

Proceedings of CCHEP II' 2002

The 2nd Canada-China International Workshop on Management

May 13-20 2002, Xi'an, China

中加高等教育项目

第二届中加管理研讨会论文集

2002年5月13-20日, 西安, 中国

促进 管理 知识 发展

席酉民

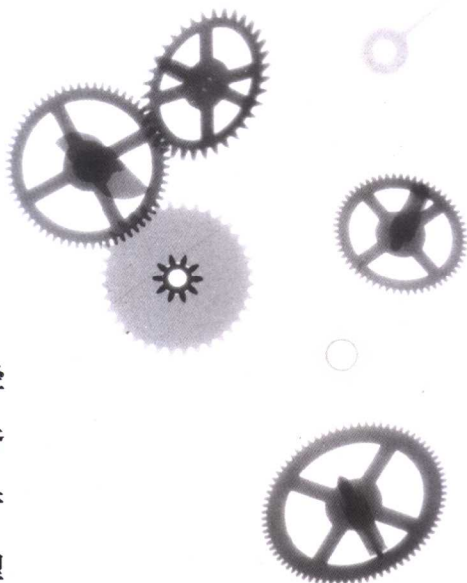
Rolf Mirus

主编

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Preface

The decision made by Canada and China in the early 1980's to cooperate in management education proved to be provident. Academic pioneers in the field like Wang Yingluo, Li Huaizu, Xi Youmin and Li Yuan recognized the need for management studies as a key ingredient for China's economic modernization. The links they forged have resulted in a vibrant research culture at Xi'an Jiaotong University which has spread to many other institutions in China and is reflected in its premier ranking among Chinese management schools.

"Enhancing Knowledge Development in Management" is just such a testimony to the productivity of Jiao-Da's School of Management: senior scholars working with their PhD students, as well as PhD graduates who have assumed academic leadership positions across China share their insights in this volume, covering the fields from Governance and Strategy to Human Resources Management, Environmental Management and Reform of the Financial System. It is, therefore, a great pleasure to see that 19 of the 32 papers involve authors who are "graduates" of the Canadian International Development Agency's (CIDA) Canada-China Higher Education Program and the preceding Canada-China Management Education Program. These programs not only built strong and lasting bridges between China and Canada, they have also made a significant contribution to China's rapid and successful economic development.

We are proud to have been associated with these fine researchers and congratulate them and the editors on this accomplishment.

Meanwhile, we would like to express our gratitude to Prof. Li Huaizu (李怀祖教授), Prof. Wan Difang (万迪昉教授), Prof. Wang Kanliang (王刊良教授), Prof. Song Heyi (宋合义教授), Prof. Liu Yi (刘益教授), Prof. Guo Jue (郭菊娥教授), Prof. Zhuang Guijun (庄贵军教授), Prof. Cui Wentian (崔文田教授), Prof. Su Qin (苏秦教授), Prof. Hu Ping (胡平教授), for their helpful work in perfecting the papers selected into this proceeding.

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CORPORATE GOVERNANCE

Corporate Governance and Performance Evaluation

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Abstract: The revolution of corporation is a process, which covers with every position in the social life, so that perfecting the corporate governance aspect is not enough for the corporation to achieve the destination of improving competition. It's necessary to accompany with the revolution of managerial structure at the same time. Through discussion this article advocates combining corporate governance with corporate management and puts forward that performance evaluation system should be divided into two layers according to the organization structure of corporation: one is outer performance evaluation whose main role is providing service for corporate governance; the other is inter performance evaluation whose main role is providing service for corporate management. The whole system of performance evaluation combines organically corporate governance with management.

Keywords: Corporate Governance, Corporation Management, Performance Evaluation, Balance Scorecard

1 General Statement

1.1 The Main Viewpoints about the Corporate Governance and the Comments on Them

The theory of corporate governance had developed a lot by now and two kinds of theories are the most famous and easiest to be accepted by the public, which is Principal-Agent theory on the basis of information economics and Party at Interested theory on the basis of modern corporate governance. But every one above provides a foundation of working or a frame of responsibility system. They don't involve the specific running at all. From this angle the structure of corporate governance we are discussing widely now is only to straighten out the questions which are underlying in the strategy aspect of a corporation.

While according to the history course of corporation revolution and the summary of practice experiences from the eastern and western we can know that corporate revolution would not make the situation better and strengthen the corporation vigor and competition unless the two aspects-governance and management – are harmonized together and guided together. Corporate

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governance is a coordinating activity on the function of organization structure and effective corporate governance is not only to serve for stockholders but also serve for all relative persons. However, because the profits of interest groups are not identical to the purpose of corporates, governance is not to consider one party's profits without taking care of others' profits. So corporate governance should be a kind of balance or harmony of interest groups. The standard of good structure of governance is the satisfactory degree of different parts that are related to the corporation on the basis of survival and continuous development of corporation. According to Lin Yifu (林毅夫), the corporate governance structure is a kind of institutional arrangements which is benefit for owners to supervise and control the management and Performance of a corporation. This conception reflected the above idea.

1.2 The Content of Performance Evaluation

Performance evaluation is a management process in which the evaluation party makes an analysis of certain persons or things concerned with their interests. As a result, it can achieve the outcome of improving its management or obtaining some necessary information which may be of great help to its decision-making by forcing certain feasible excitation and restraint system. At the beginning of corporation development, performance evaluation plays a great role as a management means for corporation. With the further development of corporation, corporate governance becomes the more important aspect and is taken seriously by the public. At the same time, developing with the time performance evaluation plays greater and greater role in the aspect of corporate governance. So the system of performance evaluation is also a management system, which starts with all parts' benefits and sets up a series of indexes to evaluate the one that should be evaluated.

2 The Relationship between Corporate Governance Structures and Performance Evaluation

The governance structure of Modern Corporation refers to the governance structure whose ownership and tenure are separated under the principal-agent situation. Owners don't take part in the activities directly so that there are two layers control in this kind of corporation. The first layer control is that owners control over the managers. The main purpose of owners is capital maintenance and capital appreciation and to achieve the profits of capital. So it's necessary to make some managerial targets and managers' rewards in order to encourage and restrain managers. This is the reason that the outer performance evaluation exists. We also call it the first layer performance evaluation. The second layer control is that the managers control over the production and management activities. In order to finish the trustee responsibilities, managers need to encourage and restrain their subordinates and workers to make them work and realize the managerial targets. That is the reason that the inter performance evaluation exists. We also call it the second layer performance evaluation.



2.1 The First Layer Performance Evaluation

This evaluation's main body is owner and its evaluation targets is to realize the capital maintenance and capital appreciation and obtain the most profits of capital. Because the corporation can issue stocks at the capital market, the separation of stockholdings causes the reality that information is not symmetry between owners and managers. Owners can't and needn't know the real production and running situation of the corporation, so the control that owners over managers depends mainly on market mechanism and gains support from organization behavior.

(1) The effect of market to performance evaluation

In general, the source of a corporation's capital has two kinds: equity capital and liability capital. The structure proportion of equity capital and liability capital affects not only the capital cost and the corporation's total value but also the corporate governance and the behaviors of directors. Owners will use capital cost as a standard to judge the expectable income ratio of their investment.

To stockholders, they pay much attention to the capacity of obtaining profit from their shares, while dividend, the change of the market value and the liquidity of stocks will affect their income. These incentives to stockholders will change naturally the constraints that stockholders control over managers through capital market. So the price of stock, price-earnings ratio and dividend payment ratio are also the important factors of performance evaluation indexes system.

In addition, a corporation must have been in some industry. One important function of market mechanism is to form the average profit of the industry through free regulating of market. This figure is easy to obtain from statistics. Owners can evaluate the whole management condition and the rank in its industry through comparing profit with the average profit of the industry. Thus the average-industry profit ratio (the average profit of industry/corporate profit) is one of indexes of the first performance evaluation.

Summarizing above, the indexes system of the first performance evaluation include three parts: overall evaluation, capital maintenance and capital appreciation. The specific indexes are listed as follow in detail:

Evaluation target	Evaluation content	Basic evaluation index
Overall rank	corporation profit	average-industry profit ratio
Capital maintenance	capital structure	capital cost
	net assets	growth rate of net assets
Capital appreciation	corporation profit	yield rate of net assets
	stock value	stock price earnings ratio
	dividend	price-earnings ratio
		dividend payment ratio



(2) The effect of organization actions on performance evaluation

Although the separation of ownership and tenure, owners can restrain the managers though “voting with feet” on capital market. This is the behavior that minority stockholders take. To strong stockholders they control over the corporation not only for their biggest profit but also for other aims. So there is relationship between owners and managers in some special period and they construct an invisible organization. Owners will not reach their destination by the above evaluation unless some incentive and constraint mechanism to managers are included in organization. That is one important part of performance evaluation system. The incentive mechanism generally includes two aspects: material incentive and spiritual incentive. Material incentive mainly refers to managers’ rewards. In the request of corporate survival and development the rewards of managers should be composed of three parts: basic wages and welfares, the bonus which is designed in the light of corporation short-term running targets and is related to a quarterly profit or annual profit. Stock and stock option which is related to long-term beneficial result. Please note; the first two parts shouldn’t account for too large percentage, or it will cause short-term behaviors; it’s not good for stock option to take long time more than 5 years, or managers will lose their patient to wait for the income, which may not belong to them. If that happened this incentive measure would lose its useful meanings. Spiritual incentive mainly refers to the promotion of managers. But this incentive is only useful to those managers who are possible to promote continually rather than other managers such as CEO. To CEO promotion is rather a punishment to operating inferiority than a driving force.

From the above discussion, the first layer performance evaluation needs the aid of outer governance and inter governance together to play their role.

2.2 The Second Layer Performance Evaluation

The main body of the second layer performance evaluation is managers. The evaluation aim is to accomplish the trustee responsibility in order to make the corporation running healthily and stably. So this layer performance evaluation is the one that we often called in narrow sense. According to the characteristics of performance evaluation system, the design of targets must reflect the global strategy of corporation and be consistent or positive correlation with the goal of corporation. It consists of financial indexes and non-financial indexes and takes short-term benefit and long-term benefit into consideration. The second layer performance evaluation system is the foundation of the whole evaluation system because it involves in employees from different departments and different operational characteristics, the target system determined specific evaluation index on special operational characteristics, the industry corporation lies in different development stages and the purpose of valutors. The Balanced Scorecard system which has existed, can be used for reference.

The Balanced Scorecard system which was put forward by R . S . Kaplan professor and D.P.Norton professor of Harvard University in American in 1992 is a better method to evaluate performance. This performance evaluation system corresponds with the goal of corporation through combining current decision and business activities with long-term financial income. The



Balanced Scorecard system not only includes traditional financial evaluation indexes but also contains three aspects of non-financial indexes, which are client, internal operation process, studying and growing and so on.

(1) Financial aspect

The Balanced Scorecard keeps the main part of traditional accounting information system and financial performance evaluation. From long-term angle, only the capital gain and capital appreciation are the final goal of corporation and the essential pursuit. So financial evaluation indexes are the form of value description to strategic management results of corporation. In the balanced scorecard financial evaluation mainly consists of business income, return on capital, economic added value, cash flow and so on.

(2) Client aspect

Managers need make sure of the competitive clients they faced and market shares and estimate performance situation of corporation in their scope. Client aspect embodies corporation's reaction to the outside changes. If only you know your clients well and meet their needs, the value of your products can be realized and the corporation can obtain sustainable growing fountainhead of economy. So the core indexes of client aspect include the degree of clients' satisfaction, the degree of maintaining clients, the acquisition of new customers, customer profitability and market share and so on.

(3) Internal operation process

According to the internal value chain, internal operation process can be divided into three main process factors: innovation process, operation process and post-service process. Innovation process refers to the development and design of products or service. This process shows the long-term value creation and its indexes are to put new product into market, the proportion of revenues from new goods sold to total revenues and so on. Operation process refers to production, sale and transportation of products. This process emphasizes effectiveness and consistence and its indexes are the quality of operation process, cycle time and cost index and so on. Post-service process refers to all the service corporation provided after sale, and the service is related to maintenance and guarantee of products. This process is also the important link in value creation of corporation and its evaluation indexes are the time that customers appealed and so on.

(4) Studying and growing

Sharp global competition requests modernizing corporation to establish the basic structure of long-term growth and progress. The Balanced Scorecard makes employees, technique and organizational culture as the crucial factors and judges the indexes respectively such as maintenance ratio of employees, productive power and the growth of satisfaction. In order to check the present situation and the changes of employee's aptitude, technique structure and organization culture. If these aspects were improved, employees would bring their latent force into full play, in turn the technique results of corporation would be heightened a step further and organization culture would develop towards better orientation.

The two layers performance evaluation systems combines governance with management effectively. It has great significance for corporation to complete structures, run and develop healthily.



3 Conclusion

Summarizing above, intact performance evaluation system should include two segments: governance and management. The relationship between performance evaluation system and corporate governance firstly is that performance evaluation system is adding to new contents with the development of corporate governance. Governance will be completed with the development of Principal-Agent relationship, for example, it develops from combination of ownership and tenure to detachment of ownership and tenure, and control relations between shareholders, directorate and supervisal committee. So performance evaluation system also becomes intact system, which includes both management aspect and governance aspect in comparison to the one that makes management as the main content before. Secondly, the all-round development of performance valuation will make the structure of corporate governance perfect. The emphasis of corporate governance is supervisal, evaluation, and the control of owners to managers in order to achieve the targets of the capital maintenance and capital appreciation. The incentive and constraint mechanism and related evaluation indexes can help owners to reach their aims. When new effective incentive and constraint mechanism comes out, corporate governance will adjust itself with it and become more perfect.

Therefore, performance evaluation, which is regarded as one important measure to improve management and complete governance, combines management with governance. That makes the running mechanism of corporation sounder and provides good situation for the revolution and development of corporation. The target of our corporations revaluation is building up modern enterprise system which is characterized by clear property right, definite right and responsibility, detachment of government and enterprise, scientific management. The first and the last characters are governance content and management content respectively. Accordingly, modern enterprise system itself includes the combination of governance aspect and management aspect.

This performance evaluation system will resolve a lot of difficulties in its really use because of the incomplete corporate governance structure and indecent usage of modern management methods. As far as the first layer of performance evaluation is concerned, its effective factors are mainly market and organization behavior. Because the running of our capital market does not conform to the standard, main bodies do not form effective supervisor mechanism, functions of stockholders do not give full play, we do not find practical and effective measures to encourage and control managers and so on. Those can all influence the effectiveness of the first performance evaluation. As far as the second layer performance evaluation is concerned, because it includes financial indexes and non-financial indexes and the number of indexes is too much, it is not beneficial for information users to make decision. In addition, the cost of attaining non-financial information is so large and allocating the aim to every department and every one is so difficult that it requires policy-makers to be qualified with a lot of knowledge and practice. Those factors can all influence the second performance evaluation. Therefore, the effective implement of performance evaluation system needs every aspect's efforts.