

Corporate Governance in China: An Evolving Model

Governance Amongst Pirates

“Our Captain and his Mate used us Barbarously. We poor Men can’t have Justice done us. There is nothing said to our Commanders, let them never so much abuse us, and use us like Dogs”

--Pirate William Fly, 1726, after being captured speaking about treatment by merchant ship captains operating under Admiralty Law.

“Most of them having suffered formerly from the ill-treatment of their officers, provided carefully against any such evil now they had the choice in themselves . . . for the due execution thereof they constituted other officers besides the captain, so very industrious were they to avoid putting too much power into the hands of one man.”

--Pirate Walter Kennedy



The Capture of Pirate Blackbeard by Jean Leon Gerome Ferris

Pirates who terrorized the waters of the Caribbean, Atlantic and Indian Oceans during the 17th and 18th centuries were known for irresponsible, reckless and chaotic plunder. The reality was much different. Pirates applied rational decision making to established institutions to manage their sophisticated undertakings. Pirates during this time were a loose confederation of maritime bandits who had mostly served in navy and merchant ships. They operated over a wide geographic area with diverse crew members coming from multiple locations including America, West & East Indies, Scotland, Wales, Sweden, Holland, France, Spain, Portugal, Scandinavia, Greece and other locales. Crews averaged 80 members with some ships carrying upwards of 300 individuals. Further, ships often came together to form squadrons and a leader could command over 2,000 men which was needed to attack large coastal communities.

To effectively organize these large scale, complex operations, pirate ships and organizations had to solve three problems:

- 1) predation by autocratic captains;
- 2) social cohesion; and
- 3) the maximization of profits.

In order to be successful on such dangerous undertakings as surviving on the high seas and entering armed robbery, pirate ships needed captains who could wield unquestioned authority in battle and other emergencies. However, what then prevented an autocratic captain from behaving badly towards his crews? In the Royal Navy and on merchant ships, there was a long history of captains stealing the crews' wages and food, not providing adequate and sanitary living spaces along with using power to settle personal disputes. Admiralty law considered interfering with captain punishments mutinous. The threat of mutiny (revolution) was of little practical value in most instances. The problem is that ships, like all social organizations, are made of multiple factions or groups. Factions would have to band together overthrow the leader. This was dangerous because the captain controlled the armed enforcers on the ship and the factions had imperfect information on what the other factions would do. Thus, it was very risky for crews to attempt mutiny.

To solve the problem of predation by autocratic leaders, pirates instituted a democratic system of divided power, or as is known today in America checks and balances. Pirates used the quartermaster to counter the power of the captain. Captains did retain absolute authority in battle in order to maximize the chance of survival and profits. However, crews transferred power to allocate provisions, select and distribute loot, adjudicate crew member conflicts, and administer discipline to the quartermaster. The captain's ability to prevent factions from forming for the purpose of mutiny were now much reduced because he could no longer harm crew members through the distribution of food and booty or by arbitrary punishment. This all predated the separation of powers in England in 1688 and in the United States a century later. According to pirate sources, the captain could not undertake anything which the quartermaster did not approve. The captain was also elected by suffrage of the majority, and captains could be voted out of position due to cowardice, poor judgement, or other bad behavior. Unlike navy or merchant ships, a captain's lodging, provisions, and even pay were similar to the crew's provisions.

After solving the problem of predation by the captain, there still remained the question as to how the quartermaster was to allocate provisions, select and distribute loot, adjudicate crew member conflicts, and administer discipline. To solve this problem, pirate ships originated “articles of agreement” that were laws aimed at the conservation of their society and administration of justice to one another. In other words, laws were used to promote social cohesion and harmony. Articles of agreement required unanimous consent and were democratically formed in advance of launching an expedition. Pirates sought these agreements before expeditions to prevent disputes during voyages. The constitutions provided well-defined rules that governed behavior and limited conflict that could jeopardize their ability to plunder. But most importantly, the articles of agreement limited the power of the quartermaster who in turn was a check on the captain. The articles of agreement were common knowledge among the crew, and all knew when the quartermaster overstepped his bounds.

References:

<https://www.peterleeson.com/an-arrgh-chy.pdf>

http://webdoc.sub.gwdg.de/ebook/p/2005/history_cooperative/www.historycooperative.org/proceedings/seascapes/rediker.html

https://en.wikipedia.org/wiki/Golden_Age_of_Piracy#/media/File:Capture-of-Blackbeard.jpg

Corporate Governance

“Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.”

--Sir Adrian Cadbury, UK, Commission Report: Corporate Governance 1992



Pirate ships needed to solve complex problems that would enable the effective management of their assets. Like all societies, they did not want to waste resources on misguided ventures that depleted their wealth and increased their odds of capture or ruin. Pirates were continually being hunted by larger better funded navies along with constant challenges from their fellow buccaneers. Without more constantly replenishing and growing resources, crews would end up losing out and becoming subject to the governance of another systems (i.e. in jail or sentenced to death). To maximize the odds of capturing booty, pirates instituted a complex governance system. In modern corporate speak, in order to survive, pirates needed to efficiently (no waste) employ their assets (ships, weapons, food, crew) to grow their capital stock (booty which could be used to buy rum or grow assets).

Corporate governance is not the same as management. The management of an organization is in the hands of the executives and managers who run the day-to-day operations. Management is a scientific undertaking requiring analysis and logical reasoning. Corporate governance, in contrast, is a political process. The governing body is responsible for overseeing management and maximizing the odds of success. Limited liability companies were developed in the 18th and 19th centuries to raise capital to fund large undertakings. Ownership of limited liability companies is the basis of power in the organization. Owners nominate and elect directors, appoint auditors, receive information, set executive compensation, manage overall risk, and decide on large capital allocation options.

Without limited liability companies, a modern economy would not be able to produce food, write advanced software, manufacture semiconductors, construct housing or produce the endless other goods and services needed to survive and enjoy the pursuit of happiness. Sound corporate governance is strategically important to modern governments given the large resources limited liability companies control.

There are several models for corporate governance:

- 1) the United States unitary board, rule-based model;
- 2) the UK/Commonwealth unitary board, principles-based model;
- 3) the Continental European two-tier model;
- 4) the Asian family model;
- 5) the Asian interlocking ownership model (Keiretsu in Japan and Chaebol in South Korea); and
- 6) the Chinese model.

In the next two sections we are going to explore Corporate Governance in Hong Kong which follows the UK/Commonwealth unitary board model and then Corporate Governance in China, which is an evolving hybrid model.

Alasdair Nairn wrote the following at the beginning of chapter two in his seminal book *Engines that Move Markets*:

For the United States, the 1800s was a time of growing international trade, emigration from Europe and technology transfer from the developed economies to the New World. Some of the technology transfer simply took the form of the skills brought by the immigrant population. However, US entrepreneurs were also visiting Europe to see what new inventions and technologies could profitably be imported. In the case of the railroads, at first the Americans simply imported the steel and the locomotives.

Later, the skills and manufacturing techniques required to build a railway also began to cross the Atlantic, leading to the creation of an independent railroad industry. While America was a new country, it combined an established economic system on the eastern seaboard, resembling that of the 'Old Country', and the emerging potential of the new western frontier. Together these created a whole new set of operating conditions...

While the development of the American railroads followed a similar pattern to their counterparts in Britain, there were significant differences. Britain was in many ways the world's economic superpower, and America was an emerging market. In Britain there was an established legal and governmental system; in America, the delineation of the legal province of the individual states and central government was in many cases unclear. In America, land on which to lay track was readily available; in Britain it often had to be secured against entrenched opposition. The final and most notable difference was that, as the major financial centre of the world, Britain was an exporter of capital – and, as a developing market, America was an importer.

Prior to the US Civil War, British investors preferred to invest in American railroads bonds by owning bonds offered by states or by taking barter payment in exchange for the iron rails used for construction of the railroads. At one point, almost half of all the capital in American railways was owned by Britons as a consequence of funding by way of export rails. This changed after the US Civil War. During the war, the US suspended interest payments on bonds and thereafter foreign investors wished to own more equity capital. However, these investors also wanted fixed payments and so convertible bonds became the favored form of financing for the railroad industry in post-war America.

Cornelius Vanderbilt's foray into railroads began with the purchase of stock in the New York and Harlem Railroad. Vanderbilt began buying stock at \$9 a share and continued at prices of more than \$50 per share. Once he had control, he paid large sums of money to the New York Common Council to grant him a streetcar franchise between Battery and Broadway. When news of the franchise was published, the share price of Vanderbilt's investments went up by more than ten times. In response, George Law—a rival of Vanderbilt—persuaded politicians of the New York State Legislature to claim an exclusive right to award such franchises and announce its intention to revoke Harlem's franchise. In tandem with this, a short selling operation was launched against the stock. Vanderbilt countered with his own capital and squeezed the short sellers, profiting over \$1 million.

Cornelius Vanderbilt next moved on the Hudson River Railroad and once more bought off local politicians to gain authorization. Again, short sellers circled as rumors emerged that politicians would reverse course. However, once again, Vanderbilt emerged the winner by employing his own capital to buy stock.

In May 1869, after managing to merge all his railroad interests into New York Central, Vanderbilt recapitalized the company by issuing new stock. A large part of the money went into the pockets of directors or politicians in Albany. The higher capital base also justified the setting of higher fares charged to the public. At this time, there was no clear unitary legal framework within the US company or securities law. This was also the time of 'Tammany Hall' and the era of Boss Tweed. Protection or support from the law was usually simply a matter of the amount one was willing to pay. There was little in the way of legal protections for shareholders, and given that many shareholders were European, their ability to exercise their rights was greatly impaired due to corrupt political, legal and governance systems in the United States.

In the 1860s, Vanderbilt aimed to establish full control of routes from New York to Chicago. To do this, he need to ultimately control the Erie Railroad. The story of 'the fight for the Erie' chronicles many of the worst investment abuses of the time including profiteering, share price manipulation, anti-competitive practices, political corruption, and the abuse of minority shareholder rights. The Erie Railroad was chartered in 1832 and completed in 1851 but as a result of poor construction and route selection, its share price sank from \$33 to \$9 in 1859 and the company went into receivership. However, in the following years, the line recovered as it acquired better routes, access to coal fields in Pennsylvania, and a tie-up with the Atlantic and Great Western Railroad, along with additional business from the Civil War. In the 1860s, Daniel Drew, who had been investing in the company since 1854, became the treasurer. To try and gain control of Erie, Vanderbilt entered into an agreement with Drew and began to purchase stock. Drew, however, eventually reneged on his agreement with Vanderbilt and flooded the market with newly issued stock.

The stock came from Jay Gould and Robert Fisk. Gould and Fisk bought a smaller railroad and leased its assets to Erie at inflated rates. Erie paid these rates using convertible bonds which were then turned into equity and Gould and Fisk were appointed to the Erie's board of directors. At this same time, John Eldridge, of Boston, also purchased stock in Erie in an attempt to convince the company to build a road connecting Boston and the Hudson River. Vanderbilt convinced Eldridge to vote against Drew and his partners in exchange for Vanderbilt guaranteeing \$4 million of his debts. Outmaneuvered, Drew temporarily resigned from the board. The peace between Vanderbilt and Drew did not last long. The board, under Drew's control, had Erie issue convertible bonds to dilute Vanderbilt along with foreign owners whose proxy votes were controlled by Vanderbilt. Undeterred by his losses, Vanderbilt turned to New York Supreme Court Judge George Barnard who issued injunctions requiring the return of 25% of recently issued securities, \$3 million of convertibles and the cessation of further issues.

Not to be outdone, Drew enlisted his own politicians and judges. Drew's New York Supreme Court justices stayed all of Vanderbilt's actions and removed his appointee from the Erie board of directors.

While the injunctions were passing back and forth, Drew continued to issue stock which Vanderbilt was forced to purchase. Vanderbilt's financial position became precarious, and Judge Barnard issued contempt orders. Drew, Fisk, and Gould avoided arrest by fleeing to New Jersey while carrying \$7 million of cash and company papers with them.

The war of injunctions continued throughout 1868 during which time Drew installed cannons on the wharves near his headquarters and hired policemen for protection while Vanderbilt threatened to bring down the entire financial system if further capital was not advanced to him. Gould used his 'legal purposes' funds to lobby the New York state legislature to legalize the issuance of Erie's bond issues. For this, Gould had to pay senators over \$1 million, and Boss Tweed swung to Gould's camp. The legislators passed a bill forbidding the same group from owning the New York Central and Erie Railroad.

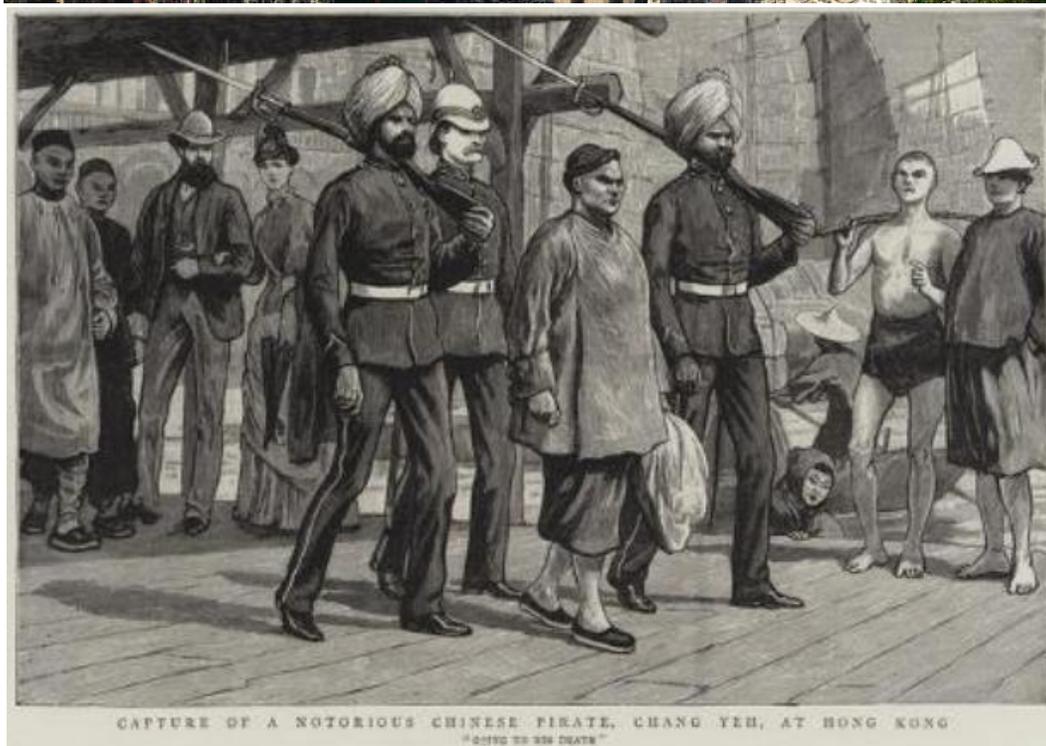
The ever-duplicitous Daniel Drew ended-up double-crossing Gould and Fisk by authorizing transactions that reimbursed Vanderbilt for his loss of control and left Erie with \$9 million in debt. Shareholders of Erie were left with what appeared to be a shell company. During this whole saga, Erie had issued \$20 million of bonds and debt without making any capital expenditures or improvements to operations. Recognizing the need for political patronage, Gould appointed William Tweed to the board. Erie then issued \$20 million more of capital for the purposes of making the improvements it had claimed to have made in earlier years. To exact revenge, Gould enticed Drew into shorting Erie and then trapped him in a liquidity squeeze forcing the price up. Gould's relationship with Tweed gave him access to New York City funds. Members of the brokerage firm Smith, Gould and Martin, along with Tweed, withdrew funds from the Tenth National Bank to tightened liquidity conditions in the financial markets.

Eventually, Gould lost control of Erie as the protective umbrella of Tweed and Tammany Hall came under fire for obvious corruption, Fisk was murdered by a mistress's lover, and disenfranchised British stockholders began to exert their rights. The reorganized Erie added J.P. Morgan to its board of directors as financiers were beginning to advance their influence to increase active participation in the management of companies. Throughout this whole saga, minority shareholder rights were violated time after time. Foreign shareholders whose ownership was diluted over and over again lacked the political patronage to lobby for their interests; and without the rule of law, their financial interests were greatly impaired. During the middle and late 19th century, America's economic system favored domestic and majority owners who controlled company boards and heavily influenced domestic political institutions. Outside financial interests, however, during this time began to demand board representation and the protection of their property rights. Over the next hundred years, the United States further developed laws to protect private property rights, created regulatory institutions to oversee limited liability companies, and strengthened the professional classes needed to properly administer the governance of corporations to ensure all stakeholders are treated fairly. Just like pirates, the United States needed to reform its institutions to prevent predation by powerful leaders while promoting social cohesion in order to maximize profits and economic output.

Corporate Governance in Hong Kong

“In one hour of questions and answers, I stated the obvious to the audience at the international convention center—1,200 of Hong Kong’s political, business, and media elite—that if Hong Kong became just another Chinese city, it was of no value to China. What made Hong Kong useful to China was its strong institutions, management expertise, sophisticated financial markets, the rule of law, the transparency of legislation and regulations, a level playing field for all, plus a cosmopolitan lifestyle with English as the language of business. These made Hong Kong different. Hong faced two contrary pulls. To be useful to China, it must learn to work the Chinese Officials and understand their different social, economic, and political systems and mindset. But it must never allow those attitudes to affect Hong Kong for otherwise it would become just another Chinese city. It had to retain the characteristics that made it an indispensable intermediary between China and the world, as during British rule.”

--Lee Kuan Yew, From Third World to First, The Singapore Story 1965-2000



CAPTURE OF A NOTORIOUS CHINESE PIRATE, CHANG YEH, AT HONG KONG
"GOING TO HIS DEATH"

Following the First Opium War in 1842, China's Qing dynasty was forced to cede Hong Kong Island to Britain. In the 19th century, Hong Kong Island was a barren place known for smuggling and pirates as opposed to the more developed and refined city of Shanghai. Following the founding of the Peoples Republic of China in 1949, many industrialists and elites from Shanghai fled to Hong Kong and began to develop the modern city. They quickly adopted British commercial and banking practices along with developing American management techniques and elite relationships in education and commerce. During this time, Hong Kong had its own governmental bodies, law courts, and currency. Thus, after World War II, the City created and developed the institutions necessary to become a major financial and commercial center.

Hong Kong corporate governance is based on the UK/Commonwealth unitary board model which is based on common law and rooted in legislation and reinforced by the courts in rulings on specific cases. The UK/Commonwealth model is principles based along the core idea of "comply or explain." Codes of corporate governance principles or good practices determine board responsibilities, not legal doctrine as passed by governments such as the practice in the United States.

The following discussions on the corporate governance in Hong Kong and China were greatly influence by the two books:

- 1) *"Chinese Companies and the Hong Kong Stock Market"*, by Flora Xiao Huang and Horace Yeung;
- 2) *"Understanding Corporate Governance in China"*, by Bob Tricker and Gregg Li.

Corporate Government Institutions in Hong Kong

The Independent Commission Against Corruption

During the development of Hong Kong following WWII, bribery and corruption became endemic. It became apparent to the British and local authorities that something had to be done, and as such the Independent Commission Against Corruption (ICAC) was established in 1974. This independent organization of civil servants was eventually successful and by 2017 Hong Kong was ranked 18th in the 2015 Transparency International Corruption Perception Index.

The ICAC is organized into three divisions: operations, corruption prevention, and community relations. Its mission is to continue to fight corruption in the city. The Commissioner of the ICAC is now appointed by the State Council of the Peoples Republic of China (PRC) in Beijing on the recommendation of the Chinese-nominated Hong Kong Chief Executive. China is a signatory of the UN's Convention Against Corruption and is required to provide mutual assistance to other jurisdictions, and as an SAR of China, Hong Kong has similar responsibilities.

Regulatory Bodies

Hong Kong has a three-tier regulatory framework. The first tier comprises frontline operators, i.e. the exchanges. The second tier is the regulators who oversee the exchanges, and the third-tier is the government which is not involved in the day-to-day operations of the securities and futures industry. The Financial Services Branch (FSB) of the Financial Services and the Treasury Bureau is responsible for this function.

Hong Kong Stock Exchange (HKEX)

The HKEX is the holding company of the Stock Exchange of Hong Kong (SEHK), Hong Kong Future (HKFE) along with the clearing corporations. HKEX focuses on trading operations and risk management.

Securities and Futures Commission (SFC)

The SFC is an independent statutory body established in 1989 by the Securities and Futures Commission Ordinance (SFCO) as the oversight regulator for detecting market malpractices with statutory implications.

The Companies Registry

Companies operating in Hong Kong must follow the Companies ordinance. The registry records the details of both local and foreign firms operating in Hong Kong, and the records are open for inspection.

Legal Professions

The Company law is the cornerstone of Hong Kong's sound corporate governance and a well administered judicial system is needed interpret and implement the law. Hong Kong's legal system is based the English system of common law with a hierarchy of courts, jury trials, and judges' decisions becoming precedents.

The Judiciary

The Judiciary in Hong Kong exists to “maintain and independent and effective judicial system which upholds the rule of law, safeguards the rights and freedoms of the individual, and commands confidence within and outside Hong Kong.”

Hong Kong Bar Association (HKBA)

The HKBA was founded in 1949 and is the professional organization of barristers who are self-employed independent legal practitioners.

The Law Society of Hong Kong

The Law Society of Hong Kong is the professional certification body for solicitors to practice law in Hong Kong with roots dating back to 1907.

Securities and Corporate Professions

In order to properly protect minority owners' rights and efficiently allocate capital, market participants need accurate and timely disclosure of information.

Hong Kong Institute of Certified Public Accountants (HKICPA)

Established in 1973, HKICPA issues practicing certificates and is responsible for the accounting, financial reporting and auditing standards in Hong Kong. HKICPA has around 36,000 members and 18,000 registered students.

Hong Kong Institute of Chartered Secretaries (HKICS)

All companies are required to have a company secretary in Hong Kong. The HKICS qualifies, registers, disciplines and represents the interest of corporate secretaries. The corporate secretary is tasked with knowing and complying with meeting notices and requirements and along with scheduling affairs to accommodate directors.

Hong Kong Institute of Directors (HKIoD)

HKIoD represents directors in Hong Kong and establishes the code of conduct for honesty, legality, diligence, accountability, and integrity.

Nominated Advisors (NOMAD)

To be listed in Hong Kong, HKSE requires companies to apply through a NOMAD that is experienced in corporate with appropriate skills and knowledge.

Institutional Investors

Overseas institutional investors account for 40 percent of local market transactions in Hong Kong. It boasts the largest hedge fund industry in the APAC region trailing only the US and UK globally. Other institutional investors include sovereign wealth funds, pension funds, insurance companies and mutual funds. All of these institutions have trained analysts and fund managers.

Education System

None of the above institutions would function without well trained individuals. Fortunately, Hong Kong has world class universities.

Primary Education

A society needs a strong primary school education system to educate youth to be prepared to enter universities. Hong Kong, along with Singapore, usually rank 1 and 2 in the world according to OECD.

Universities

Five of Asia’s top 10 universities are in Hong Kong.

Top 10 Chinese universities
According to Times Higher Education



University	THE ranking
University of Hong Kong, Hong Kong	43
Peking University	48
Tsinghua University	49
Hong Kong University of Science and Technology	51
Chinese University of Hong Kong	129
City University of Hong Kong	192
Fudan University	193
University of Science and Technology of China	201-225
Hong Kong Polytechnic University	201-225
Nanjing University	251-275

MBA's and other Advanced Degrees

Competitive companies need trained engineers, managers and leaders.

Hong Kong Corporate Legislation

The Hong Kong Companies Ordinance (CO)

The CO is the primary piece of legislation governing companies and their activities from incorporation to winding up. The CO also deals with non-Hong Kong companies that are incorporated outside Hong Kong but which have established a place of business in Hong Kong. The CO was first enacted in 1965 and was derived from the UK Companies Act 1862.

Securities and Futures Ordinance (SFO)

Under Article 109 Basic Law, the government is to provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial center.

Hong Kong Corporate Governance Codes and Guidelines

The SFC has consolidated all SFC codes and guidelines into a regulatory handbook that is divided into two volumes, the first addressed the SFC and its role and approach. And the second volume contains all the latest versions of the codes and guidelines. Apart from the CO, which mandated information disclosure through the annual accounts, the listing rules require that listed companies are also required to comply with a listing agreement to ensure that investors have and maintain confidence in the marketplace. The Corporate Governance Code sets out principles of good corporate governance along with recommendations.

Core Competencies of an Effective Director (HKIoD)

Group 1: Corporate Business Functions, at a Strategic, rather than Operational, Level

1. Strategic Planning:
 - 1.1 Change management: vision of change and to align the company accordingly, down-sizing or right-sizing, merger and acquisition, corporate restructuring, IPO, policy development.
 - 1.2 Monitoring and follow-through from strategic planning to implementation.
 - 1.3 Managing performance: installing performance appraisals and instilling confidence.
 - 1.4 Evaluation of results.
 - 1.5 Contingency planning, risk management and crisis management.

2. Finance:
 - 2.1 Interpretation of financial statements.
 - 2.2 Evaluation and monitoring of the financial health of a business and identifying warning signals.
 - 2.3 Determining the level of details and frequency of reporting for effective direction.
 - 2.4 Financing alternatives.
 - 2.5 Business/project planning and appraisal.

3. Marketing:
 - 3.1 Concepts of marketing strategy.
 - 3.2 Processes in developing marketing strategy.
 - 3.3 Evaluating marketing strategy.

4. Production and Product/Service Delivery:
 - 4.1 Customer needs and market demands.
 - 4.2 Processes in production or service development.
 - 4.3 Customer care and after-sale support.

5. Organisation and Human Resources:
 - 5.1 Organisation development, culture and structure.
 - 5.2 Directing and motivating senior management.
 - 5.3 Compensation tools.
 - 5.4 Continued training and education.
 - 5.5 Succession planning.
 - 5.6 Evaluation of organisation effectiveness and HR strategy.

6. Information Technology:
 - 6.1 IT as a tool in business development.
 - 6.2 IT as a tool in management.
 - 6.3 Strategy of investment in IT.
 - 6.4 Evaluation of IT strategy.
7. Compliance and legal knowledge for business.

Group 2: Power, Responsibility and Liability of the Board and the Individual Director.

1. Significance of corporate governance.
2. Duties to stakeholders - shareholders, employees, creditors, regulators and community.
3. Fiduciary duties.
4. Responsibilities in directing management, disclosure, accountability and avoiding conflict of interest.
5. Relevant knowledge in Companies Ordinance, Articles of Association, Directors' service contracts, compensation, termination, resignation.
6. Risks, Directors & Officers liability insurance.
7. Winding up.

Group 3: Board Development and Boardroom Practice.

1. Board structure, culture and decision-making processes.
2. Board proceedings, running board meetings and call of general meetings.
3. Roles and relationships - Chairman, Managing Director/CEO, NEDs, INEDs etc.
4. Working with committees.
5. The Audit Committee.
6. Working with external professionals, lawyers, auditors, advisers.
7. Board audit/assessment.
8. Continuing development and training of directors.
9. Update on law, rules and regulations (listing and funding sources).

Group 4: Individual Attributes and Qualities.

1. Communication skills including language proficiency.
2. Vision and creativity.
3. Team-building and team-playing skills.
4. Analytical and synthesizing skills.
5. Judgment and decisiveness.
6. Coaching and facilitation skills.
7. Initiative and taking action.
8. Networks and skills to influence.
9. Health - mental and physical.
10. Emotional stability.

11. All qualities associated with IQ (intelligence quotient), EQ (emotional quotient), AQ (adversity quotient), CQ (creativity quotient), VQ (virtue quotient).

Group 5: Business Ethics.

1. Corporate sustainability,
2. Social responsibilities and the justification of a corporation.
3. Stakeholders relations.
4. Anti-corruption practices, checks and balances.
5. Equal opportunities.
6. Data protection (privacy).
7. Environmental protection.
8. Ethical investment.
9. Transparency.
10. Corporate citizenship.
11. Contribution to professional or industry development.

Corporate Governance in China

...After 20 years of practice a socialist market economy has been basically established in China. But there are still many problems. The market lacks order, and many people seek economic benefits through unjustified means; the market for factors of production lags behind in development, unable to allocate the factors of production to meet the effective demand; the lack of unified market rules has resulted in rampant protectionism initiated by departments or local governments; and market competition is not good enough to select the superior and eliminate the inferior, and thus slows down economic restructuring. If left unsolved, these problems will hinder the development of a sound socialist market economy.

Over the past two decades since the Party's 14th National Congress we have kept searching for a new positioning for the relationship between the government and the market through practice and theoretical research. The Party's 15th National Congress proposed that "the market plays a basic role in allocating resources under state macro control," the Party's 16th National Congress proposed to "give fuller play to the basic role of the market in allocating resources," the Party's 17th National Congress sought to "introduce institutions to give better play to the basic role of the market in allocating resources," and the Party's 18th National Congress stipulated that the Party should "leverage to a greater extent and in a wider scope the basic role of the market in allocating resources." From the above progression it can be seen that we have been constantly deepening our understanding of the government-market relationship...

...State-owned enterprises (SOEs) constitute an important force for advancing modernization and protecting the common interests of the people. Through many years of reform SOEs have by and large assimilated themselves into the market economy. At the same time, however, they have also found problems and drawbacks in their system, which call for further reform. The Decision proposes a series of targeted reform measures: We must ensure that state-owned capital increases its input into public-service-oriented enterprises; in natural monopoly industries in which state-owned capital continues to hold controlling interests, carry out a reform focusing on separation of government administration from enterprise management, separation of government administration from state assets management, franchise operation, and government oversight, separate network ownership from operation, and deregulate control over competitive businesses in light of the conditions of different industries; improve the corporate governance structure to ensure smooth operation and effective checks and balances; establish a system of professional managers, and give better play to the role of business executives; establish a long-term incentive-and-restraint mechanism, and strengthen investigations into the accountability of SOE operations and investment; and explore ways to publicize important information, including SOE financial budgets. Moreover, SOEs should appropriately increase the proportion of market-based recruitment, and properly determine and strictly regulate the salary level, post-related benefits and expenses as well as business spending of SOE managerial personnel. These measures will stimulate SOEs to improve the modern corporate system,

enhance their operating efficiency, better fulfill their social obligations and play a better role in the economy...

... We must adhere to the “two unwaverings” in order to continue and improve our basic economic system. The Decision proposes reform measures on multiple levels to encourage, support and guide the development of the nonpublic sector of the economy, and to stimulate its vigor and creativity. On functional positioning, the Decision points out that both the public and nonpublic sectors are important components of the socialist market economy, and an important basis for China’s economic and social development. On the protection of property rights, the Decision points out that the property rights of both the public and non-public sectors are inviolable. On policy treatment, the Decision stresses equal rights, equal opportunities and identical rules, and a unified market access system. The Decision encourages non-public enterprises to participate in the reform of SOEs, encourages development of mixed-ownership enterprises in which private capital holds majority shares, and encourages qualified private enterprises to establish a modern corporate system. All these will contribute to the healthy development of the non-public sector of the economy...

... It was at this meeting that Deng Xiaoping pointed out profoundly: “To ensure people’s democracy we must strengthen our legal system. Democracy has to be institutionalized and written into law, so as to make sure that institutions and laws do not change whenever the leadership changes, or whenever the leaders change their views or shift the focus of their attention...

... As long as we respect and implement the Constitution the people will be able to be masters of the country, and the cause of the Party and the state will be able to progress smoothly. If the Constitution is disregarded, weakened or even sabotaged, the people’s rights and freedoms cannot be guaranteed, and the cause of the Party and the state will suffer. Therefore, precious inspirations from long-term practice must be cherished. We should be more active in taking the initiative in abiding by the principles prescribed by the Constitution, carrying forward its essence and fulfilling the duties it prescribes. While fully affirming our achievements, we should also be aware of our shortcomings: The oversight mechanisms and pertinent systems to ensure the implementation of the Constitution are not yet complete; laws are not properly observed or strictly enforced, and lawbreakers are not prosecuted by some local regions and government agencies; problems concerning the people’s direct interests remain prominent in law enforcement and jurisdiction; abuse of power, malfeasance and dereliction of duty by government employees, and lawbreaking by law-enforcement personnel for personal gain have seriously damaged the authority of the national legal system; and awareness of the need to observe the Constitution among citizens and some officials needs to be further enhanced. We must pay close attention to and earnestly solve these problems...”

Xi Jinping, The Governance of China, 2014

40 YEARS & BEYOND CHINA REFORM AND OPENING UP



DENG XIAOPING

Deng Xiaoping launched China's Reform and Opening Up policy during the Third Plenary Session of the 11th Central Committee of the Communist Party of China in 1978.

He focused on modernizing four of China's major industries: agriculture, industry, science and technology, and the military, while also decentralizing the economy and embracing a "socialist market economy."

CGTN AMERICA

40 YEARS & BEYOND CHINA REFORM AND OPENING UP



XI ZHONGXUN

The father of current Chinese leader Xi Jinping, Xi Zhongxun, as party chief of Guangdong province, oversaw market modernization and the implementation of China's first Special Economic Zone.

After Guangdong, Special Economic Zones were established throughout the country. These zones allowed for Chinese manufacturers to export goods, raise revenue, and encourage direct foreign investment.

CGTN AMERICA



Historical Perspective

To properly understand corporate governance in China today, one must try to understand China's complex history. As the review of governance in Hong Kong demonstrated, corporate governance requires a complex set of institutions staffed by trained professionals that can properly manage and govern a hyper innovative society in the modern area. These institutions cannot be created overnight, and people take years (think in decades and generations) to train. A government cannot just decree that it has trained lawyers, competent judges, honest regulators, smart MBAs or prudent investors and it will be so. It has taken western countries well over three centuries to create such institutions. China is still only at the beginning of its fifth decade of modernization, and it started from a very low point after centuries of tumult.

Foreign Powers and Forced Opening

The following section is largely taking from the third chapter of Henry Kissinger's book *On China*.

China experienced almost every imaginable shock to its historic self-image during the nineteenth century. While still a largely agrarian pre-nation state dynasty, China faced three threats:

- 1) the expansion of the West across the oceans which lead to shock of China's world view and never-ending economic concessions;
- 2) from the north and west an expansionist and militarily dominant Russia was in China's hinterland; and
- 3) finally, from the East came Japan.

These threats eventually lead to serious challenges. When Jesus's younger brother showed up on earth, somewhere between 20 million and 70 million individuals lost their lives in the peasant led Taiping uprising against the Qing dynasty. During the Taiping, Muslim, and Nian upheavals China's population declined from roughly 410 million in 1850 to 350 million in 1873.

While China was weakened by these civil conflicts, France, America and Britain made inroads into China. Most notably, in 1856, British forces seized Guangzhou of the southern Pearl River delta and the Dagu forts in northern China from which they could easily march on Beijing. The British, urged on by aggrieved opium traders, characteristically pressed with missionary zeal that they were providing a public service by bringing China into the modern world. Qing authorities had differing opinions. In 1860, by threatening to intervene in the conflict between China and the West, Russia secured a broad swath of Outer Manchuria along the Pacific coast including what is today Vladivostok.

Japan, like China, encountered western ships wielding unfamiliar technology and overwhelming force in the mid-nineteenth century when American Matthew Perry landed in 1853 with his black ships. In 1868, the Meiji Emperor, in his charter oath, announced that "Knowledge shall be sought from all over the world, and thereby the foundations of the imperial rule shall be

strengthened.” Japan’s Meiji Restoration opened the door to stunning economic growth. In 1874, Japan used an incident between Taiwanese tribesmen and a shipwrecked Japanese crew to mount a punitive expedition. And by 1894, China’s naval forces were easily destroyed. The defeat cost China 230 million taels of silver from China. This was roughly equal to three years of China’s state revenues at time when China’s economy was bigger than both Britain’s and Japan’s economies.

In 1898, the Boxer Rebellion sprung up and eventually led to down fall of the Qing dynasty in 1912. The Boxer Rebellion was a popular uprising against foreigners and symbols of the new order. Diplomats, Chinese Christians, railroads, telegraph lines, and western schools were under attack. After a century of vacillating between disdain and anguished appeasement, China entered a state of war against all foreign powers. The consequences were harsh as an Eight-Power allied expeditionary force consisting of France, Britain, the United States, Japan, Russia, Germany, Austria-Hungary, and Italy arrived in Beijing in 1900 to relieve their embassies. After suppressing the Boxers and the Qing dynasty, these powers imposed another unequal treaty that included cash indemnity and further occupation rights.

After the First World War, Japan found itself once again in the position of conqueror in China. European and American powers opposed Japan and after Japan’s surrender in 1945, China was left devastated and divided. Once again millions died in the struggle and by 1949, the Chinese Communist Party had gained control. After the Nationalists lost and the end of the Kuomintang era, many of Chinese business elites fled the country taking capital and talent with them. Unfortunately, for the Chinese the suffering did not stop. Under Mao, there was continual upheaval. First, there was the Great Leap Forward from 1958 to 1962 that led to up to 45 million deaths. Then, the Cultural Revolution claimed another upwards of 20 million people and dislocated countless families.

Feeling the Stones

It wasn’t until December 1978 that Deng Xiaoping announced a new Open-Door Policy, to open China to foreign businesses. For the first time since the Kuomintang era, the country was opened to foreign investment. One can easily imagine how depleted China’s human, social and physical capital was just 45 years ago. Further, complicating the governance matters was that the state owned everything. So, there was no deep social class of managers, regulators, lawyers, and business owners. Thus, at the beginning of the liberalization, corporate governance was nonexistent, and China had the further challenge of developing governance for both State-Owned Enterprises (SEOs) and newly emerging private businesses.

China’s Corporate Governance has developed in five states: The first period, the **Pre-Reform Stage**, was from 1978 to 1984 starting with the Four Modernizations of the agriculture, industry, defense, and science and technology. The second period, the **Economic Reform Stage**, lasted from 1984 to 1992 and paralleled the meteoric rise of the Chinese economy. The third stage, the **Transitional Stage**, from 1993 to 2003, saw the greatest changes and installations of new

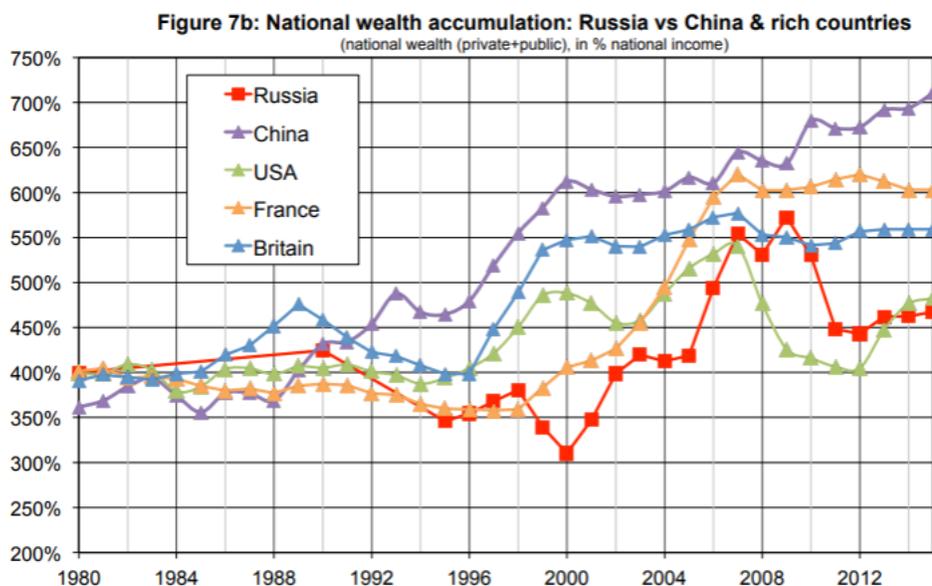
corporate governance practices and regulations along with the recognition that modern enterprises need the separation of ownership and management. The fourth period from 2004 to 2017, the **Convergence Stage**, saw China's attempt to harmonize its corporate governance with those of the UK and US. This lasted until the Trump Presidency, and then China entered the fifth period, the **Emergence Stage**, from 2017 onwards during which China is beginning to acquire companies abroad and move westward through the Belt and Road Initiative.

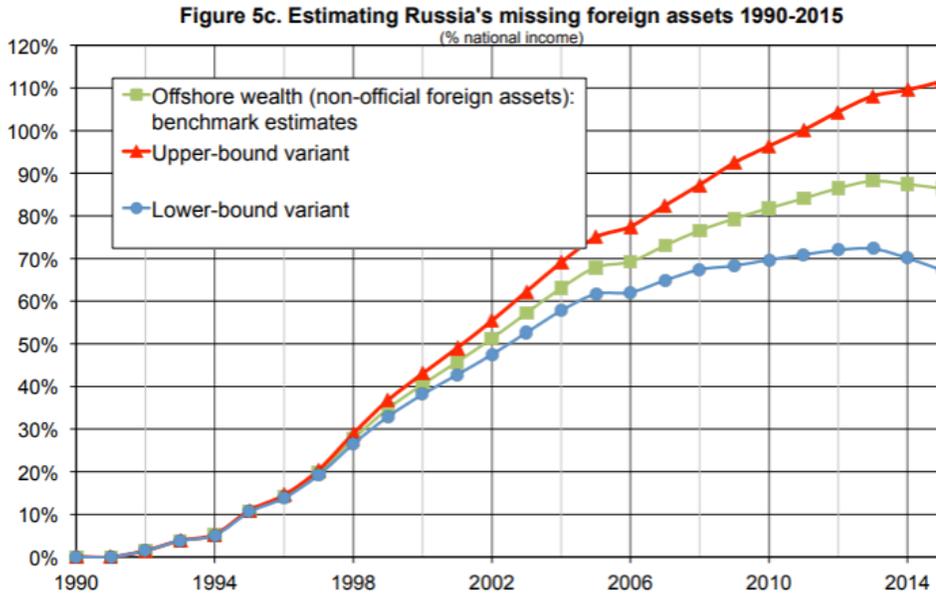
Corporate Governance Challenges of a Developing Nation

For enterprises to efficiently allocate capital (human, physical, and intellectual), there must be regulation of misconduct as even swashbuckling pirates realized four centuries ago. On the one hand, enterprises need strong leadership and risk taking to succeed. On the other hand, however, humans need a sense of fairness in order to work together, which means predation needs to be checked. On a pirate ship, this can be done without a deep set of trained professionals. In a country of over a billion people, it is unrealistic to assume the ship of society will function without well-established institutions to counter insider dealings (a captain taking the best booty), market manipulations (spreading lies amongst the crew) and poor disclosure of information (the quartermaster lying about the content of the booty). There will not be adequate protections of minority rights without a large number of trained individuals who understand complex laws, fast moving businesses, and constantly changing technologies and markets.

Further complicating matters for China is how do they were to divvy up ownership when no one had private property to make a purchase during the opening up period? And without private ownership or educated regulators, how do you govern management who were often party members or have close relationships with the Chinese Communist Party (CCP)?

These are not just academic questions. After the fall of the Soviet Union, there was a large social impact from the emerging economic crises. During *katastroika*, life expectancies fell, leading to millions of excess adult deaths, birth rates collapsed, and crime and illegal trafficking exploded. Further, Oligarchs emerged as owners of old state assets.





<https://wid.world/document/soviets-oligarchs-inequality-property-russia-1905-2016/>

To avoid the fate of the USSR and steer China to a socialist market economy, the CCP slowly opened up its economy and gradually introduced governance reforms to its market enterprises. Until 1978, most enterprises were state owned and governed. After the 1980s, China kept administrative control as the last resort and used to rein in wayward firms. During the **Economic Reform Stage** of corporate governance reform, the state kept a good proportion of the listed shares. The party did this to maintain control in case of extreme circumstances and to also sell at later dates for higher prices, to give to employees, and to fund social insurance programs. During these early periods, shares were held in roughly equal portions by three parties, which included the government, legal persons, and public individual shareholders.

Chinese leadership since opening up has refused to make a clean break with its socialist roots and likely never will. This has led to two main themes running through the development of securities regulation in China: one, to ensure the primacy of socialist ownership and two, restrict foreign ownership in SOEs. China needs outside investors to improve the management and capital allocation of SOEs but does not want to give up control of strategically important industries. To accomplish this, the CCP formed joint stock companies with multiple share classes. Any SOE converting into a shareholding structure would have to divvy its shares into three classes, with two-thirds not tradable and a third of shares freely tradable and owned by individuals and legal persons. One half of the non-tradable would be split between founders of the corporation, business partners, and employees. The other half of non-tradable shares would be held by the government.

After introducing novel reforms for SOEs, China opened the door to limited foreign competition so that local companies could learn to play by market rules and also so incentives could change.

Thus, China entered the WTO and encouraged local exporters to paly by and be governed by international rules. In the **Transitional Stage**, China began to introduce corporate governance systems to enhance efficiency of the country's assets. The changes during this period included a flurry laws and regulations to reinforce rights, duties, and the power of directors and shareholders along with introducing laws and regulations to support the regulatory infrastructure. By 2001, the Chinese Securities Regulatory Commission (CSRC) had adopted guidelines for establishing independent boards of directors in listed companies. And by January 2002, China's Code of Corporate Governance for listed companies was formulated. In 2007, during the **Convergence Stage**, The National People's Congress (NPC) promulgated a new law that gave individuals the same legal protection for their property as the state. This strengthened the rule of law and moved the country away form the concept of joint ownership as understood under the philosophy of communism. This law did not, however, give full property rights as peasants could not sell their land for example.

China's Ownership Structure

Type of Ownership	Description
State-Owned Enterprises	Directly owned by the government in strategically important industries
Collectives	Set up by low-level administrative organizations
Town & Village Enterprises (TVEs)	Collectives owned by the town or village
Conglomerates (jituan)	A group of companies but not a legal entity. Share common services
Foreign Invested Enterprises	Joint ventures were allowed after 1979. After 2000, foreigners could own 100% of an enterprise in certain industries
Joint Stock Cooperative Enterprises	Members are executives and management
Limit Liability Corporations	LLCs that have more than 1 but fewer than 49 investors
Private-Owned Enterprises	Privately owned for profit enterprises that inlucd limited liability corporations, partnerships, and sole proprietorships.
Incorporated Companies	Listed companies with tradable capital

Tradable	Shares	Description
No but private block transfer is possible	G-Shares (State owned)	These shares are managed by the Bureau of National Asset Management or held by other state-owned enterprises. The ultimate owner is the State Council. After 2005 reforms, state shares became tradeable. About a third of SOE shares are G-Shares
No	Legal Person (LP) Shares	Domestic institutions which are securities companies and SOEs with at least one non-state owner. About a third of SOE shares are LP Shares
No	Employee	Sold to employees
Yes	A-Shares	Shares traded in RMB in Shanghai and Shenzhen and are restricted to investors from the Mainland or Qualified Foreign Investors
Yes	B-Shares	Shares traded in Shanghai and Shenzhen in foreign currencies
Yes	H-Shares	Shares listed overseas

SOEs, Corruption and Minority Rights

By the end of 2001, 1,103 of the 1,160 listed companies were originally SOEs. The problem with having so many SOEs is the expropriation of minority rights by corrupt party members. This can happen through insider dealing, loan guarantees, funneling projects to connected persons, transfer company assets out of the company, not paying dividends, and other shenanigans. A check on this would be a well-established regulator, outside investors and securities analysts. However, in 2001, regulators were weak and understaffed. Very often, the party member in charge of the SOE had more power within the party than the regulator. Also, early on there was not a well-established investment industry with trained analysts or fund managers. Further, there were not up-to-date laws that could be mediated by trained lawyers and judges. As documented earlier, China went through several centuries of upheaval reducing their professional classes.

Mechanisms for Supervision and Discipline

An obvious solution to rooting corruption would have been to allow foreign financial firms into the market. These firms would have quickly rooted out inefficient firms and directed capital to better managed enterprises (think higher share prices, lower interest rates, larger IPO proceeds, etc.). However, China was unwilling to allow large foreign financial firms into the country before its own financial firms could compete on an even basis. Over the last forty years, domestic banks and other financial firms have built up better management capabilities and have adopted modern technologies. Also, regulations and regulator capabilities were weak and could have been easily exploited and influenced by well-funded foreign investors. The Chinese Communist Party has always been fearful that enterprises with large pools of capital will overtake or strongly influence the state. It is fair to say that the United States would not welcome CITIC securities to dominate its brokerage market and unduly influence legislators. In 2020, Morgan

Stanley, Goldman Sachs, and Credit Suisse received regulatory approval from Beijing to own majority stakes in their Chinese ventures. And in 2021, JP Morgan received a license for 100% ownership of its Chinese brokerage. Thus, the CCP was slow to allow foreign financial institutions into the country but in 2019 it passed *The Foreign Investment Law*:

***Article 1** This Law is formulated in accordance with the Constitution for the purposes of further expanding opening up, actively promoting foreign investment, protecting the legitimate rights and interests of foreign investors, regulating foreign investment administration, striving to form a new structure in the pursuit of opening up on all fronts, and promoting the healthy development of the socialist market economy.*

The other mechanism to monitor companies and enforce discipline on the management and use of assets for a developing country is through overseas listing. This accomplishes two goals: first, it bonds individual companies to higher governance standards and regulatory regimes; and second, it spurs domestic regulatory regimes to develop better practices. During the **Convergence Stage**, many Chinese companies listed overseas in Hong Kong, New York, and London. These companies were forced to adhere to higher disclosure standards and were supervised by capital market participants and regulatory bodies that were much more developed than could be found in China. Also, during the **Convergence Stage**, China greatly enhanced its Laws, Ordinances and Rules & Regulations as explained in the next section. The spurring of regulatory reform happens because stock exchanges along with local securities, legal and accounting professions are in competition with foreign systems and in order to attract capital listings, these participants must demand changes in their regulatory environment so investors are comfortable advancing their capital in the home market.

To see how this works, compare certain rights and duties under the original Company Law introduced in 1993 to the updated Company Law in 2006. In 1994, the State Council published the *1994 Special Provision on Joint Stock Limited Companies Issuing Shares and Listing Overseas (Special Provisions)* and the *1994 Mandatory Provisions for the Articles of Association of Companies Listed Overseas (Mandatory Provisions)* both in accordance with Articles 85 and 155 of original Company Law. The *Special Provisions* included Dual Disclosure Rules that maintained the information disclosed within mainland China and abroad shall not be self-contradictory in content and if a contradiction is found, it should be revealed to overseas stock exchanges immediately. Obviously, this provision was not strictly followed, and Chinese companies took advantage of poor analysis by overseas investors on overseas exchanges. Many Americans have taken the wrong lesson from the spat of fraudulent Chinese companies listing on American exchanges. They assume this was sanctioned by the CCP and most Chinese companies are fraudulent. This is unlikely the case. It is naïve to assume the CCP leadership would expend political capital prosecuting fraud committed in the United States since no Chinese citizens were harmed. The Politburo's Standing Committee has 7 members in a 95-million-member party in a country of 1.4 billion people. The CCP will likely let these fraudsters off and continue to live with no consequences in China. Instead, what CCP wants is for American, English, Singapore and

Hong Kong investors to flush out fraudulent companies and allocate capital to better governed enterprises.

The *Mandatory Provisions* also included stronger duties on directors and managers that include the duty of good faith and diligence to the company, the duty not to make private gains by taking advantage of their position and power, and the duty to ensure the fair and equal treatment of shareholders. Again, this has not been strictly followed in overseas markets. *Mandatory Provisions* further imposed that majority shareholders cannot use his rights to vote in a prejudicial manner to the interest of shareholders generally or a portion of shareholders.

The new Company Law incorporated these features as shown below.

Description	Original Company Law	Mandatory Provisions	New Company Law
Fiduciary Duties	Duty of Loyalty	Duties of Loyalty and Care	Duties of Loyalty and Care
Fiduciary Duties of Controlling Shareholders	None	30%> shareholders must show good faith in exercising their rights	50%> shareholders must show good faith in exercising their rights
Exit Strategy	None	During merger or split	Failure to distribut profits, merger or split, or renewal of operation term or dissolution
Information Rights	Basic passive	Enhanced passive right	Enhanced right plus right of making inquiries
Private Placement of Shares	Not allowed	Allowed	Allowed
Pre-emptive Rights to buy shares in any future offering	None	None but rpived by HK Lisitng Rules which were recognized by the Mandatory Provisions	Yes
Shareholder Action	No mention of civil remedies	Disputes resolved through Chinese Courts	Derivative actions (shareholders suing on behalf of the corporation) permitted and in some cases direct actions

Market Regulations -- Laws

Laws are developed by the National People's Congress (NPC) or its Standing Committee. By the end of 2005, a legal framework had taken shape focusing on three key pieces of legislation: the Company Law, the Securities Law, and the Securities Investment Fund Law.

The Company Law

The Company Law was promulgated by the Standing Committee of the NPC in 1993, came into force in 1994, and has been amended several times since then. In 1992 the policies of a shareholding system were outlined in a series of regulations that aimed to enhance the efficiency of state assets, facilitate the efficient allocation of social resources, and the transformation of enterprises into independent economic entities. These regulations culminated in the 1993 Company Law. In 2005, the Company Law added an amendment to replace the provision of "company operation under the state" with "business compliance with the laws and administrative regulations" in Article 5. The amendments also introduced the concept of fiduciary duties.

Reference: http://www.npc.gov.cn/zgrdw/englishnpc/Law/2007-12/12/content_1383787.htm

Article 1 *This Law is formulated in accordance with the Constitution of the People's Republic of China in order to meet the needs of establishing a modern enterprise system, to standardize the organization and activities of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, to maintain socio-economic order and to promote the development of the socialist market economy.*

Article 2 *The term "company" mentioned in this Law refers to a limited liability company or a joint stock limited company incorporated within the territory of the People's Republic of China in accordance with this Law.*

Article 3 *A "limited liability company" or "joint stock limited company" is an enterprise legal person.*

In the case of a limited liability company, shareholders shall assume liability towards the company to the extent of their respective capital contributions, and the company shall be liable for its debts to the extent of all its assets.

In the case of a joint stock limited company, its total capital shall be divided into equal shares, shareholders shall assume liability towards the company to the extent of their respective shareholdings, and the company shall be liable for its debts to the extent of all its assets.

Article 4 *The shareholders of a company shall, in their capacity of capital contributors, enjoy such rights of owners as benefiting from assets of the company, making major decisions and selecting managerial personnel in accordance with the amount of their respective capital investment in the company.*

A company shall enjoy the right to the entire property of the legal person formed by the investments of the shareholders and shall possess civil rights and bear the civil liabilities in accordance with law.

The ownership of State-owned assets in a company shall be vested in the State.

Article 5 *A company shall, with all its legal person assets, operate independently and be responsible for its own profits and losses according to law.*

A company shall, under the macro-economic control of the State, organize its production and operation independently in accordance with market demand for the purpose of raising economic benefits and labour productivity and maintaining and increasing the value of its assets.

Article 6 *An internal management mechanism shall be implemented within companies, which is characterized by clear definition of powers and responsibilities, scientific management and combination of encouragement and restraint.*

Article 7 *State-owned enterprises restructured to form companies must transform their operating mechanism, gradually produce an inventory of their assets and verify their funds, delimit their property rights, clear off their claims and debts, evaluate their assets and establish a standard internal management mechanism in accordance with the conditions and requirements set by laws and administrative regulations.*

Article 11 *Articles of association must be formulated in accordance with this Law when a company is incorporated. A company's articles of association shall have binding force on the company, its shareholders, directors, supervisors and managers.*

A company's scope of business shall be defined in its articles of association and registered in accordance with law. Items within the company's "scope of business" that are subject to restrictions under laws, administrative regulations shall be approved in accordance with law.

Companies shall engage in business activities within their registered scope of business. A company may change its scope of business by amending its articles of association in accordance with statutory procedures and making such amendments registered with the company registration authority.

Article 18 *This Law shall be applicable to limited liability companies with foreign investment. Where laws concerning Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and foreign-funded enterprises provides otherwise, such provisions shall prevail.*

The Standing Committee of the 13th National People's Congress issued a draft amendment to the *Company Law* on December 24, 2021.

Key highlights include:

- Clarify that the board of directors is the executive body of the company. Relax the organizational structure requirements for smaller scale companies, eliminating the requirement to establish a board of directors and board of supervisors. Small and medium-sized companies could choose to have one executive director or manager.
- Different classes of shares: to meet the different investment requirements, allow for the issuance of classes of shares having rights different from ordinary shares, such as preferred shares and inferior shares, special voting rights shares, and transfer restricted shares; allow companies to choose between shares with face value and shares without face value. This new development suggests that China is moving towards international standards with respect to more sophisticated capital structures and shareholder rights.
- Improve the provisions of duties of loyalty and diligence for directors, supervisors and senior managers, and tighten their responsibilities to maintain the company's capital.
- Strengthen the regulation of related party transactions by expanding the scope of related parties and increasing the reporting obligations of related party transactions. The draft Amended Company Law would impose a reporting and approval requirement on related party transactions where directors, officers or supervisors must report a related party transaction to the board of directors or shareholders meeting for review and approval.
- Clarify the joint liability of controlling shareholders and management personnel in the event of wrongdoing attributed to them. Directors and officers who commit willful misconduct or gross negligence in performing their duties in the company causing damages to third parties will be jointly liable for such damages. Directors and officers who aid or abet a controlling shareholder in abusing its power causing damages to legitimate interests of the company or its minority shareholders will also bear joint liability.
- Companies to consider interests of stakeholders such as employees and consumers. Encourage companies to participate in social welfare activities.

Reference: <https://www.jdsupra.com/legalnews/china-publishes-draft-amendment-to-4602636/>

The Securities Law

The Securities Law came into force in 1999 with articles regulating the issue and trading of securities, takeovers of listed companies, securities exchanges, securities companies, and the duties and responsibilities of regulatory authorities among other things. The 2005 amendments significantly expanded the scope of securities regulations; the separation of regulation for different financial sectors among banking, insurance, and securities industries; public offerings; forward trading; money and stock lending/financing; permitting SOEs and banking funds to the stock market; and better protections of investors.

http://en.npc.gov.cn.cdurl.cn/2019-12/28/c_674672.htm

Article 1 *This Law is enacted in order to standardize the issuance and transaction of securities, protect the legitimate rights and interests of investors, maintain the socioeconomic order and public interests of society and promote the development of the socialist market economy.*

Article 2 *This Law shall apply to the issuance and transaction of stocks, corporate bonds, depository receipts and other securities lawfully recognized by the State Council within the territory of the People's Republic of China. Where there are no such provisions in this Law, the provisions of the Company Law of the People's Republic of China and other laws and administrative regulations shall apply.*

This Law shall apply to the government bonds and shares of securities investment funds listed for transaction. Where there are specific provisions in other laws and administrative regulations, such specific provisions shall apply.

The administrative measures of issuance and transaction of asset-backed securities and asset management products shall be formulated by the State Council in accordance with the principles of this Law.

Where the issuance and transaction of securities outside the territory of the People's Republic of China have disrupted the market order within the territory of the People's Republic of China and damaged the legitimate rights and interests of investors within the territory, such activities shall be handled and investigated for legal responsibility in accordance with the relevant provisions of this Law.

Article 3 *The issuance and transaction of securities shall follow the principles of transparency, fairness, and equitability.*

Article 4 *The parties involved in the issuance and transaction of securities shall enjoy equal legal status and shall abide by the principles of voluntariness, compensation and good faith.*

Article 5 *The issuance and transaction of securities shall comply with laws and administrative regulations. Any fraud, insider trading and manipulation of the securities market shall be prohibited.*

Article 6 *The separated operation and management shall apply to securities business, banking business, trust business and insurance business. The securities companies and banks, trust business institutions and insurance business institutions shall be established separately, unless otherwise provided for by the State.*

Article 7 *The securities regulatory authority under the State Council shall carry out centralized and unified supervision and administration of the securities market nationwide according to law. The securities regulatory authority under the State Council may, as it deems necessary, establish dispatched offices which shall perform the duties of supervision and administration according to authorization.*

Article 8 *The national audit institutions shall carry out audit supervision of the securities exchanges, securities companies, securities registration and clearing institutions and securities regulatory bodies according to law.*

The Securities Investment Fund Law

1997 saw the first promulgation of Tentative Rules for Securities Funds which was replaced in 2003 with the Securities Investment Fund Law. The law spells out regulatory principles and operational framework for securities investment funds and provided a legal environment for the future development of the Chinese fund industry. Most importantly, the Securities Investment Fund Law legally acknowledged the significance of the fund industry and encouraged the existence of institutional investors.

Article 1 *This Law is enacted to regulate securities investment fund activities, protect the lawful rights and interests of investors and relevant parties, and promote the sound development of securities investment funds and the capital market.*

The Judges Law

To ensure true discipline, a market system (socialist or otherwise) needs independent referees. In 2019, the NPC passed the *Judges Law*. It is fair to assume the CCP does not want to tie its hands even partially until it is assured the market economy is socialist in nature.

Reference: http://en.npc.gov.cn.cdurl.cn/2019-04/23/c_674709.htm

Article 1 *This Law is enacted in accordance with the Constitution to advance the cultivation of high-caliber judges, strengthen the management and supervision over them; safeguard their legitimate rights and interests; ensure that people's courts independently exercise their judicial power in accordance with the law and that judges legally perform their functions and duties, and safeguard justice.*

Article 2 *Judges refer to members of the judiciary who exercise state judicial power in accordance with the law, including the presidents, vice presidents, adjudication committee members, and chief judges and associate chief judges of court divisions, and the judges of the Supreme People's Court, all local people's courts, and special people's courts such as military courts.*

Article 3 *Judges shall observe the Constitution and laws, safeguard social fairness and justice and be devoted to serving the people.*

Article 4 *Judges shall treat the parties and other participants in the proceedings fairly, and be equal in the application of the law to all individuals and organizations.*

Article 5 *Judges shall stay diligent, honest, and clean, and live by professional ethics.*

Article 6 *Judges shall perform their duties objectively and impartially on the basis of facts and law.*

Article 7 *Judges shall be protected by law, and brook no interference from administrative bodies, social groups or individuals when performing their duties in accordance with the law.*

Other Important Legislation:

- 2000: The Accounting Law laid out requirements on accounting practices
- 2001: The Guidance Opinions Regarding Formulating Rules Concerning Independent Directors of Listed Companies
- 2002: Code of Corporate Governance
- 2003: Directive on quarterly reporting
- 2005: Bank governance guidelines (China Banking Regulatory Commission)
- 2006: The Criminal Law was designed to match the amended Securities Law and Company Law
- 2007: CSRC launched three-year campaign to strengthen listed company governance: use of funds, operation of board, internal controls
- 2007: The Administrative Measures on Information Disclosure by Listed Companies
- 2007: Corporate Bankruptcy Law which applied to SOEs, foreign investment enterprises, and domestic companies
- 2008: SSE Launched its Corporate Governance Index
- 2013: CBRC new Corporate Governance Guidelines for commercial banks
- 2014: China Association for Public Companies (CAPCO) issue guidelines for Independent Directors in discharging duties
- 2014: The Rules on Shareholders' Meetings of Listed Companies
- 2014: The Administrative Measures on Takeover of Listed Companies (the **"Takeover Code"**)

Market Regulations – Administrative Ordinances (AOs) and CSRC Rules & Regulations

AOs are developed by the highest administrative authorities, such as the State Council, in accordance with the Constitution and other laws. The Chinese Securities Regulatory Commission are subordinate to the laws and AOs.

Administrative Ordinances

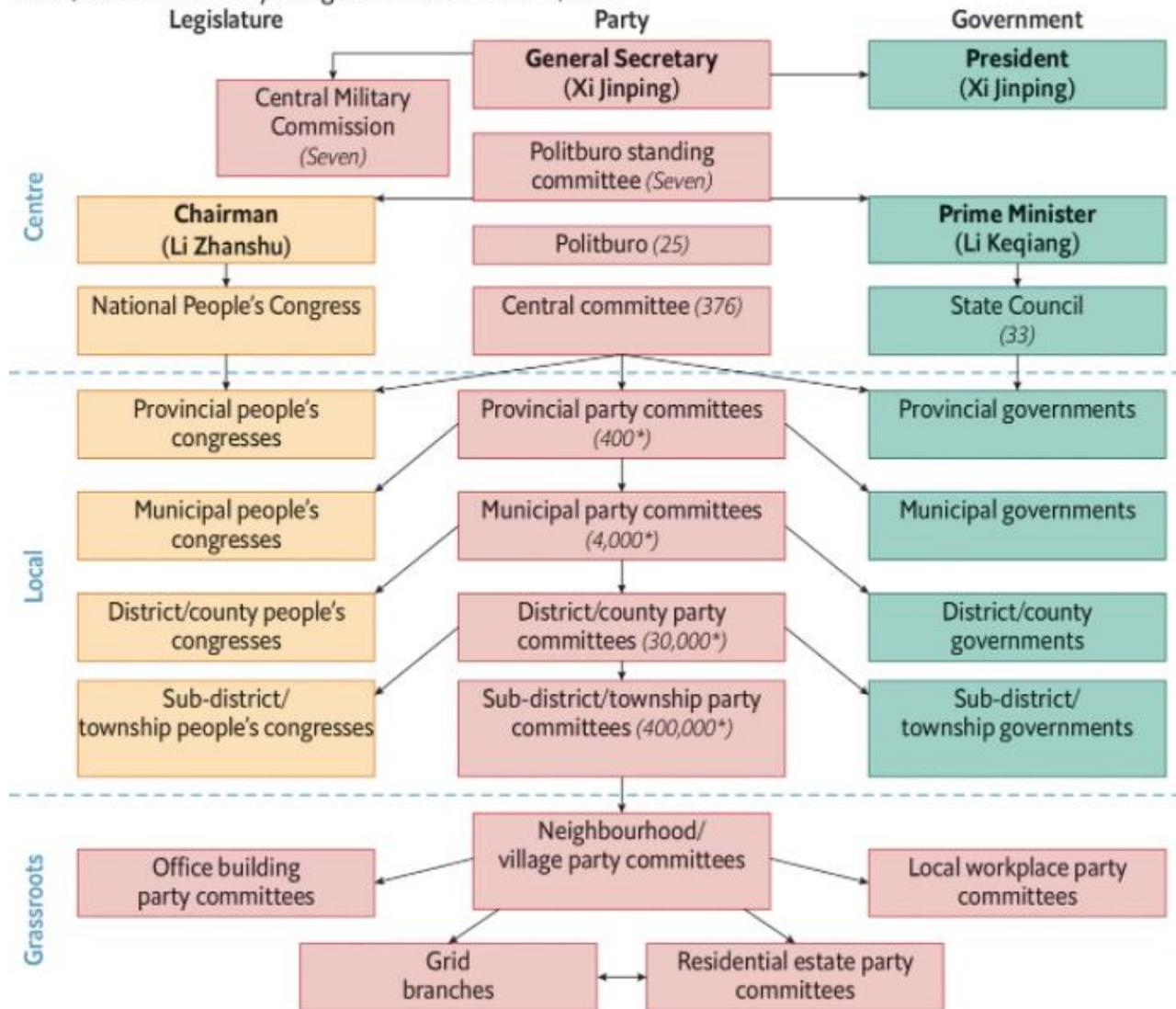
Administrative ordinances are developed by the highest administrative authorities, such as the State Council, in accordance with the Constitution and other laws. By the end of 2007, there were 14 pieces of securities-related administrative ordinances.

CSRC Rules & Regulations

The Chinese Securities Regulatory Commission (CSRC) develops rules and regulations in accordance with laws and administrative ordinances that cover various securities and futures issues such as the Corporate Governance Code for Listed Companies which sets for the basic principles for corporate governance, shareholder rights and the basic rules and moral standards for the management of listed companies. The Supervisory Board supervises the Management Board which makes more technical and tactical decisions.

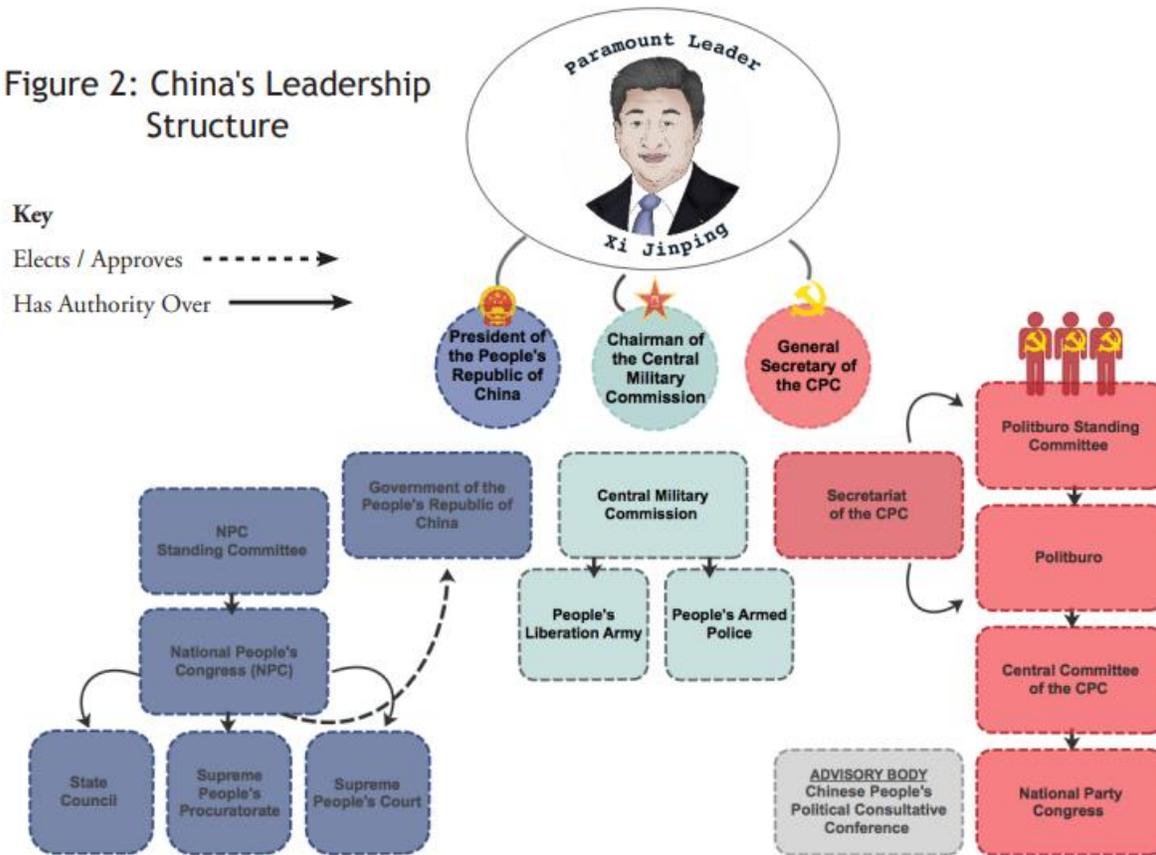
Regulatory Bodies

China, Communist Party and government structure, 2021



Sources: "The Party and the People", by Bruce Dickson; press reports; *The Economist*

Figure 2: China's Leadership Structure



The above chart shows the organization of the Chinese Communist Party along with the government that is used to administer laws and carry out Party objectives. Using corporations and pirate ships as metaphors, the people of China are shareholders or crewmembers, The CCP is the board of directors or captain of the ship, and the government is the management team or quartermaster. A key difference between China's government and Western democracies, is that the judicial branch is not independent of the Party. The CCP has been very slow to open to foreign powers because it never wanted to lose its position as the captain of the ship. However, Deng Xiaoping and his followers clearly saw the need for better discipline along with a better incentive system to more efficiently allocate resources.

References:

https://en.wikipedia.org/wiki/Government_of_China

<http://www.gksoft.com/govt/en/cn.html>

Below are key participants in the operating and regulation of market mechanisms within China.

Key Participants:

- The Chinese Communist Party (CCP);
- **The State Council**; final authority on regulatory bodies
- **The CSRC**, equivalent to the SEC or the SFC in Hong Kong and reports directly to the State Council;
- The China Banking Regulatory Commission (CBRC);
- The China Insurance Regulatory Commission (CIRC);
- The Ministry of Foreign Trade and Economic Cooperation (MOFERT);
- The NDRC which is the state's long-term planning czar;
- The State Asset Management Bureau (SAMB);
- The Ministry of Finance (MoF);
- China Accounting Standards Committee (CASC);
- SASAC, which reports directly to the State Council;
- The State Economics and Trade Commission (SETC);
- The State Administration of Foreign Exchange (SAFE);
- People Bank of China (de facto Central Bank);
- The Securities Trading Automated Quotation System (STAQ), equivalent to NASDAQ;
- The Shanghai and Shenzhen Stock Exchanges (SSE and SZSE).

The two below commissions are especially important for the governance of corporations in China.

The State-Owned Assets Supervision and Administration Commission (SASAC)

The Chinese Government need to set up a body to transfer valuable assets from the state to the market, and the 16th Party Congress in 2002 presented guiding principles for the state-owned asset management reform. SASAC would control and allocate capital, and the state would no longer manage the SOEs. SASAC can very loosely be thought of as a sovereign wealth fund that was responsible for SOEs.

The Chinese Securities Regulatory Commission (CSRC)

The CSRC is equivalent of the SEC and aims to promote and develop market infrastructure, perfect the operations of the infrastructure, develop the corporate bond market, and tighten market supervisions. The below is taken from the *Securities Law*:

Article 179 The functionaries of the securities regulatory authority of the State Council shall be devoted to their duties, act impartially and honestly according to law, and shall not take advantage of their positions to seek illegitimate interests or divulge any commercial secret of the relevant entities or individuals which has come to their knowledge...

A Mixed Corporate Model

The CCP has not hesitated to borrow ideas and practices from foreign jurisdictions when it suits China's needs. The NPC and its Standing Committee have drafted laws and borrowed ideas from a wide range of sources. The original 1993 Company Law is an example of combining China's own concepts and practices with those of Western countries. Various parts of the law were specially designed for China such as provisions with respect to SOEs and the functions of the Communist Party within corporations (Capitalism with Chinese Characteristics). Concepts were borrowed from the English/Hong Kong tradition along with German corporate governance ideas and American notions of management and justice.

Corporate governance models can broadly be placed into two groups: the German/Japanese model (or the stakeholder model) and the Anglo-American model (or the shareholder model). The German/Japanese model incorporates representatives from all stakeholders including shareholders and banks and has two tier board with a large involvement of employees. The Anglo-American model is characterized by dispersed shareholders, a developed securities market, sound legal system, freedom of employment and a unitary board. China has combined these two models.

In the 1980s, Chinese enterprises were controlled by the state as the majority shareholder and employees participated in enterprise management. In the 1990s, China aimed to introduce more Anglo-American concepts. This history has led to a hybrid corporate model for large public companies. China has a two-tier board. In addition to the board of directors, Chinese companies also have a supervisory board. The supervisory board is small in size and usually has labor union, major shareholder, and the CCP representation. Along with a two-tier board, China has developed strong securities markets that include concepts such as independent directors, fiduciary duty, the right to know, derivative actions, strengthened voting rights and the right to exit.

From the *Company Law*:

Article 14 *A company must, when engaging in business activities, abide by laws, observe professional ethics, strengthen the construction of socialist culture and ideology and accept supervision of the government and the public.*

Article 17 *The grass-root organizations of the Communist Party of China in companies shall carry out their activities in accordance with the Constitution of the Communist Party of China.*

Article 118 *A company limited by shares shall have a board of supervisors, which shall be composed of not less than three members. A board of supervisors shall include representatives of shareholders, and representatives of the staff and workers of the company in an appropriate proportion, which shall be not less than one-third of the total number of members on the board of supervisors. The specific proportion shall be*

prescribed by the company's articles of association. The representatives of the staff and workers on the board of supervisors shall be democratically elected by the staff and workers of the company through the conference of the representatives of the staff and workers, or the general meeting of the staff and workers, or through other forms. The board of supervisors shall have one chairman and may have one vice-chairman. Both shall be elected by more than half of all the supervisors. The chairman of the board of supervisors shall convene and preside over the meeting of the board; where the chairman of the board of supervisors cannot perform the functions or fails to do so, the vice-chairman shall convene and preside over the meeting of the board; and where the vice-chairman cannot perform the functions or fails to do so, a supervisor jointly elected by half or more of the supervisors shall convene and preside over the meeting of the board. A director or senior manager shall not concurrently serve as supervisor.

Conclusion

...The development of modern human society, the increase in the demands of all aspects of modern human life, the complex intertwining of modern society, politics, economics, culture, entertainment, health, art, transportation and other fields, have posed a serious challenge to the management system of society. Can a political and administrative system bear all the burdens of modern society? This is a difficult question for all countries. From both theoretical and practical aspects, I am afraid that no political and administrative system has the capacity to directly manage and assume all the responsibilities. If the political and administrative system has to assume it due to structural and functional constraints, it will inevitably lead to a situation where the whip is too long to reach. Because the energy of any political and administrative system is limited, for small societies, the government has the possibility to hold its own, as in Singapore, Hong Kong, South Korea, etc. For large societies, especially those with hundreds of millions of people, it is unlikely that the government can directly and comprehensively manage all levels and areas of society. History has shown that societies that have embarked on this path by institutional design have often had political and administrative systems that do not address many of the basic needs of society very well, and have accumulated piles of problems. Striving to give the various spheres of social life their own organization and dynamics to meet the needs of society on their own, so that the political or administrative system plays only an indirect regulatory role, is an effective way to win in this area...

The development of the commodity economy has led to a dual structure of governance in society: the social self-organized system is responsible for all kinds of specific matters, and the political system is responsible for coordinating the various self-organized systems. This is a major characteristic of macro-management in this society. These are just a few examples, but it should not be assumed that commodification necessarily makes things perfect. It simply means that commodification offers the possibility of making government lighter. It is impossible for government to function efficiently if it is involved in a thousand and one things in society. But after government is lightly loaded, it still has to regulate activities in various fields, only now it has changed from direct to indirect...

Therefore, commodification can reduce the burden of the political and administrative system, but there is an important premise, which is that the political and administrative system must regulate commodification. The real essence of commoditization is not that everything becomes a commodity, but that the commodity is in a rational mechanism of operation. The economic levers coordinate this mechanism, and so must the political and administrative systems. When many basic areas of society have become self-organizing systems, the political and administrative systems will have the conditions to separate from them, to move from direct to indirect management. The process of commodification is the process of these spheres becoming self-organized systems. This process does not take shape in a short time, and even after a considerable period of development, contradictions, conflicts, obstacles and confusion are still inevitable. However, the political and administrative system will be more powerful and effective

than managing dozens of large self-organized systems than managing thousands of specific activities...

For, in any society where money is the symbol of value, there is no livelihood without it. To some extent, American society is organized around money. Acknowledging this fact reveals a wonderful phenomenon that I call: "Money governs society". Money becomes a fundamental medium in the management of society. People manage money, and at the same time they use money to manage people. A set of mechanisms centered on money constitutes an important mechanism in the management of American society. People serve money. Because of the importance of money, people have tried to invent mechanisms, methods and techniques to manage it. As a result, a huge management system is formed through the medium of money. It is precisely this system that capital uses for the purpose of obtaining surplus value. This system is independent of the government, independent of the political system, and does not require direct control by the political system. It undertakes a large and complex management process by itself. Marx said that under the capitalist system, the commodity economy is apparently a relationship between things, but in fact it is a relationship between people. This is a most famous saying, and it applies to any relationship between people that takes the form of material relations. When people manage money, they actually manage people. This non-governmental money mechanism regulates people's thinking, emotions, and behavior...

This shows how effectively and powerfully capital controls society at large, and thus society as a whole. Most of the institutions in this set are private, but in fact they manage a very large part of the affairs of the whole society. This management is not based on coercion and command, but rather on voluntarily by each individual. People either voluntarily, or driven by social circumstances, automatically seek to be governed. Americans like to be governed least, but they like money most. The logic of money is to lead people to be governed. This mechanism is related to the basic survival of each person, and therefore effective management. Perhaps mobilizing the ability of a society's money to govern people is a very important aspect of reducing the pressure on the political system to manage. The amazing dynamism of money connects individuals to individuals and institutions to institutions. The government transcends this set of mechanisms and controls them indirectly by legal means. The people in this mechanism, all operating in their own interest, maintain the balance of this set of mechanisms. I am afraid that if it were only a deposit relationship, a management mechanism would not have developed. The key question is the extent to which money has developed into a set of institutions on which people must depend. Americans believe in freedom and do not rely on other institutions, but they rely on this one.

A society cannot be effectively managed without a system of subject management on which everyone depends. Societies have different subject systems at different stages of development, and in a fully developed economy, there may have to be a transition from a political to an economic system.

-- Wang Huning (5th Ranking Politburo member), America Against America, 1991

Reference: <https://dokumen.pub/america-against-america.html>

The first thing westerners need to understand about corporate boards in China is the speed of change the country has experienced in the last forty years. Western countries had several hundred years to build foundations for their modern economies. China started from almost scratch in 1978. The *Company Law* was first introduced in 1993 and sent shockwaves through society. Organizations were forced to become more efficient, and millions were laid off and reallocated. From 1978 to 2012, the population of China's cities grew by a **half a billion** people as more than 260 million migrants moved to urban centers.

Today, the biggest challenge for Chinese corporations is finding quality directors. As alluded to earlier, it takes generations to train all the need lawyers, accountants, managers and regulators to staff a modern corporate governance system. Like all countries, China has good and bad actors. However, due to rapid growth over such a short period, China is having difficulties enforcing laws and regulations. This stems results from two intertwined reasons. First, *guanxi*, is the Chinese term for relationship-based networks as everyone tries to be connected for personal and family advancement. Chinese historically have had low trust in institutions; and when leadership is not explicit, decisions are communal. This is obviously sounds good for governance, but problems occur when the decisions are made in a tight group of family, friends or immediate co-workers without regard to outsider interests. Second, as we saw, the CCP has grassroots networks throughout the country and 95 million members. And if a corporate leader has a *guanxi* with a local, powerful CCP member, it makes it hard for the CSRC to enforce regulations. This means investors do not trust Chinese institutions and fail to allocate capital to the better firms as the pricing mechanism is broken.

Another challenge facing many Chinese firms is strong and egotistical founders. Many of these founders are eccentric, some may have earned their money in less than ethical ways, and many have no idea of checks and balances. A company's ethics is usually based on its founder's ideas and behavior. In China, when leadership is explicit, the norm of decision making is hierarchical where the *boss* is expected to set the policy. Obviously, this can lead to many problems.

Fortunately, for China, this is changing. There has been growing professionalism at both SOE and private board levels as MBAs and other educated individuals join the governance and management of firms. Also, the *Foreign Investors Law* and overseas listings have been pushing companies to adhere to higher standards. Dynamic, complex and large companies will be needed if China wants to continue to expand its economy. These companies will need to raise capital from third parties, and outside investors will only commit large pools of capital if information is properly disclosed and shareholder interests are upheld. For China to escape the middle-income trap, grow an internal consumer base for a dual circulation economy, develop home grown technology for the fourth industrial revolution, internationalize the yuan, and ensure common prosperity for all citizens, its regulatory bodies will need to ensure pricing mechanisms work and corruption is controlled. Like pirate ship captains, the CCP needs modern governance structures to survive.

Case Study: China PengFei Group Limited

We worked harder to develop the underlying institutions for a market system, and pushed forward reforms to ensure production factors are allocated by the market. We continued to reduce the number of procedures and length of time it takes for enterprises to gain government approval. More government services were made available online. A package of successful practices in local reform were applied nationwide, and trials were conducted to improve the business environment. We bolstered regulation and adopted new regulatory approaches, took action against business monopolies, and prevented the unregulated expansion of capital, thus ensuring fair market competition. We continued implementation of the three-year action plan for SOE reform and supported the healthy development of private businesses. The reform to delink industry associations and chambers of commerce from government was basically completed. The Beijing Stock Exchange and Guangzhou Futures Exchange were opened. Solid strides were made in reforms in agriculture, rural development, social programs, and ecological conservation. We deepened practical cooperation to jointly advance the Belt and Road Initiative. Efforts to ensure stable performance in foreign trade and investment were intensified. We successfully hosted a number of major expos, including the China International Import Expo, the China Import and Export Fair, the China International Fair for Trade in Services, and the first China International Consumer Products Expo. Comprehensive trials for further opening up of the services sector were expanded to four more areas, and new measures for developing the Hainan Free Trade Port were adopted...

To develop a high-standard socialist market economy, we should give play to the roles of both the government and the market, seeing that the market plays the decisive role in the allocation of resources and the government better fulfills its role. We will step up efforts to transform government functions. We will do more to build a high-standard market system, carry out a comprehensive pilot reform for the market-based allocation of production factors, and strive to accelerate the development of a unified domestic market. We will deepen reforms to streamline administration and delegate power, improve regulation, and upgrade services with a focus on creating a market-oriented, law-based and internationalized business environment.

We will make sure that at the same time as government approval for a certain matter is canceled or delegated to lower-level authorities, corresponding regulatory steps are taken and responsibilities are assumed.

-- Le Keqiang, Premier of the State Council, Report on the Work of the Government, 2022

Overview and Ownership History

China Pengfei Group is one of the leading manufacturers of rotary kiln and grinding equipment in China and the global market. The Company is mainly engaged in equipment manufacturing, the installation and production line business, and provides customized one-stop solutions for design, procurement, construction and trial operation. Jiangsu Pengfei has R&D platforms such as the National Enterprise Technology Center and Postdoctoral Workstation, and the Company is committed to the R&D of new technologies such as energy-saving energy storage and the comprehensive utilization of resources. Its products have been installed in more than 100 cement production line projects, and have been exported to more than 60 countries including Vietnam, Indonesia, Uzbekistan, Kazakhstan, Pakistan, India, Ethiopia, Zambia, Algeria, Brazil, Colombia, Bolivia, etc.



The Company plans to invest in a project to manufacture a rotary kiln with the latest roasting and pyrolysis technology, in order to enter the metallurgical, chemical and environmental protection industries, mainly focusing on the treatment of various municipal solid wastes, and the rotary kiln is also expected to be used for the treatment of low-grade coal and non-ferrous metals. In view of this expansion plan, Jiangsu Pengfei also plans to build a new production plant. In anticipation of the growth of its business operations and preparations for expansion in the global market, new construction is essential for expansion into the metallurgical, chemical and environmental industries, and is the key to gaining a larger market share and maintaining a competitive advantage over major competitors in the applicable relevant industry.



Working site of dia. 5*74m rotary kiln built by Pengfei Group at Guangxi Taini (GuiGang)Cement Co.,Ltd.

The Company was incorporated in the Cayman Islands under the Cayman Companies Law as an exempted company with limited liability on 31 July 2017 and is based in Haian City, Jiangsu Province, the PRC. The Group's history traces back to 1994 when Jiangsu Pengfei Group Company was founded as a collective enterprise. Later, Jiangsu Pengfei Group Company was converted into a joint stock company which was called Jiangsu Pengfei Industrial Group Limited in 2002 and renamed as Jiangsu Pengfei in 2003. Jiangsu Pengfei was involved in collective interests until 2010, when all remaining collective interests held by collective enterprise shareholders had been transferred to individual shareholders.

Following the 2002 restructuring Jiangsu Pengfei shareholders included the following. In the red boxes are current executive directors with Wang Jiaan as the Chairman:

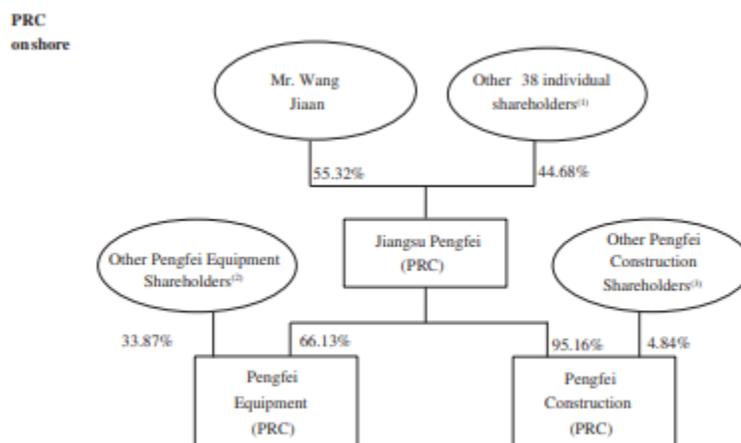
Shareholders ⁽¹⁾	Subscribed capital contribution ⁽²⁾ (RMB)	Approximate percentage of Shareholding (%)
Haian County Dagong Collective Assets Management Company Limited* (海安縣大公集體資產經營有限公司) ⁽³⁾		
	24,869,600	48.40
Haian County Building Equipment Manufacturing Plant* (海安縣建材設備製造總廠) ⁽⁴⁾		
	17,956,300	34.94
Ben Youlan (賁友蘭)	2,630,000	5.12
Wang Jiaan (王家安)	1,380,000	2.69
Zhu Chun (朱純)	710,000	1.38
Wang Yun (王雲)	380,000	0.74
Zhou Yinbiao (周銀標)	280,000	0.54
Ben Daochun (賁道春)	280,000	0.54
Chen Yulou (陳玉樓)	280,000	0.54
Chen Lidong (陳黎東)	280,000	0.54
Ben Daolin (賁道林)	230,000	0.45
Cai Tongfu (蔡同富)	200,000	0.39
Ben Xudong (賁旭東)	200,000	0.39
Yu Yangui (于延桂)	200,000	0.39
Dai Xianru (戴賢如)	160,000	0.31
Liu Chengguan (劉成官)	120,000	0.23
Qian Jiayin (錢加銀)	120,000	0.23
Zhang Doufa (張門發)	80,000	0.16
Ding Jialin (丁佳林)	80,000	0.16
Zhou Bugao (周步高)	70,000	0.14
Chen Jixiang (沈吉祥)	70,000	0.14
Wang Xiaobo (王小波)	40,000	0.08
Yu Zhongwen (于中文)	40,000	0.08
Lin Xianyue (林先月)	40,000	0.08
Yuan Chuanjun (袁傳軍)	40,000	0.08
Wang Shiqin (王世芹)	40,000	0.08
Ding Qinghai (丁慶海)	40,000	0.08

Haian County Dagong Collective Assets Management Company Limited was a collective enterprise established on 7 February 2002 collectively owned by Haian County Dagong Town Enterprise Service Center and Haian County Dagong Industry Supply and Marketing Management Department with a business scope of investment in collective assets. Haian County Building Equipment Manufacturing Plant was a collective enterprise established on 26 December 1980 and the main investor of Jiangsu Pengfei Group Company when it was established in 1994. The collective enterprise has been deregistered.

The individual shareholders were employees of Jiangsu Pengfei at the date of its establishment. During the restructuring of Jiangsu Pengfei Group Company, the shareholders of Jiangsu Pengfei made capital contribution with object capital (such as machine and equipment) or land use rights. The capital contribution of Haian County Dagong Collective Assets Management Company Limited included rural collective land of approximately 112,433 square meters with an estimated value of RMB14,069,600. Under PRC Company law, shareholders of a company who contribute non-cash capital shall go through the transfer procedures according to law. Under PRC law, except for special circumstances stipulated by laws and regulations, the collective land use rights of peasant could not be assigned, transferred, or leased for non-agricultural construction purpose. Therefore, the transfer of rural collective land of Haian County Dagong Collective Assets Management Company Limited to Jiangsu Pengfei could not be registered at that time, thus there was a shortfall of RMB14,069,600 capital contribution. During the restructuring of Jiangsu Pengfei in 2010 for all remaining collective interests transferred to individual shareholders, Dagong Town People's Government confirmed that the shortfall of capital contribution by Haian County Dagong Collective Assets Management Company Limited should be replenished by Wang Jiaan and other 11 existing shareholders who were the transferees for the restructuring of Jiangsu Pengfei. The shortfall of RMB14,069,600 was replenished by cash contribution of RMB18,060,000 in October 2018 by Wang Jiaan and 38 natural person shareholders of Jiangsu Pengfei.

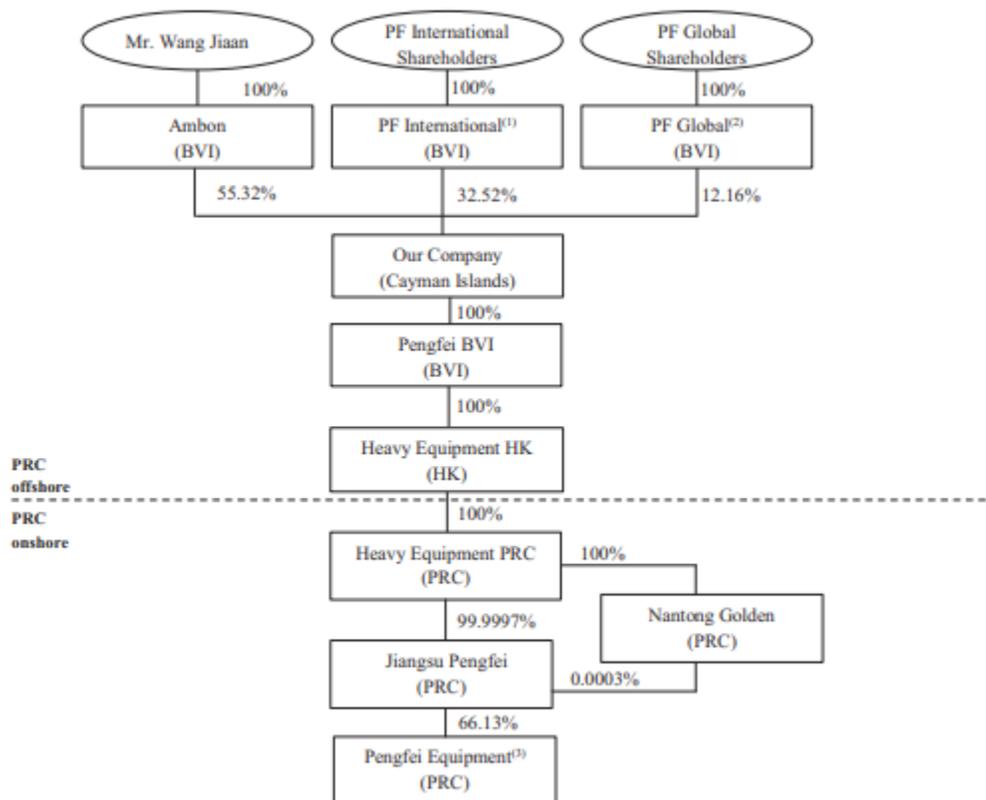
Following the equity transfer, ownership included the following:

Shareholders ⁽¹⁾	Subscribed capital contribution (RMB)	Approximate percentage of Shareholding (%)
Wang Jiaan (王家安) ⁽²⁾	28,425,900	55.32
Zhou Yinbiao (周銀標)	4,430,000	8.62
Yu Yangui (于延桂)	3,100,000	6.03
Dai Xianru (戴賢如)	2,800,000	5.45
Wang Yun (王雲)	2,290,000	4.46
Chen Yulou (陳玉樓)	2,040,000	3.97
Ben Daolin (賁道林)	1,630,000	3.17
Chen Lidong (陳黎東)	1,380,000	2.69
Cai Tongfu (蔡同富)	1,350,000	2.63
Ben Xudong (賁旭東)	1,200,000	2.34
Ben Daochun (賁道春)	1,080,000	2.10

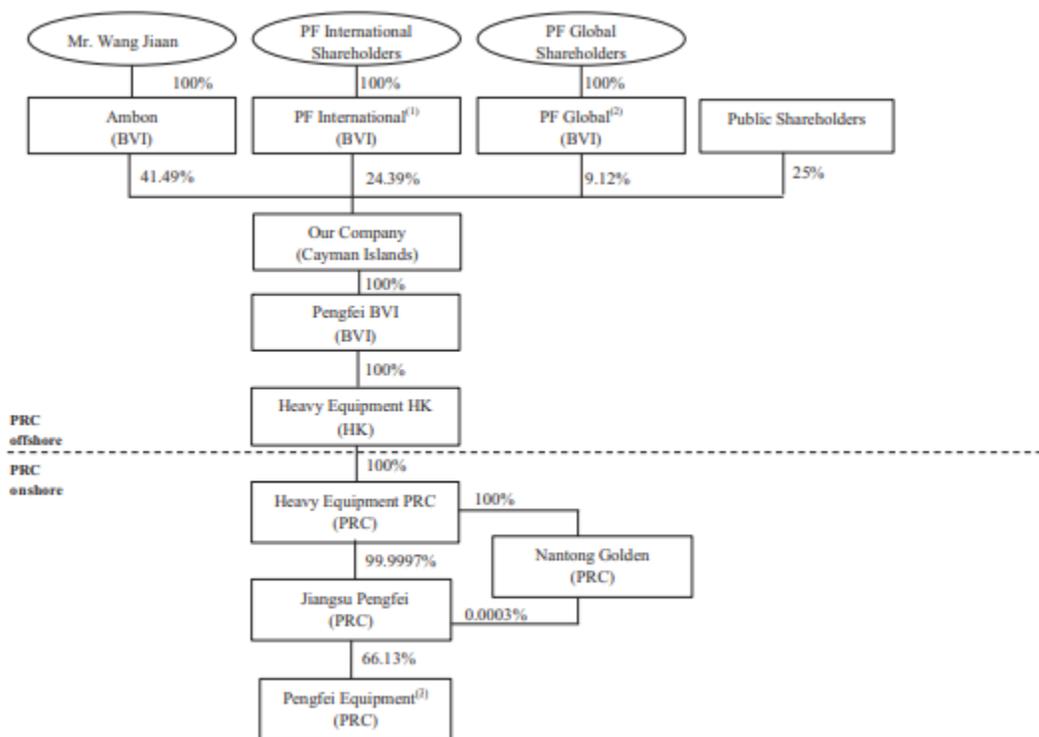


Pengfei Equipment and Pengfei Construction were established in 2001 and 2004 with capital contributions by minority shareholders. Pengfei Equipment originally carried out the business of rotary kiln and cement production lines in China, but this is now largely carried out by Jiangsu Pengfei.

Following the restructuring in 2018:



PF International is owned as to the following approximate shareholding: 26.51% by Zhou Yinbiao, 18.55% by Yu Yangui, 16.76% by Dai Xianru, 13.70% by Wang Yun, 9.75% by Ben Daolin, 8.26% by Chen Lidong and 6.46% by Ben Daochun. PF Global is owned by other minority shareholders of the 2002 restructured Jiangsu Pengfei. Following the capital raise in 2018, ownership was as follows:



The public shareholders include the cornerstone investors of China High Speed Transmission (CHS) (SEHK: 658), Suzhong Construction, and Peak Holding. CHS is principally engaged in research, design, development, manufacture and distribution of various types of mechanical transmission equipment for a broad range of applications in wind power generation and industrial use, and is a major supplier to Jiangsu Pengfei. Suzhong Construction is a stock limited company established in the PRC. Its principal business includes, among others, industrial and civil projects construction, survey, design, equipment installation, interior and exterior decoration, undertaking municipal construction projects and other overseas and domestic construction project, overseas projects and domestic international bidding projects. It is one of the leading construction services providers in Jiangsu Province. Peak Holding is a company incorporated in the BVI with limited liability and primarily engaged in the equity and debt investment business. Peak Holding is ultimately and beneficially owned by other independent third parties and led by Mr. Gu Guomin who is an individual investor with investment experience in, among others, the automotive, rail transit and building materials industries. The other owners of Pengfei Equipment are other unrelated individuals.

Reason for Capital Raise

For China to avoid the middle-income trap, the Country needs its companies to develop advanced technology and manufacturing processes. Further, The CCP's plans include upgrading national performance features for environmental protection and energy savings along with reducing the labor input factor for industries (i.e. increasing efficiency) as it faces a declining population. Also, in 2013, China launched the Belt and Road initiative as a development strategy that aims to integrate countries in the Asian Pacific region including Africa, the Middle East, Southeast Asia and Central Asia. To accomplish these objects, companies will need to raise large amounts of capital that can only be raised by pooling together funds from multiple sources. Further, the most successful companies will see a rising share price which means they will be able to raise more capital (equity or debt) on better terms than competitors.

China Pengfei Group raised HK\$178 million in 2018. HK\$95.6 million, or 78.7% of the total net proceeds from the Share Offer, will be used for investing in a project for manufacturing the rotary kilns possessing the latest roasting and pyrolysis technology for (i) roasting non-ferrous metals in metallurgy industry; (ii) coal pyrolysis in chemical industry; and (iii) the treatment of various types of solid waste in environmental protection industry. The Company expects annual production capacity of rotary kilns is to increase by 45%, from 66 units to 96 units as a result of such investment. The Company also expects to recruit six technicians and/or experts with experience in the research and development of the latest roasting and pyrolysis technology, increase product quality testing capacity, file patent applications, and perform joint research local universities and other industry professionals.

The joint research aims to improve rotary kiln pyrolysis for the treatment of co-processing solid waste, enhance heat transfer technology of rotary kilns, develop multi-heat source heating and prevention and control of pollutant technology and flexible control technology of rotary kiln pyrolysis using synergistic treatment. All of this research aims to reduce the use of coal and energy in order to reduce the economy's impact on the environment and increase efficiencies throughout the country. Less coal use means less labor in mining and transportation industries.

Information Disclosure

Another key to governance reform is the timely and accurate disclosure of information. The following was provided by Deloitte Touche Tohmatsu, Hong Kong CPAs, in the prospectus:

Our responsibility is to express an opinion on the Historical Financial Information and to report our opinion to you. We conducted our work in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 200 “Accountants’ Reports on Historical Financial Information in Investment Circulars” issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”). This standard requires that we comply with ethical standards and plan and perform our work to obtain reasonable assurance about whether the Historical Financial Information is free from material misstatement.

Our work involved performing procedures to obtain evidence about the amounts and disclosures in the Historical Financial Information. The procedures selected depend on the reporting accountants’ judgement, including the assessment of risks of material misstatement of the Historical Financial Information, whether due to fraud or error. In making those risk assessments, the reporting accountants consider internal control relevant to the entity’s preparation of the Historical Financial Information that gives a true and fair view in accordance with the basis of preparation and presentation set out in Note 2 to the Historical Financial Information in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Our work also included evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors of the Company, as well as evaluating the overall presentation of the Historical Financial Information. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Opinion In our opinion, the Historical Financial Information gives, for the purposes of the accountants’ report, a true and fair view of the Group’s financial position as at 31 December 2016, 2017 and 2018 and 30 April 2019, of the Company’s financial position as at 31 December 2017 and 2018 and 30 April 2019 and of the Group’s financial performance and cash flows for the Track Record Period in accordance with the basis of preparation and presentation set out in Note 2 to the Historical Financial Information.

Governance Reform and Corruption Control

To deploy funds, China Pengfei will need good governance that makes sure the funds are not funneled off for nefarious uses or spent on bad projects. The CCP uses the Hong Kong Stock Exchange because it promotes strong internal controls, good disclosure, and high governance standards. The following passage is taken from the prospectus and quite long but worth reading while keeping in mind the CCP can either set up internal mechanisms to control corruption within the Party while it tries to manage the economy, or it can use market mechanisms to control corruption of business executives who are more able to efficiently allocate resources. Instead of controlling the economy the government, which is controlled by the CCP, regulates businesses. It becomes clear why the Party is reforming its corporate sector after reading the passage from Wang Huning on pages 44 & 45.

We have adopted know your client and other internal control and risk management measures to help us continuously monitor and evaluate our business and take measures to protect the interest of our Group and our Shareholders from economic sanctions risks. We have adopted enhanced internal control and risk management measures to help us continuously monitor and evaluate our business and take measures to protect the interest of our Group and our Shareholders from economic sanctions risks. The following measures have been implemented as at the Latest Practicable Date:

- we have set up and maintained a separate bank account, which is designated for the sole purpose of the deposit and deployment of the proceeds from the Share Offer or any other funds raised through the Stock Exchange;*
- to further enhance our existing internal risk management functions, our Board has established a risk management committee. The members of such committee comprise Wang Jiaan, Zhou Yinkiao, Dai Xianru and Ben Daolin, and their responsibilities include, among other things, monitoring our exposure to sanctions risks and our implementation of the related internal control procedures. Our risk management committee will hold at least two meetings each year to monitor our exposure to sanctions risks;*
- we will evaluate the sanctions risks prior to determining whether we should embark on any business opportunities in Countries subject to International Sanctions and with Sanctioned Persons. According to our internal control procedures, the risk management committee needs to review and approve all relevant business transaction documentation from customers or potential customers from Countries subject to International Sanctions and with Sanctioned Persons. In particular, the risk management committee will review the information (such as identity and nature of business as well as its ownership) relating to the counterparty to the contract along with the draft business transaction documentation. The risk management committee will check the counterparty against the various lists of restricted parties and countries maintained by the U.S., the European Union, United Nations or Australia, including, without limitation, any government, individual or entity that is the subject of any OFAC-administered sanctions which lists are publicly available, and determine whether the counterparty is, or is owned or controlled by, a person located in Countries subject to International Sanctions or a Sanctioned Person. If any potential sanctions risk is identified, we will seek advice from reputable*

external international legal counsel with necessary expertise and experience in International Sanctions matters; • our Directors will continuously monitor the use of proceeds from the Share Offer, as well as any other funds raised through the Stock Exchange, to ensure that such funds will not be used to finance or facilitate, directly or indirectly, activities or business with, or for the benefit of, Countries subject to International Sanctions or Sanctioned Persons where this would be in breach of International Sanctions; • the risk management committee will periodically review our internal control policies and procedures with respect to sanctions matters. As and when the risk management committee considers necessary, we will retain external international legal counsel with necessary expertise and experience in sanctions matters for recommendations and advice; and • if necessary, external international legal counsel will provide training programs relating to the sanctions to our Directors, our senior management and other relevant personnel to assist them in evaluating the potential sanctions risks in our daily operations. Our external international legal counsel will provide current list of Countries subject to International Sanctions and Sanctioned Persons to our Directors, senior management and other relevant personnel, who will in turn disseminate such information throughout our domestic operations and overseas offices and branches

Our Board of Directors is responsible for establishing our internal control system and assessing its effectiveness. In accordance with applicable laws and regulations, we have established procedures for developing and maintaining internal control systems. Such systems cover corporate governance, operations, management, connected transactions, anti-bribery and anti-corruption, legal matters, finance and auditing, as appropriate for the needs of our organization. We have established comprehensive risk management, primarily composed of departments specialized in auditing, finance, safety and quality, investment and legal matters and other functional management departments, through which we monitor, evaluate and manage risks related to work safety, financial matters, market development, capital management, human resources and other matters that we are exposed to in our business activities. We plan to review and refine our risk management system regularly, based on changes to our business. Our senior management oversees our risk management systems and reviews the results of our annual risk assessment. Our risk assessment is conducted by a number of risk management departments within our Group. These departments conduct annual risk evaluations and regular risk management and controls, and report to senior management about material findings, in a timely manner. We also run training programs for our risk management personnel each year in order to enhance their overall risk management ability and knowledge. Our Group has established an anti-bribery and anti-corruption policy to mitigate the potential risk arising from the use of deceptive and other illegal means to seek illegitimate interests resulting in damaging our Group's interests; or to seek improper economic interests from our Group, as well as behaviours that may bring illegitimate benefits to any person. The anti-bribery and anti-corruption policy of our Group sets out a number of measures to be implemented by our Group including the responsibilities, communications, assessment of anti-bribery and anti-corruption risk and establishment of control system, reporting channel and department, investigation and reporting results. Details are as below: Responsibilities • The senior management of the

Company shall be responsible for monitoring any incident of fraud of the Group and establishing anti-bribery and anti-corruption procedures and controls for fraud risk assessment and fraud prevention and conducting self-assessment for members of the Group. The Company has established an administrative office headed by Mr. Ben Daolin (an executive Director) (the “Administrative Office”) which is responsible for, among others, implementing cross-departmental, company-wide anti-bribery and anti-corruption procedures.

The anti-bribery and anti-corruption policy and procedures and related measures of the Group should be effectively communicated within members of the Group in various forms (through employee handbooks, company rules and regulations, publicity or local area networks) and the human resources department should inform new employees of such policy and procedures.

The Board of Directors should incorporate fraud risk assessment into the enterprise risk assessment conducted at the beginning of each year. • The Board of Directors should establish and adopt measures to confirm, prevent and reduce false financial reports or abuse assets of the Group; anti-bribery and anti-corruption control measures should be established at all levels and departments of the Group. • There may be corruption risks when a member of the Group selects its business partners (customers, suppliers, sub-contractors, agents, consultants, contractors, related parties, etc). It is therefore important for members of the Group to only engage business partners which have an anti-corruption commitment. The Company should inform all its business partners of its anti-bribery and anti-corruption policy. As far as practicable, members of the Group should take suitable anti-bribery and anti-corruption measures when entering into the agreements with their respective business partners, this will include: • prohibition against bribing of the Group’s staff; • without the permission of a director of the relevant member of the Group, prohibiting the Group’s staff against offering of advantages to any party who will or potentially will enter into business relationship with the Group; • prohibition against bribery of any form in carrying out business under the contract/partnership or on behalf of any member of the Group; • ensure that all the relevant personnel are made aware of the anti-corruption requirements, such as through a code of conduct, guidelines and trainings; • apply the same anti-corruption requirements to all business partners; • take proper action, such as reporting any corruption/fraud detected to the relevant law enforcement agency; and • the right for the relevant member of the Group to terminate the contract with the business partner if it or its staff member breaches the anti-corruption requirements. • In order to prevent the directors and senior management of the Group from using their positions to harm the interests of the Group through the use of connected transactions (as defined under the Listing Rules) for personal gain, members of the Group should comply with the disclosure and/or Shareholders’ approval requirements for connected transactions under the Listing Rules. A connected person with a material interest in the transaction shall abstain from voting at the meeting on the resolution approving the transaction in accordance with the requirements set out in Chapter 14A of the Listing Rules.

The Administrative Office is responsible for establishing a hotline for reporting ethics and fraud cases, etc., and publishing the hotline number and e-mail address to the employees at all levels and the parties with economic relations directly or indirectly with the Group in order to act as a reporting channel for any cases of violations of professional ethics by the Group company and its personnel, or any actual or suspected fraud cases.

The Administrative Office is responsible for evaluation of the fraud cases reported and determines if investigation is required. If the report involves the management of the relevant member of the Group, the Directors and the relevant department management personnel may form a special investigation team to conduct a joint investigation. In the relevant investigations, external experts may be engaged to participate in the investigation if needed; the internal control of the affected business units should be evaluated and recommendations for improvement should be made. • The Administrative Office should report to the Board of Directors at least once a year on the anti-bribery and anti-corruption work and maintain a written report. The Board of Directors authorizes this policy to be implemented by the Administrative Office and the revision of which shall be subject to approval of the Board of Directors. The Board of Directors should review the policy on an annual basis in accordance with the Corporate Governance Code and Corporate Governance Report as set out in Appendix 14 to the Listing Rules and the requirements of the relevant anti-corruption laws and regulations in Hong Kong and the PRC. During the Track Record Period and up to the Latest Practicable Date, we complied with all applicable PRC and overseas anti-bribery and anti-corruption laws and regulations to the extent applicable to our Group. We have also adopted the following internal control measures recommended by our Internal Control Consultant: • We will provide additional and regular trainings the management and relevant human resources personnel regarding to legal and regulatory requirements applicable to the business operations of our Group from time to time.

To prevent future non-compliances with the relevant PRC laws and regulations relating to the social insurance and housing provident funds, our responsible management personnel will review and reconcile the amount of the social insurance and housing provident funds with the total number of employees in the PRC each time before making payment for contribution. • To prevent future non-compliance with the relevant PRC laws and regulations relating to fire safety, we will review annually the fire safety measures to ensure that they meet the required standard by the relevant authorities in the PRC. • We have adopted internal control measures governing our investment in financial products as part of our treasury measure, with details set out in the section headed “Financial Information — Discussion of selected items in consolidated statements of financial position — Financial assets at fair value through profit or loss (“FVTPL”). • Our internal audit department and compliance department will review the internal control system regularly to ensure compliance with applicable legal and regulatory requirements, and report the review results to our senior management and our Board. • We will also seek advices, where necessary, from legal advisers on the latest requirements of applicable laws and regulations of the PRC. In addition, for the purpose of preparing for the Listing, our Internal Control Consultant

has reviewed our internal controls over financial reporting systems (the “Internal Control Review”). The Internal Control Consultant did not identify material internal control deficiency in the Internal Control Review under the agreed scope of review.

Executive and Independent Directors

The table below sets forth information regarding our Board of Directors.

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Date of joining the Group</u>	<u>Date of appointment as a Director</u>	<u>Principal responsibility</u>	<u>Relationship with other Directors and/or senior management of the Group</u>
<i>Executive Directors</i>						
Mr. Wang Jiaan (王家安)	61	Executive Director and chairman of the Board	8 May 1994	31 July 2017	Overall management, corporate policy making and strategic planning of our Group's business operations	Father-in-law of Mr. Shi Pengyu (施鹏宇), a senior management of our Group
Mr. Zhou Yinbiao (周银标)	59	Executive Director and vice-chairman of the Board	8 May 1994	7 November 2018	Overall management, production operation, internal management of the Group	Not applicable
Mr. Dai Xianru (戴贤如)	60	Executive Director and finance director	8 September 2001	7 November 2018	Overall management, financial operation, internal management of the Group	Not applicable
Mr. Ben Daolin (黄道林)	53	Executive Director	8 May 1994	7 November 2018	Overseeing the human resources and administrative management of the Group	Not applicable

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Date of joining the Group</u>	<u>Date of appointment as a Director</u>	<u>Principal responsibility</u>	<u>Relationship with other Directors and/or senior management of the Group</u>
<i>Independent non-executive Directors</i>						
Ms. Zhang Lanrong (張嵐蝶)	62	Independent non-executive Director	25 October 2019	25 October 2019	Providing independent judgement on the Group's strategy, performance, resources and standard conduct	Not applicable
Mr. Ding Zaiguo (丁再國)	55	Independent non-executive Director	25 October 2019	25 October 2019	Providing independent judgement on the Group's strategy, performance, resources and standard conduct	Not applicable
Mr. Mak Hing Keung, Thomas (麥興強)	56	Independent non-executive Director	25 October 2019	25 October 2019	Providing independent judgement on the Group's strategy, performance, resources and financial operations	Not applicable

Mr. Wang Jiaan, aged 61, is an executive Director and the chairman of the Board. Mr. Wang was appointed as our Director on 31 July 2017 and re-designated as our executive Director on 13 March 2019. Mr. Wang is primarily responsible for overall management, corporate policy making and strategic planning of our Group's business operations. Mr. Wang is the father-in-law of Mr. Shi Pengyu, a senior management of our Group.

Mr. Wang has more than 40 years of experience in special equipment manufacturing business. Prior to joining our Group, Mr. Wang worked in Haian County Building Equipment Manufacturing Plant as a mechanical workshop technician and workshop manager from October 1977 to July 1984 and was promoted as the deputy plant manager and technical manager from July 1984 to May 1994. Since then, Mr. Wang joined Jiangsu Pengfei and served as the deputy general manager from May 1994 to October 2001 and was promoted as the general manager from October 2001 to October 2003. Since October 2003, Mr. Wang has served as the chairman and general manager of Jiangsu Pengfei.

Mr. Wang has completed the provincial level mechanical industry professional technical staff high-level transformation innovative upgrading senior training course at the Jiangsu Provincial Department of Human Resources and Social Security; and Jiangsu Province Mechanical Industry Association in August 2012. Mr. Wang has completed the Nantong City modern entrepreneur senior training course at Shanghai Jiaotong University in the PRC in April 2012. Mr. Wang was awarded with a certificate after completion of the 7th Jiangsu province technological entrepreneur (investment & financing strategy and capital operations) training course at Renmin University of China in the PRC in March 2011. Mr. Wang has completed the senior business administration executive training course at Tsinghua University in the PRC in July 2008. Mr. Wang was awarded with a certificate after completion of the building materials mechanical professional certificate at Yancheng Industrial Institute in February 1996.

Mr. Wang is a researcher-level senior engineer, recognised by the Jiangsu Provincial Department of Human Resources and Social Security in November 2012, and is a first level / senior technician, recognised by the Ministry of Human Resources and Social Security, the PRC in November 2012. Mr. Wang participated in public services including, among others, acting as the Vice-chairman of the 5th Committee of the China Building Materials Machinery Industry Association from December 2008 to December 2013, the Vice-chairman of the 5th Committee of the China Building Materials Federation from October 2016 to September 2021, the Chairman of Haian County Building Materials Machinery Business Association from October 2016 to September 2021, a member of the 16th Committee of the Chinese National People's Congress of Haian County from January 2017 to December 2021, the Chairman of the 4th Machinery Committee of Jiangsu Province Building Materials Industry Association from March 2017 to February 2022 and a member of the 14th Committee of the Chinese National People's Congress of Nantong City from January 2012 to December 2016. Since August 2017, Mr. Wang has also held the position as the secretary of Jiangsu Pengfei branch of the Chinese Communist Party.

The other executive directors also have a long history in the industry and Mr. Zhou Yinbiao was also a member of the Communist Party.

Below are short biographies of the independent directors.

Ms. Zhang has more than 12 years of experience in building materials industry. Prior to joining our Group, Ms. Zhang has worked as the chief editor of “Jiangsu Building Materials” magazine since January 2006. She was appointed as the secretary of the board of directors of China Jiangsu International Economic and Technical Cooperation Group Ltd. from December 2015 to June 2017 and has a master’s degree in economics from Nanjing University of Science and Technology.

Mr. Ding Zaiguo has more than 20 years of legal experience. He is currently a qualified lawyer in the PRC as accredited by the People’s Republic of China Ministry of Justice Lawyer Qualification Review Committee in August 1996. He is also accredited by Nantong City Professional Lawyers Review Committee as a level four lawyer in July 1999 and obtained professional lawyer license from Jiangsu Province Judicial Department in October 1997. Prior to joining the Group, Mr. Ding worked as a lawyer and a deputy manager in Jiangsu Victory Law Firm from March 1996 to May 2002. Since then, Mr. Ding has worked as the deputy manager in Jiangsu Bright Eyes Law Firm. Mr. Ding obtained a Bachelor of Laws from Southeast University in the PRC.

Mr. Mak Hing has over 15 years’ experience in accounting and financial management. Mr. Mak is currently a member of the Canadian institute of Chartered Accountants and a fellow member of the Hong Kong Institute of Certified Public Accountants. Prior to joining our Group, Mr. Mak worked in Ernst & Young for about 7 years. From October 1997 to May 2000, Mr. Mak worked as a manager in the listing division of Stock Exchange. Mr. Mak has worked as the CFO of other listed companies and has been both a nonexecutive and an executive director of other listed companies. Mr. Mak obtained a bachelor’s degree of commerce from Queen’s University, Canada in May 1989.

Recent News Releases

In April 2020, Anhui Chaohu Hengxin Cement Co., Ltd. ordered the 3.8x13m tube mill + 1.8x1.2m roller press manufactured by Jiangsu Pengfei Group to form a double-cycle semi-final grinding system. Chairman Kong Dekai, General Manager Ye Mingwei, Hu Shanchao Under the leadership of the production director, through the joint efforts of technical personnel, the system design is optimized, the production process is adjusted, the best operation plan is selected, and the sample site is carefully built. , 52.5 grade cement production of 220 tons / hour. The production process is stable and the cement quality is very good, which has been fully affirmed by experts in the same industry. The environment of the factory has been greatly improved, and it has become a model for joint grinding of energy saving and emission reduction in the national cement industry.



Jiangsu Pengfei Group has an annual output of more than 200 sets of grinding equipment such as roller presses, tube mills, and vertical mills. In December 2020, the large-scale roller press production base was put into operation. With the help of professors Liu Pingcheng and Yang Xiaohong from Yancheng Institute of Technology In the future, **the double-cycle semi-final grinding system of tube mill + roller press is adopted, the grinding efficiency is increased by 50-100%, the power consumption is reduced by 30-50%, and the power consumption per unit product is reduced to 19 degrees, becoming a peer demonstration project.**

The new process of double closed-circuit internal circulation semi-final grinding has the characteristics of short process, small occupied space, low operating power and low investment. It is not only suitable for the application of new lines, but also for the transformation of old-line systems. Jiangsu Pengfei and Chaohu Hengxin cooperate sincerely to learn and adopt advanced joint grinding new technology, learn from each other and improve together, and contribute to the ecological energy saving of cement grinding in the country.

"Pengfei" roller press grinding technology has rapidly expanded from the cement industry to the mining field, and the market demand space for roller presses in the mining industry is worth looking forward to. In the field of mining, roller presses can replace cone crushers or ball mills, and are mainly used in the pre-grinding of iron ore and non-ferrous metal beneficiation and have obvious advantages of energy saving and efficiency enhancement.

References:

<http://www.pengfeichina.com.cn/view.asp?keyno=1920>

<http://www.pengfeichina.com.cn/view.asp?keyno=1921>

On the morning of September 1 (2021), Huang Weicheng, deputy director of the Standing Committee of the Nantong Municipal People's Congress, led a team to Jiangsu Pengfei Group for investigation. Zhang Yaxi, Director of the Standing Committee of the Haian Municipal People's Congress and Secretary of the Leading Party Group, Zhang Mingxing, Member of the Standing Committee, Minister of the Organization Department, and Minister of the United Front Work Department of Haian City, Chu Kaiquan, Deputy Director of the Standing Committee of the Municipal People's Congress, Deputy Secretary of the Leading Party Group, and Deputy Mayor Cao Cheng participated in the investigation. Jin Shancun, Secretary of the Party Committee of Dagong Town, Wang Jun, Chairman of the National People's Congress, Cao Yang, Deputy Mayor, Xue Qiukui, United Front Worker, and Wang Jiaan, Chairman of Jiangsu Pengfei Group Co., Ltd.



At the site of the production project of complete sets of equipment for comprehensive utilization of resources by Jiangsu Pengfei Group Co., Ltd., Huang Weicheng listened to the introduction of the company's chairman Wang Jiaan on the investment scale, land area, building area, and construction progress of the complete set of equipment production project for comprehensive utilization of resources. In addition, he also communicated with Wang Jiaan on issues such as the approval procedures for project construction, the transportation of bulky products, and the impact of the epidemic on the company's product exports.

Huang Weicheng expressed his appreciation for the development achievements of Jiangsu Pengfei Group Co., Ltd. He pointed out that relevant departments should attach great importance to the project

construction, make every effort to do a good job in project construction, further clarify responsibilities, implement work responsibilities, do a good job in corporate counterpart services, take the initiative to help solve problems in the process of project advancement, and urge enterprises to complete project tasks on time and put into production as soon as possible. Effective. He emphasized that focusing on projects is focusing on economy and development. Party committees and governments at all levels, departments and project builders must fully understand the importance of project construction, further clarify responsibilities, do a good job in overall coordination, strengthen project scheduling, and speed up project progress. He demanded that it is necessary to further strengthen the attraction and cultivation of major industrial projects and make every effort to ensure the project service.

Reference: <http://www.pengfeichina.com.cn/view.asp?keyno=1926>

Recently, Li Xiaobing, Secretary of the Party Committee and Director of the International Economic Cooperation Affairs Bureau of the Ministry of Commerce, led Wang Yue, Director of the System Department, Zhang Mingwu, Director of the Asia Department, Wu Yu, Director of the Southeast Africa Department, and Lin Qian, the Manager of the System Department, to Pengfei, Jiangsu. The Group Co., Ltd. conducted a special investigation on how to promote the high-quality development of foreign aid work. Feng Yongjin, member of the party group and deputy director of the Municipal Bureau of Commerce, Huang Liuchun, secretary of the party group and director of the Municipal Bureau of Commerce, director of the Management Committee of the Commerce and Logistics Industrial Park, and Shi Xiabing, deputy secretary of the party group and deputy director, accompanied the investigation.



Wang Jiaan, Chairman of Jiangsu Pengfei Group Co., Ltd. led the research team to visit the production workshop and exhibition hall, **introduced the company's domestic and foreign development orientation and the general situation of the projects in countries along the "Belt and Road" to the**

research team, and introduced the company to the research team. The current development status, the operation of overseas projects and the company's future development vision.

Director Li Xiaobing fully affirmed the contribution made by Jiangsu Pengfei Group in participating in the national "Belt and Road" construction, **and highly praised the company's unswerving ability to go global despite the impact of the epidemic, which not only shows the corporate culture of listed companies, It also reflects the responsibility and responsibility of private enterprises.** He pointed out that enterprises should have a deep understanding of the new ideas, new ideas and new requirements of the "Belt and Road" initiative, play a leading role, actively participate in the construction of national foreign aid projects as the main force, further strengthen close cooperation, and expand the scope of enterprises going global. The depth and breadth help enterprises to go global and achieve long-term stability.

References:

<http://www.pengfeichina.com.cn/view.asp?keyno=1924>

<http://www.pengfeichina.com.cn/view.asp?keyno=1930>