number of listed companies offering interim dividends. According to data from the China Listed Companies Association, as of August 31, 2023, 162 listed companies in the Shanghai and Shenzhen Stock Exchanges had announced interim cash dividend plans for 2023, accounting for only 3.05% of the total 5,305 A-share companies. Much could be done to enhance stable dividend distribution to protect investors' interest and their returns on investment in the Chinese market.

On December 15, 2023, the CSRC issued the "Regulatory Guidance No. 3 for Listed Companies – Cash Dividends of Listed Companies" (the "Cash Dividend Guidance") and the "Decision on Amending the 'Guidance for the Articles of Association of Listed Companies'" to further optimize regular dividend payout mechanism for listed companies to raise the level of investor returns. The CSRC will extend institutional restrictions for companies that do not pay dividends, paying particular attention to companies with substantial financial investments but a low dividend payout ratio to encourage an increase in dividend distribution. Also, companies that distribute dividends abnormally will be under more serious monitoring to promote the practice of reasonable and continuing dividend policies.

[5] Statistics reveal that among companies listed in the recent decade, more than 100 have had a total cash dividend payout of zero from 2013 to 2022. During the past three years (based on dividend payout data disclosed in the annual reports), 1,203 companies did not pay any dividends. Excluding the 257 companies that went public in 2023, there are still 946 companies that have not paid dividends in the last 3 years. Companies such as *Berry Genomics, Guizhou Zhongyida* Co., Ltd., and *Xueda* Education Group have maintained a record of not paying dividends for over 20 years. Notably, *Shenyang Jinbei* Automotive Company Limited has never made a cash dividend distribution during its 31 years since going public.

[6] *Huabao* Flavors & Fragrances Co., Ltd. distributed a total of RMB 4.387 billion in cash dividends from 2016 to 2018, which exceeded the company's cumulative net profit of RMB 3.59 billion during the same period.

4.1.3. ESG information disclosure

The ESG information disclosure by listed companies in China is primarily voluntary. However, some companies in key polluting industries are mandated to disclose more relevant information. The SSE enforces the disclosure of social responsibility reports for companies listed on the STAR Market Index. Composing companies in the "STAR 50 Index" are specifically required to disclose either a social responsibility report or an ESG report separately.

Furthermore, it is mandated that companies listed in the "Shenzhen 100 Index" issue social responsibility reports. Table 1 shows the current state of ESG reporting among Chinese listed companies.

Table 1
The percentage of ESG report publication by listed companies in China

Market type	2019	2020	2021	2022
Shanghai Exchange	39.2%	37.92%	41.81%	40.54%
Shenzhen Exchange	18.4%	20.48%	22.64%	21.89%
Total	27.06%	28.04%	31.12%	39.87%

It is argued that the current ESG disclosure regulations in China should be further standardized. On the one hand, disclosure of ESG information by listed companies is voluntary, and there is no mandatory requirement for all Chinese listed companies to make ESG disclosure at present. On the other hand, while regulatory authorities and self-regulatory organizations have preliminarily established an ESG disclosure framework, there is a lack of detailed disclosure standards and guidance, leading to inconsistencies in the scope and depth of corporate ESG disclosures. This may deprive investors of obtaining high-quality, standardized, and comparable ESG data and mislead stakeholders' decision-making.

Regarding the quality of disclosure, first, the ESG information disclosed by Chinese listed companies is often superficial and incomplete, lacking substantive content that corresponds to the requirements of the stock exchanges and professional guidance. Second, the quality of environmental information disclosure is insufficient, with only aggregate carbon emission data provided, or in some cases, there is no disclosure at all. The ESG information is often descriptive, with a scarcity of quantitative data, and there is a lack of horizontal comparison. Lastly, the information on social governance tends to be overly positive, avoiding disclosure of negative aspects. The reports present, in general, "what has been done" rather than "what has not been achieved" with regard to corporate ESG performance.

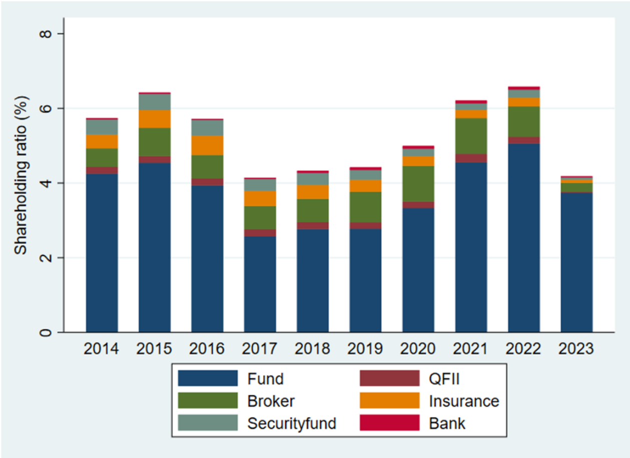
ESG reports issued by Chinese listed companies are still being reviewed through an internal process, with less than 4% of ESG reports having been assured by third-party auditors. The absence of external review or auditing diminishes the credibility of ESG reports, which is not helpful to bolster investors' confidence in the Chinese market.

4.2. External issues

4.2.1. Efficacy of supervision by institutional investors

In China, the term "institutional investors" typically encompasses a variety of entities, including mutual funds, Qualified Foreign Institutional Investors, insurance companies, securities firms, social insurance funds, trust companies, corporate pensions, and private equity funds. Most listed companies in China have ownership structures characterized by a high degree of concentration.

Figure 2
Institutional investor shareholding of Chinese A-share listed companies (2014–2023)



Although the average holding percentage of the largest shareholders has been declining in recent years, it remains above 30% at present. Chinese regulatory authorities stipulate that a single institutional investor is not permitted to hold more than 10% of the total shares in a listed company. By examining the data from 2003 to 2018, [8] reveals that the average ownership percentage held by all institutional investors in a listed company is 6%, in contrast to the average of 36% held by the controlling shareholders. Figure 2 shows the average ratio of institutional shareholding in Chinese listed firms from 2014 to 2023. We observe that the shareholding ratio in 2023 was as low as 4%.

Consequently, institutional investors may lack both the incentive and the capability to engage in active and effective corporate governance to monitor the controlling shareholders and the management.

Moreover, due to relatively low shareholding ratios, institutional investors in China struggle to exert an influence over controlling shareholders or internal corporate managers. This situation has led to a short-term vision among Chinese institutional investors, with a pronounced inclination toward speculative motives rather than participating in long-term corporate governance activities [3, 9].

4.2.2. Supervisory role of financial institutions

Commercial banks are the main creditors of Chinese listed companies, and they have exhibited a diminished interest to fulfill supervisory duties. This has been exemplified in the Evergrande Real Estate debt crisis, where the company's liabilities to banks and other financial institutions amounted to over RMB 500 billion. Despite the involvement of so many commercial banks and a relatively dispersed creditor base, the individual risk exposure of each financial institution is not substantial. However, this case indicates a deficiency in the oversight of corporate governance by financial institutions.

Major commercial banks in China are predominantly state-owned and have to bear the social responsibility of assisting business enterprises through difficult times and stabilizing employment. Yet, this role has the potential to distort their duty of efficient resource allocation and diminish their supervisory impact on corporate clients. It is necessary to reexamine the role of financial institutions to ensure their involvement does not compromise the governance and financial health of their debtors.

4.2.3. Roles of market intermediaries

The debt default by Evergrande Real Estate has triggered a crisis of confidence in the capital market regarding the role of market intermediaries, as CITIC Construction Investment Securities[7] and PricewaterhouseCoopers (PwC) are at the center of scrutiny. Most market participants have questioned why these two intermediary institutions continued to assist Evergrande Real Estate in issuing bonds despite being aware of the company's imminent risk of bankruptcy. Furthermore, the market has expressed skepticism about the quality and reliability of professional services provided by these firms.

In the regulatory framework, external auditors are entrusted with the responsibility of assuring the truthfulness and fairness of corporate financial reporting. Their independence and professionalism form the foundation of market trust. However, in China, the independence and professionalism of external auditors face many challenges, which are clearly reflected in the Evergrande Real Estate debt default event.

PwC has been the auditor for Evergrande Real Estate and provided continuous services for 10 years, including 6 years of audit services, and consistently issued unqualified audit opinions during this time. However, in February 2024, an investigation into Evergrande's financial fraud revealed that between 2019 and 2020, Evergrande had inflated its revenues by RMB 564.1 billion through false financial reporting, thereby defrauding the issuance of RMB 20.8 billion in bonds. The long-term relationship between auditor and client may lead to a dependency of the auditor on the client, potentially compromising the independence and professional judgment of the external auditors. Much should be done to enhance the independency of market intermediaries with regard to good corporate governance in China.

5. Directions for Future Development of Corporate Governance in China

5.1. Deepening corporate governance reforms

With the implementation of the new Securities Law, Chinese listed companies are confronted with stricter governance requirements and higher market expectations. Thus, the continuation of corporate governance reforms is pivotal for enhancing the overall quality and competitiveness of business enterprises. The essence of corporate governance reforms lies in the strict adherence to legal and regulatory frameworks, particularly those stipulated by the new Securities Law and related regulations. It should be more active to protect the interests of minority shareholders. Market regulatory authorities should also continuously experiment with innovative monitoring mechanisms to curb potential tunneling behaviors by controlling shareholders from an institutional perspective and to ensure the rational allocation and utilization of corporate resources. The reform of mixed ownership should not just achieve a mixture of shareholding structures but also delve into the refinement of systemic governance mechanisms. By adopting diversified

[7] CITIC Construction Investment Securities, a large securities firm based in China, played a significant role as one of the lead underwriters in the fraudulent issuance of RMB 20.8 billion in bonds by Evergrande Real Estate. As a key participant in the transaction, CITIC Construction Investment Securities bears a certain degree of responsibility for the debt default events that transpired.

capital and management concepts, the innovation vitality and market competitiveness of SOEs should be stimulated.

In terms of the independent director system, regulatory authorities should actively explore avenues for improvement, raising the proportion of independent directors on the board, strengthening training and assessment to enhance their responsibility for supervision, and ensuring that independent directors can truly exercise their independence and professionalism in corporate governance. Concurrently, optimizing the compensation scheme for independent directors, in alignment appropriately with the risks they undertake, can motivate their proactivity in playing an indispensable role in the improvement of corporate governance.

Institutional investors, as significant market participants, should embrace the concept of shareholder activism and engage deeply in corporate governance. By combining the strategies of "voting with their feet" and active participation, they can elevate the quality of corporate governance, reduce speculative managerial behaviors, and foster the healthy and stable development of the capital market. Banks and other financial institutions should fully leverage their supervisory roles in corporate governance. It is beneficial to enhance the motivation and approaches of financial institutions to be involved in closely monitoring the financial health of listed companies so they can identify and preempt potential risks and secure the financial robustness of business enterprises and the stability of the financial market.

External market intermediaries, for example, auditors, valuators, and legal service providers, should bear more responsibilities in corporate governance. They should diligently fulfill their duties and strictly adhere to the joint liability system for market intermediaries as stipulated by the Securities Law, which is critical to ensure the professional services they provide are both independent and reliable. China's newly amended Securities Law has emphasized the due diligence obligations of market intermediaries by stipulating that the sponsors, underwriting securities companies, and their directly responsible personnel should bear the joint compensation liability with the issuer if they cannot prove their innocence. This measure is expected to strengthen the responsibility among market intermediaries and should be more effectively enforced in practice.

5.2. Further improvement of information disclosure

The quality of ESG information disclosure is essential for the sustainable development of business enterprises and society. Regulatory authorities should expedite the process of making ESG disclosure mandatory and standardized and stipulate authoritative rules and guidelines for corporate ESG disclosure. In addition, information platforms with big data and other new information technologies should be established as the ESG information tracking database to further refine the quantity and quality of corporate ESG disclosures. Efforts should also be made to construct a standardized ESG assessment system with Chinese characteristics, taking into consideration the unique national conditions and industry fundamentals. The design of assessment indicators, measurement methods, and weighting parameters should better represent the ESG performance of Chinese business enterprises.

Accelerating the capitalization and disclosure of data assets is also crucial. In the era of the digital economy, data resources are not only the backbone of the digital economy but also a significant driver of high-quality economic development. For businesses, data resources will become strategic assets of future growth, and data assets have emerged as core components of business resources that should be capitalized and disclosed. In August 2023, the Ministry of Finance in China issued the "Interim Provisions on Accounting Treatment of Enterprise Data Resources," marking a milestone in encouraging and guiding business enterprises to account for data resources. Incorporating business data assets into financial statements is under experimentation, which can significantly enhance the recognition of the value of data resources and promote data asset transactions and utilization. The development can unleash new drivers of business growth and high-quality economic development. Correspondingly, capitalization of data resources will impact both business operations and governance. Business enterprises should be encouraged and guided to strengthen the disclosure of information related to data resources or digital assets proactively. This is a new critical task for improving corporate financial reporting, enhancing the quality of accounting information, and further increasing corporate valuation.

5.3. Explorations in corporate governance in the context of digital economy

The digital economy has given rise to numerous new technologies and business models, profoundly altering the development environment and modes of interaction for companies and society. It challenges the traditional theory and practice of corporate governance that is based on agency problems and information asymmetry. Current research has begun to investigate the potential impact of new technologies such as Big data, blockchain, and AI, on corporate managers, institutional investors, minority shareholders, auditors, and other parties involved in corporate governance [38], as well as the advantages and disadvantages of new technologies in mitigating agency problems [39].

The Chinese government is closely monitoring the development of the digital economy and has introduced a range of policies at both national planning and capital market levels to support business enterprises in undertaking digital transformations. In the face of rapidly evolving business and operational innovations, traditional corporate governance concepts will be reexamined. For instance, it is yet to be determined whether new technological tools in the digital economy can alleviate or even eliminate the problem of information asymmetry that is a key consideration in contemporary corporate governance. In addition, corporate demands for new technologies may lead to a greater emphasis on professional technical talent. It raises the question of whether and how the business founders and management teams who are equipped with core technology and key resources can supplant capital (shareholders) in the corporate hierarchy to better fulfill the operational and governance objectives.

As the digital economy continues to evolve rapidly, it is imperative to fully consider the impact of adaption and restructuring on corporate governance to ensure that the governance structures can remain effective and relevant in this new era of the digitalized business world.

6. Conclusions

We present a comprehensive review of the historical evolution, achievements, and existing challenges of corporate governance in pace with the reopening of the capital market and examine its practices and challenges contextual to economic transition in China. The corporate governance in China has undergone four distinct evolutionary phases, with significant accomplishments having been obtained, including the optimization of shareholder governance, deepening of mixed-ownership reform, improvements in board governance, enhancements in the quality of information disclosure, and advancement of sustainable development. However, internal issues such as the effectiveness of the independent director system, the rationality of cash dividend distribution, and the quality of ESG information disclosure, along with external issues like the supervision effectiveness of institutional investors, monitoring by financial institutions, and the efficacy of market intermediaries, all require further exploration and refinement.

We outline the direction for the future development of corporate governance in China and advocate that more concrete efforts should be made to deepen corporate governance reforms, improve information disclosure, and explore new models of corporate governance in the context of the growth of the digital economy. Measures, such as increasing the proportion and compensation of independent directors, enhancing activism of institutional investors, strengthening the supervisory role of banks and other financial institutions, and increasing the accountability of market intermediaries, should contribute positively to improve corporate governance effectively. The further optimization of corporate governance can better protect investor rights and promote market stability and healthy development in China.

Moreover, we propose that it is crucial to enhance mandatory and standardized disclosure of ESG corporate performance, experimentation of capitalization and disclosure of business data resources, construction of an ESG assessment system of corporate performance with Chinese characteristics, and exploration of new corporate governance issues in the digital economy. All of these efforts should help Chinese business enterprises better adapt to the developmental needs under the rapidly changing business environment and enhance corporate competitiveness and contribute Chinese wisdom and solutions to corporate governance in the global arena. Through the implementation of these comprehensive measures, corporate governance in China will proceed steadily in light of the rule of law and creating greater value for shareholders, employees, and society, which provide support for high-quality economic development.

This study has several limitations. First, we primarily focus on explicit institutional factors in the discussion of corporate governance, while the influence of implicit cultural factors on corporate governance has not been thoroughly explored. Recent research has begun to analyze the impact of social and unique cultural elements on Chinese corporate governance [40–42]. Therefore, a comprehensive review of these new issues is crucial for identifying cultural elements that contribute to effective corporate governance.

Second, our analysis focuses on formal institutions, while informal institutions – such as the role of relationships (*Guanxi*) in Chinese business operations – have not been fully examined [43–46]. Given the importance of interpersonal relationships in Chinese society, it is necessary to conduct an updated literature review on the role of informal institutions in Chinese corporate governance to assess their current impact.

Ethical Statement

This study does not contain any studies with human or animal subjects performed by any of the authors.

Conflicts of Interest

The authors declare that they have no conflicts of interest to this work.

Data Availability Statement

Data sharing is not applicable to this article as no new data were created or analyzed in this study.

Author Contribution Statement

Qidi Zhang: Methodology, Software, Validation, Formal analysis, Investigation, Data curation, Writing – original draft ,Visualization. **Zhijun Lin**: Conceptualization, Methodology, Vali -dation, Formal analysis, Investigation, Writing – review & editing ,Visualization, Supervision, Project administration.

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