

# Theoretical exploration of executive compensation in state-owned enterprises

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## Abstract

**Purpose** – This paper aims to establish a theoretical framework that can comprehensively explain the executive compensation in state-owned enterprises (SOEs) within the context of socialism with Chinese characteristics.

**Design/methodology/approach** – The author develops a theoretical framework for executive compensation in SOEs from the perspective of Marxist economics and points out that the executives in SOEs are engaged in management labor, and their compensation should adhere to the principle of distribution according to labor contribution.

**Findings** – Based on this theory, the author posits that the continuous upward trend of executive compensation in SOEs, is consistent with the trend of SOEs' ongoing expansion, which reflects a continuous improvement of SOE executives' management labor in both quality and quantity.

**Originality/value** – It is necessary to start with Marxist economic theory and scientifically study the issue of SOE executive compensation, adhere to the principle of distribution according to work in the context of a socialist market economy and implement the specific guideline of the Party Central Committee; only in this way can the long-term healthy development of SOEs be promoted continuously.

**Keywords** Executive compensation in state-owned enterprises, Marxist economics, Management labor, The principle of distribution according to work

**Paper type** Translated paper

Executive compensation in China's state-owned enterprises (SOEs) has witnessed a general increase over the past decade, with varying characteristics at different levels. This phenomenon has aroused widespread concern in society and made executive compensation in SOEs an important issue for academic research due to the SOE's special nature. Many studies have employed existing foreign theoretical paradigms to analyze this topic. However, due to the particularity of SOEs in the socialist market economy, the direct application of these theoretical paradigms cannot capture the complexity and accurate understanding of executive compensation in SOEs. Moreover, these theories themselves harbor various limitations, rendering them inadequate to fully account for the intricacies of executive compensation phenomena. Therefore, it is necessary to meticulously scrutinize and critically evaluate these theories, discerning the genuine from the spurious and extracting the essence from the rudimentary, so as to derive enlightening insights for the research on executive compensation in SOEs and further establish a theoretical framework that can comprehensively explain the executive compensation in SOEs within the context of socialism with Chinese characteristics.

The study of executive compensation abroad has generated substantial literature, particularly over the past three decades. This surge in research reflects the dramatic changes in the issue of executive compensation itself. For instance, executive compensation in



American firms has skyrocketed since the 1980s, with long-term incentive compensation and equity incentives contributing more than half of the growth in the USA. From 1978 to 2018, CEO compensation in the USA experienced a drastic increase of 940.3%, while the annual salary of average workers only saw a modest rise of 11.9% during the same period. The pronounced nature of this change is more evident when examining the multiple by which CEO compensation surpasses ordinary worker wages. In 1965, CEOs earned 20 times more than the average worker's salary, a ratio that surged to a peak of 368 times in 2000 before receding to 278 times in 2018. Nevertheless, it still remained significantly higher than the levels observed in the 1960 and 1970s [1]. With the ongoing changes and societal conflicts stemming from the issue of executive compensation, research in this area is experiencing rapid growth. As Kevin Murphy (1999), a leading scholar in the field, exclaimed, "... , CEO pay research has grown even faster than CEO paychecks."

When tracing the literature on executive compensation back to its origins, its initial theoretical assumptions or underlying theoretical context can always be found. From the historical development trajectory of executive compensation research, the author identifies three distinct perspectives within the economic domain for understanding executive compensation. The first perspective is the market equilibrium approach, consistent with the theory of factor price determination in classical economics, positing that the market facilitates optimal resource allocation, and executive compensation represents the price realization of enterprise executives as a factor of production. The second is internal corporate power, which originates from enterprise theory and enables scholars to delve into the mechanism that shapes executive compensation within these enterprises. The third perspective is socio-economic structure, which derives from a reflection on the above two mainstream theories of executive compensation and aims to dynamically examine changes in executive compensation from a more macroscopic viewpoint. Although these theories differ, they are interrelated. However, none of these perspectives can adequately explain the issue of executive compensation in Chinese SOEs. Therefore, the author proposes a Marxist economic perspective to understand the executive compensation in SOEs, which can help to better analyze the executive compensation issue in China under the consideration of the principle of distribution according to work under socialism.

## 1. Executive compensation theory from the perspective of market equilibrium

The SOEs have the general meaning of enterprises under the conditions of the socialist market economy. The theory of executive compensation from a market equilibrium perspective assumes that executive compensation can achieve a reasonable and balanced state through the market effect. Within the framework of new classical economics, enterprises are regarded as "black boxes" that only need to consider costs and outputs. The new institutional economics school, represented by Coase, has unveiled this "black box" of enterprises and interpreted them as an organizational structure composed of a series of contracts aimed at reducing transaction costs. With the opening of the enterprise black box, a boundary point in executive compensation theory has emerged from the perspective of market equilibrium. One viewpoint still holds that enterprises are "black box" and examines how the external labor market influences the compensation of executives as special labor, while another viewpoint uncovers the "black box" of the enterprise and contracts the internal corporate power relationship, aiming to study how to achieve the equilibrium state of executive compensation.

### 1.1 Theory of management labor market

This type of research considers "enterprise executives" or "professional managers" as a factor of production that can be freely traded in the market, with prices determined by market

supply and demand. The labor market for executives has its unique characteristics, and short-term changes in demand or supply will not affect the salaries and quantity of executives. On the one hand, executives and enterprises usually sign long-term employment contracts, which ensures the stability of the amount of salary. On the other hand, becoming a qualified executive requires a lengthy process that cannot be expedited to meet immediate demand. To underscore the executives' capability to generate value, some scholars regard this management skill of executives as a type of "human capital", and executive compensation is essentially compensation for utilizing such human capital. Consequently, the greater the marginal output of executives, the higher their return on human capital investment and corresponding compensation. [Lucas \(1978\)](#) posited that the differences in managerial competence account for the differences in enterprise size, with more competent managers operating larger-scale enterprises and receiving higher salaries. The research by [Murphy and Zbojnik \(2004\)](#) indicates a rise in the proportion of US enterprises selecting CEOs from external sources since the 1970s, increasing from 15 to 26% in the 1990s. This reflects the growing importance of general CEO skills, namely, the competencies of CEOs to manage across different enterprises effectively, and the value placed on these skills has contributed to the rise in executive compensation. Hiring CEOs externally is increasingly prevalent due to the growing universality of executive skills. The concept of "management capital" in the general sense has replaced firm-specific capital, which includes organization-specific expertise, knowledge, social networks, and experience. This shift has resulted in decreased internal promotions, increased external hiring, and higher compensation for executives compared to the average worker ([Frydman, 2019](#)). Other studies have examined social and psychological factors that contribute to executive market prices, such as "social circle premium" ([Ang et al., 2008](#)) and "competitive benchmarking" ([Yang, 2013](#), p. 34). The substantial surge in US executive compensation can be primarily attributed to the extensive use of stock-based remuneration. However, the reason behind the gradual prevalence of stock-based compensation in executive pay remains inadequately explained by the management labor market theory, as it fails to provide a convincing rationale.

In light of the changes in executive compensation of Chinese SOEs, the management labor market theory can offer some insights into the upward trend of executive pay in SOEs. As a result of the ongoing reform and opening-up, along with the advancement in the market environment, technological capability, and the opening-up level, there is a growing demand for highly competent SOE executives with higher compensation. Meanwhile, the development of the socialist market economy has also led to a more standardized set of skills for executives and increased opportunities for executive mobility between SOEs and enterprises under other types of ownership. This trend also drives up the compensation for SOE executives. However, it should be noted that this theory cannot serve as the theoretical basis for guiding executive compensation practice in SOEs. Since the SOEs are owned by the people, the executives in SOEs are not labor commodities, and the relationship between the SOEs and executives is not a capital-employment relationship but rather a socialist labor relationship. Thus, the compensation for executives in SOEs should be obtained based on the principle of distribution according to work instead of the management labor market theory. It is necessary to apply theories consistent with the nature of SOEs to gain a scientific understanding of executive compensation in SOEs.

### *1.2 Efficient contract theory*

Efficient contract theory posits that an optimal equilibrium between corporate performance and personal gains can be achieved through an effective contract between an enterprise and its executives. [Jensen and Murphy \(1990\)](#) contended that executive compensation should closely align the utility of executives with the interests of shareholders to maximize the

interests of shareholders. [Demsetz and Lehn \(1985\)](#) demonstrated a positive correlation between risk and compensation performance sensitivity, indicating that managers should increase corporate equity ownership as the enterprise's risk rises. [Jensen and Murphy \(2010\)](#) found that the performance sensitivity of executive compensation was significantly low between 1974 and 1986. This can be attributed to the low percentage of performance-based compensation in the executive compensation structure. The median ownership stake held by the CEOs in the top 120 largest US companies declined from 0.30% in 1938 to merely 0.05% in 1974 and just further dropped to 0.03% in 1984. They asserted that the compensation of enterprise executives resembles that of government officials rather than it does management pay within enterprises. Consequently, they advocated for an increase in "salary-performance sensitivity" concerning executive compensation and posited that implementing more equity incentives was the most effective means of achieving this. Their research garnered a widespread social response in the USA, leading to the adoption of equity incentives in executive compensation on a large scale in Western countries such as the US. Some scholars regard it as one of the few instances that academic research successfully directly influenced real economic behavior ([Giroux, 2015](#)).

Many studies have utilized this theory to examine the correlation between executive compensation and business performance in SOEs. For instance, according to [Jiang \*et al.\* \(2014\)](#), due to the explicit performance demands placed on managers by SOEs, coupled with greater social oversight, weaker motives for embezzlement, and the uniqueness of multiple roles held by state-owned enterprise managers, the incentive contracts for these managers in SOEs prioritize company performance more than those in non-SOEs. However, other scholars have arrived at divergent conclusions. For example, [Chen \*et al.\* \(2005\)](#) argued that the state-owned enterprises' compensation control policies lead to more severe on-the-job consumption among executives, resulting in inefficient compensation arrangements within SOEs. According to [Zhang \*et al.\* \(2013\)](#), the excessive employee burden in SOEs significantly reduces the sensitivity between executive compensation and corporate performance, a phenomenon not observed in non-SOEs. From the perspective of efficient contract theory, SOEs should utilize a reasonable compensation system to enhance the sensitivity between executive compensation and corporate performance. This viewpoint holds certain significance for the practices of SOEs in China. However, if SOEs significantly increase executive equity incentives on a large scale, like companies in Western countries, they may encounter interpretative challenges under public ownership and inevitably suffer from the negative consequences of excessive use of such incentives. More importantly, the equilibrium state in the efficient contract theory is not a realistic norm. The notion that executives can receive reasonable compensation as long as effective compensation contracts are established is seriously challenged both theoretically and practically. The executive compensation theory from the internal corporate power perspective falsifies the possibility of such an equilibrium.

## 2. Executive compensation theory from the perspective of internal corporate power

After years of reform, SOEs have established a completely modern corporate structure. Senior management personnel occupy the top position in the hierarchical power structure in modern enterprises, while enterprise owners cannot directly exercise management power. When there is a deviation of interests between enterprise owners and executives, the strong exclusivity of executive decision-making within the company makes it difficult for enterprise owners to dismiss executives as easily as they would with general employees. The interaction between such power dynamics is intricate, imbalanced, and ever-changing and cannot be resolved through the role of market supply and demand. This paper refers to such a theory that portrays the dynamics among internal corporate power and its impact on the quantity

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and structure of executive compensation as the executive compensation theory from the perspective of internal corporate power.

### *2.1 The agency theory's explanation of executive compensation*

The agency theory offers an effective tool for explaining power dynamics within enterprises, rendering it the theoretical basis for numerous studies on executive compensation. The earliest recognized agency problem is actually a legal term, denoting "Agency" as a set of legal norms that empower the principal to authorize an agent to establish a legal relationship with a third party. This agency relationship necessitates the agent's loyalty toward the principal, while the enterprise is a legal entity reliant on this agency relationship (Giroux, 2015).

Legal scholar Adolf Berle and economist Gardiner Means (2005) were the first to systematically analyze this phenomenon, pointing out the divergence of interests between the enterprise owners and managers and attributing this separation to the expansion of corporate ownership. Jensen and Meckling (1976) developed the agency theory in economics and formalized this theoretical model. They assumed that enterprises or organizations aim to maximize profits and that both principals and agents are rational. Agents seek additional returns (rent-seeking), and compared to general workers, it is difficult to monitor and quantify the output of executives. Thus, agency costs become a primary factor to consider when establishing compensation contracts. Murphy (2012) categorized the agency problem into three types: equity-based problem, which primarily arises between corporate shareholders and executives; cash flow-based agency problem, referring to the conflicts between the company's financial investors and executives; and debt-based agency problem, referring to the conflicts of interest between the company's equity holders and debt holders. Jensen (1993) summarized four approaches to address the agency problem, namely through the board of directors, the capital market, the legal/political/regulatory system, and the product market, to constrain the behavior of corporate executives. However, each of these methods also has its own issues. For example, evidence suggests that introducing capital markets into the executive compensation systems leads executives to focus more on the "expected market" rather than the "real market", prompting them to benefit from stock options trading by manipulating short-term stock prices, which harms the long-term value of the company (Jensen and Murphy, 2012). The board of directors has traditionally been considered a crucial mechanism for addressing the agency problem, in which independent directors act on behalf of shareholders to constrain the executive's power. However, research has found that because directors typically only hold a small portion of the company's shares, they are more inclined to provide executives with excessive compensation, using shareholders' money to curry favor with the executives (Fracassi and Tate, 2012).

State-owned enterprises also face agency problems. In the process of SOE reform, enhancing corporate governance has been a crucial part, which helps to constrain internal power imbalances and, to some extent, makes the executive compensation system in SOEs more standardized. However, can a sound corporate governance mechanism alone ensure that executives in SOEs receive reasonable pay? The "managerial power theory" delves into this question and argues that the key issue does not solely lie in the completeness of the corporate governance system. Rather, the corporate governance system has become a tool or means that executives can manipulate, enabling them to largely determine the executive pay according to their desires regardless of the company's interests.

### *2.2 Managerial power theory*

According to the most representative research on the Managerial Power Theory by Bebchuk and Fried, executives hold greater power and influence within the company compared to

shareholders due to their advantageous positions. The executives can leverage this power and influence to impact the compensation-setting process, leading the board of directors to establish a compensation system that is more favorable to executives. As a result, executives can obtain so-called “rents” beyond what would be considered “fair consideration”, which may not align with shareholders’ interests (Bebchuk *et al.*, 2009). Yermack (1997) confirmed that during the early 1990s, companies commonly disseminated favorable corporate announcements prior to the exercise of stock options granted to executives, indirectly demonstrating that executives leverage their power for personal gain in the compensation-setting process. Bebchuk *et al.* (2009) argued that the determining factor in executive compensation is no longer competitive market forces but rather the continuous extraction of managerial rents by capable executives. They further introduce the concept of “outrage cost”, indicating that the public’s perception of excessive executive pay can effectively constrain an irrational increase in executive compensation. The upper limit of the excessive pay obtained by executives through internal corporate power depends on the level of public acceptance of their discontent.

Many scholars have also raised questions about this theory. Some argue that as corporate governance improves, the power of corporate executives should have weakened over time, and the executive’s power should be most potent at the early stages of corporate development, which does not align with the fact that executive compensation began to rise rapidly only after the 1970s (Holmstrom and Kaplan, 2001). It has also been noted that according to the managerial power theory, the CEOs appointed internally should have received higher compensation than CEOs selected externally. However, empirical data from the USA shows that externally hired CEOs receive 15.3% higher total compensation than internally promoted CEOs, and this disparity has been increasing over time (Murphy and Zbojnik, 2004). Kaplan (2012) found that executive compensation in the USA has decreased in the past 2 decades compared to other high-income groups. If high executive compensation is attributed to the executive’s power, it also raises the question of why attorneys or sports stars that lack executive authority have experienced substantial income growth.

The managerial power theory does provide a unique perspective for studying executive compensation but fails to identify the source and nature of the executive’s power. Whether it is the timing of information disclosure by the company or the influence exerted on board members, executives exercise such power in these instances. The lack of solid theoretical grounding makes the managerial power theory susceptible to question and limits its ability to comprehensively and profoundly explain executive compensation issues.

Some scholars have applied the managerial power theory to study executive compensation in Chinese SOEs. They believe that SOEs face greater public scrutiny, leading to higher social “outrage costs” associated with executive pay. As a result, SOE executives are more inclined to use non-monetary benefits and on-the-job consumption to increase their overall compensation levels (Quan *et al.*, 2010). Lv and Zhao (2008) analyzed the differences in executive compensation in SOEs under different levels of managerial powers. Executives with great power can design their incentive packages, obtaining high monetary compensation along with power-related benefits, while executives with weak power focus more on monetary compensation and may resort to fabricating profits through earnings management to meet the compensation assessment targets. However, the managerial power theory may not be a theoretical framework for explaining executive compensation in Chinese SOEs. With the gradual improvement of regulatory systems for SOEs in China, the supervision and constraint mechanism has become more effective, resulting in better effective restrictions on managerial power in SOEs compared to non-SOEs. Since the continuous increase in executive compensation in SOEs cannot be solely attributed to the rise in managerial power, it is challenging to explain the stylized facts of executive compensation in SOEs solely based on the managerial power theory.



### 3. Executive compensation theory from socio-economic structure

Executive compensation in SOEs is not just a corporate issue but also a socio-economic phenomenon with multiple determinants and multifaceted impacts. A major problem of the abovementioned mainstream executive compensation theories is that they understand the executive compensation issue from a static and isolated corporate perspective. The perspectives of market equilibrium and internal corporate power only possess strong explanatory power within a specific period but are hard to achieve historical and logical coherence when considering the long-term trends in executive pay. The following studies adopt a structural model to analyze executive compensation, considering it as a result of interconnections and interplay of socio-economic factors. The author refers to this approach as the executive compensation theory from the perspective of socio-economic structure, providing a broader theoretical framework for understanding the issue of executive compensation in SOEs.

#### *3.1 Executive compensation in the corporate innovation theory*

Scholars represented by Lazonick explored executive compensation from the perspective of corporate innovation theory. This theory posits that the purpose of an enterprise is to allocate productive resources innovatively, and the role of executives is to carry out this innovative allocation, and executive compensation should effectively incentivize executives to perform this function (O'Sullivan, 2000). The core idea behind the mainstream executive compensation theories is essentially derived from the concept of "Maximizing Shareholders' Value", which holds that shareholders are the bearers of business risks and are the most efficient allocators of corporate resources. However, Lazonick (2015) argued that shareholders' purchase of stock does not contribute to the company's accumulation, nor do they bear the "risks" associated with new businesses or expansions – they merely evaluate opportunities for stock appreciation, seeking maximum profits with minimal risks, and are ready to buy or sell stocks as they please ("Wall Street Walk"). He believed that in innovative companies, the most crucial assets are human resources, not shareholder capital, and "maximizing shareholders' value" is merely a theory about value extraction rather than value creation.

Lazonick (2012) criticized the excessive use of equity incentives in executive compensation. One significant negative consequence of this incentive approach is the widespread stock buybacks by US listed companies, driving up the US stock market index. While it satisfies the pursuit of personal interests by shareholders and executives, it severely damages the long-term competitiveness and innovation capacity of American companies. Furthermore, Lazonick (2014) noted that the members of the board of directors who decide on executive compensation tend to favor higher pay and equity incentives, while those who genuinely care about the company's productive capacity, such as taxpayers and workers, are excluded from the boardroom. Therefore, taxpayer and workers should be given seats on the board. Lazonick emphasized that the process of resource allocation in companies is crucial for national economic security. To achieve shared prosperity, executives should adapt to reasonable compensation levels and allocate resources for the company's long-term development while providing workers with better living conditions and contributing more tax revenue to the government.

The corporate innovation theory is significant in understanding the executive compensation issue in SOEs. Executive compensation theories based on neoclassical economics, such as the management labor market theory and the efficient contract theory, overlook the productive nature of enterprises and interpret them from an exchange perspective, making it difficult to accurately analyze the position and role of executives in the production process of the enterprise, as well as the essence of executive compensation. Reasonable compensation for executives in SOEs should not only promote the improvement

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of their operational performance but also encourage their continuous investment in production and innovation. However, the innovation theory attributes the rapid increase in executive compensation to the excessive use of equity incentives, which is in turn attributed to the spread of the concept of “maximizing shareholder value”, raising concerns about subjective determinism.

### *3.2 The “regulation school” of executive compensation theory*

The French regulation school analyzes executive compensation from a more macro perspective. According to Boyer (2005), executives possess exclusive power, knowledge, and information within the corporate governance process, which are inaccessible to financial markets, competitors, and labor representatives. In the context of financial liberalization, as investor interests have been prioritized, equity incentives have been increasingly incorporated into executive compensation to better control executives’ managerial actions and meet investors’ profit expectations. This has led to the formation of a covert alliance between corporate executives and investors, which tightly binds investor interests with those of executives, where their earnings are closely linked to the company’s stock performance in the capital market. Consequently, investors can leverage executives’ knowledge and power, channeling executives’ pursuit of self-interest toward “maximizing shareholder value”. In turn, executives can leverage investors’ demands to redesign the executive compensation structure and exploit the internal corporate power and information asymmetries for personal gain, resulting in the rapid growth of executive compensation in the USA. However, research indicates that this increase in executive pay has not significantly improved company performance.

Boyer (2014) summarized this series of socio-economic structural changes as a novel form of finance-driven capital accumulation, with the core being the alliance between executives and financial capitalists. Under this form of capital accumulation, the stock market becomes the focal point of attention, and the working class is more susceptible to the impact of macroeconomic fluctuations. Fordism faces resistance, but loose credit conditions ensure the continuation of consumption, allowing this fragile system to function smoothly. The widespread use of equity incentives and the resulting explosive growth in executive compensation are among the external characteristics of this accumulation structure.

The regulation school contextualizes the issue of executive compensation within the system of social capital accumulation, providing a new perspective on understanding executive pay in SOEs. On the one hand, it should be acknowledged that the knowledge and skills required by executives in SOEs have indeed been consistently improving, and this knowledge and skillset have a certain degree of irreplaceability. On the other hand, the issue of executive compensation in SOEs is not merely an internal income distribution matter – the level of connection with the capital market and the regulatory status of the financial system also influences the level of executive pay.

### *3.3 Piketty’s executive compensation theory*

Piketty (2014) described the surge in executive compensation as “the rise of the supermanagers”, which he argued is the primary reason for increased income inequality in all English-speaking countries over recent decades. His research findings suggest that “the rise of the supermanagers” and the resulting income inequality is an “Anglo-Saxon phenomenon”, as similar occurrences have not been observed in other developed countries. This indicates that institutional differences among different countries play a more central role than general exogenous factors like technological advancements.

Piketty (2014) argues that this phenomenon primarily is mainly due to the unique nature of the labor performed by executives, making it difficult to measure the marginal productivity of their work. As a result, executive compensation cannot be explained solely through the lens



of marginal productivity theory. Instead, it should be understood from the perspective of social norms and societal acceptance. Particularly for top management in large companies, their labor has become increasingly difficult to replicate, leading to larger estimation errors in assessing productivity for any given job. In such circumstances, the explanatory power of the “skill-technology” logic weakens while that of social norms strengthens. Piketty attributes these shifts in social norms to the “conservative revolution” that swept across the USA and the United Kingdom in the 1970 and 1980s. This movement brought about a higher tolerance for excessively high executive compensation. It was partly motivated by the trend of these countries being surpassed by nations, including other European countries and Japan, on the economic front. Evidence suggests that tax-cut policies under the “conservative revolution” have provided incentives for executives to lobby other stakeholders for substantial pay raises. [Piketty \*et al.\* \(2014\)](#) developed a bargaining mode. They found that the elasticity of executive compensation related to “luck” (i.e. wage differences not attributable to managerial talent, as other companies in the same industry could perform equally well) is greater than the elasticity related to “talent” (differences that industry variables can not explain), and this luck elasticity is higher in countries with lower highest marginal tax rates, explaining why executive compensation has surged dramatically in some countries while not in others. Differences in company size and the importance of the financial industry cannot account for this disparity, and the claim that the sharp rise in executive pay is due to a lack of competition and that more competitive markets and better corporate governance could resolve the issue does not align with reality.

However, Piketty’s understanding of executive compensation fails to explain the fundamental reasons for the rise in executive pay. Changes in social norms and societal acceptance belong to the realm of superstructure changes, which must be based on changes in the economic base. Moreover, Piketty’s theory did not address what kind of changes occurred in the economic base; thus, the theory is incomplete and less persuasive. This is also a common problem in executive compensation theories from the perspective of social-economic structure, which often attribute the fundamental factors leading to these structural changes to the superstructure when analyzing executive compensation issues, falling into metaphysical misconceptions.

#### **4. Insight: the necessity of a theoretical framework based on marxist economics for analyzing executive compensation in state-owned enterprises**

According to Article 6 of the Constitution of the People’s Republic of China, “The foundation of the socialist economic system of the People’s Republic of China is socialist public ownership of the means of production, that is, ownership by the whole people and collective ownership by the working people. The system of socialist public ownership has eradicated the system of exploitation of man by man, and practices the principle of ‘from each according to his ability, to each according to his work.’ In the primary stage of socialism, the state shall uphold a fundamental economic system under which public ownership is the mainstay and diverse forms of ownership develop together and shall uphold an income distribution system under which distribution according to work is the mainstay, while multiple forms of distribution exist alongside it.” Public ownership is the prerequisite for the implementation of distribution according to work, and only in an economy of public ownership can such a system be effectively implemented. As the “pillar” of socialism with Chinese characteristics, SOEs naturally adopt a primarily work-based distribution system internally, which ensures that work-based distribution remains the dominant income distribution system across society. If the distribution system within SOEs deviates from work-based principles, it would be difficult to meet the requirements of the basic distribution system in the primary stage of socialism within the whole society.

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The Third Plenary Session of the 18th CPC Central Committee has guided the next steps of SOE reform, including a section on executive compensation in SOEs: “SOEs should appropriately increase the proportion of market-oriented recruitment, and rationally determine and strictly regulate the salary standards, position benefits, position-related expenses and business spending of SOE management personnel.” It appears that a crucial aspect to address in theory regarding the compensation of SOE executives is how to fully incorporate the principle of “distribution according to work” into the formulation of their compensation. To theoretically elucidate this issue, it is necessary to establish a framework rooted in Marxist economics for analyzing the pay of SOE executives, rather than relying on other executive compensation theories. This approach will provide a standardized benchmark for understanding the current situation of executive compensation in Chinese SOEs to more effectively explain the issue. Moreover, it will provide guiding coordinates for further developing an SOE executive compensation system with Chinese characteristics, offering crucial support for improving the fundamental economic system at the primary stage of socialism. In the author’s view, adopting Marxist economics as the fundamental theoretical framework for analyzing SOE executive compensation, supplemented by executive pay research from other theoretical perspectives when dealing with specific details, will facilitate the construction of a Marxist theory of executive compensation in SOEs with explanatory power.

#### 4.1

The labor invested by SOE executives is a form of management labor, which is the fundamental starting point for understanding executive compensation in SOEs. Marx (2004) argued that management labor is an essential component of the social production process and a necessary element in the collective labor process. He pointed out that “all combined labor on a large scale requires, more or less, a directing authority, in order to secure the harmonious working of the individual activities, and to perform the general functions that have their origin in the action of the combined organism, as distinguished from the action of its separate organs.” As the complexity of production increases, the managerial functions within a company gradually fall under the responsibility of general management personnel. As the managers of enterprises, SOE executives exercise managerial functions within the enterprise, which involve organizing, coordinating, and planning the production and operational activities of the enterprise – this constitutes management labor. It is a distinct form of labor, different from other types, as it requires specialized training and the accumulation of special experiences; it is also a more complex form of labor that can generate more value than simple labor. Since the reform and opening-up, SOEs have adapted to the socialist market economy through continuous reforms and developed a modern SOE system with Chinese characteristics. This has led to the content of management labor invested by SOE executives being largely similar to that of executives in other forms of enterprises. The studies mentioned above have shown that with the continuous expansion of enterprises and the increasing complexity of organizational structures, the knowledge and skill level required for managing business operations has also increased, indicating that the complexity of management labor has also increased.

Some scholars argue that the selection and appointment of executives in SOE possess particularities and categorize these SOE executives into two main groups: “government employees” and “corporate employees” (Jin, 2014). The former, referred to as “administrative executives” (Song and Meng, 2012) and appointed by the government, should have their pay determined based on criteria similar to those for civil servants, while the latter group follows the regular compensation system used in general businesses. However, the executives are selected and appointed before they contribute specific management labor to the enterprise. Since executive compensation serves as remuneration for executive labor and the prior appointment of executives does not directly influence the characteristics and quantity of management labor invested by executives in SOEs, the executive appointment cannot

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explain the features and amount of executive compensation. Instead, the characteristics of executive management labor are determined by various factors such as the enterprise scale, the industry and the organizational structure and are not related to the method of executive appointment and selection. Thus, the explanation for executive compensation solely from the perspective of the appointment and selection process misinterprets the true rationale behind determining executive pay. Therefore, it is essential to fully recognize the characteristics of executive management labor in SOEs and develop an executive compensation system providing fair remuneration for the managerial efforts of executives.

#### 4.2

The pay of SOE executives should adhere to the principle of distribution according to work. In the market economy, where enterprises become independent legal entities responsible for their profits and losses, the principle of distribution according to work done is practiced at the basic unit level of the enterprise. Equal pay distribution according to work at the same level can only occur within a single accounting unit (Zhang *et al.*, 1981). Before an SOE conducts internal income distribution, a portion of the enterprise earnings must first be deducted and adjusted by the government according to needs, which includes a certain proportion of profits and taxes to be handed over to the government. Additionally, SOEs must determine the proportion of retained earnings based on national policies and corporate development plans. The remaining enterprise earnings are subject to internal income distribution, following the principle of distribution according to work (Zhang, 2016).

During the income distribution according to work, full respect should be given to the laws of the market economy, and the market-driven salary levels should serve as an important basis for accessing the reasonableness of executive compensation in SOEs. Since the management labor invested by corporate executives is a form of complex labor, its impact on the production process is undoubtedly multiplied compared to simple labor. The determination of this multiplier, according to Marx (2004), "is established by a social process that goes on behind the backs of the producers." In a socialist market economy, these social processes necessarily involve the process of market exchange. On the one hand, the effectiveness of executive management labor can only be truly tested in the market environment. On the other hand, corporate executives, as labor commodities with special labor skills, determine their worth through exchanges in the management labor market, which translates to their compensation. Of course, the labor capabilities of executives in SOEs are not commodified, which is a fundamental characteristic of the public economy. In the socialist market economy, however, the compensation of SOE executives is also subject to market forces. The price of labor as a commodity is determined by its value, which depends on the amount of value required to reproduce the labor force commodity. The higher the value needed to reproduce a particular labor force commodity, largely due to higher training and learning costs associated with reproducing that labor force commodity, the higher the inherent labor capacity in that commodity. Therefore, the price differences among different labor force commodities can, to some extent, reflect their varying roles in the production process and the conversion of complex labor into multiples of simple labor, providing a reference for measuring the level of executive compensation. In a competitive market environment, if executive pay falls significantly below the market-driven rate, it suggests that the compensation received by the executive cannot meet the reproduction cost of the labor force commodity investing management labor. This would negatively affect the executives' standard of living and seriously constrain their motivation for productive activities, potentially leading to talent attrition.

Therefore, a reasonable compensation level for SOE executives should be market competitive, particularly in competitive industries (Zhang, 2015). However, some scholars have pointed out that executives in SOEs, especially in central enterprises, have opportunities for promotion to government positions. Huang (2000) considered control rights as an important incentive and constraint factor for SOE entrepreneurs; Yang *et al.* (2013)

summarized the main characteristics of executives in central enterprises as “quasi-officials” and pointed out that the incentive of “political promotion” can significantly lower the pay level of executives in central enterprises. Wang *et al.* (2014) also argued that “political promotion” can effectively incentivize executives in SOEs. It should be noted that, due to the ongoing reform of SOEs and the increasing market-driven level of their operations, the opportunity for promotion to government positions exists only for a very few senior executives of central enterprises, and since internal promotions in enterprises should not be considered “political promotions”, this highly exceptional situation cannot be used as a standard to judge the overall situation of executive compensation in SOEs. Using “political promotions” as an incentive to reduce the monetary compensation of SOE executives is, in fact, a distortion of reasonable compensation for the SOE executives.

### 4.3

The compensation system for executives in SOEs should be oriented toward promoting the production of these enterprises. The managerial labor invested by SOE executives and their special authority within the organization are two sides of the same coin, inseparable from each other. Executives can engage in managerial labor due to their exclusive knowledge, skills, and experience, enabling them to lead, organize, and supervise the production and operations of the enterprise. This process also involves the exercise of their authority within the enterprise. The executive's power influences organizational mechanisms within an enterprise, making it challenging to monitor and regulate executive conduct internally. If executives wield their power solely to maximize their personal gain, it will severely impede the productivity and development of the enterprise, which is precisely what the “managerial power theory” seeks to elucidate. When enterprise executives conspire with external financial forces to pursue mutual financial benefits, they form a “de facto alliance of executives with financiers”, as Boyer pointed out.

Therefore, a key to ensuring the reasonableness of executive compensation in SOEs is supervising and constraining executives' power within the organization through an appropriate organizational mechanism to prevent executives from influencing the determination of the total compensation and the formulation of the compensation system based on their own interests, ensuring that executive compensation can contribute to the production and development of SOEs. From the perspective of this paper, it is possible to effectively prevent the negative issues seen in foreign executive compensation practices by leveraging the unique advantages of the modern state-owned enterprise system with Chinese characteristics. Firstly, the executive compensation system of SOEs can be regulated through an external supervisory mechanism. As the supervisory and management unit of SOEs, the State-owned Assets Supervision and Administration Commission (SASAC), has a relatively comprehensive performance evaluation system for SOE executives. Party organizations also play a crucial role in constraining SOE executives. Party organizations at higher levels or local party organizations can supervise and evaluate SOE executives, and party discipline is more stringent than laws, with a more robust organizational structure (Zhang, 2017), which can effectively regulate executive compensation in SOEs and ensure that the compensation system is conducive to the production and development of SOEs. Secondly, the presence of worker directors can serve as a check on the internal income distributions of the SOEs. The board of directors in SOEs has established a relatively mature system of worker directors, allowing it to review internal compensation plans and prevent excessive executive pay, promoting fair and reasonable distribution within the enterprises. Thirdly, the equity incentive for executives should better align with the nature of SOEs. The misuse of equity incentives has been a primary factor driving the surge in executive compensation in countries like the USA, seriously hindering the long-term development and innovation of enterprises. The SOEs in China are owned by the whole nation. The equity incentive plan for executives can adopt a shareholding committee structure possessing a certain degree of collective ownership. Executives are entitled to dividends and share appreciation;

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however, their shares should be strictly regulated regarding circulation time, recipients, and methods. This approach can effectively limit the negative impact of equity incentives while ensuring public ownership attributes without conflicting with the socialist nature of SOEs.

#### 4.4

The issue of executive compensation in SOEs possesses social nature, and the interplay between executive compensation in SOEs and social factors must be recognized. Executive compensation in SOEs is not merely an internal distribution matter within the enterprise but is also influenced by societal norms and social psychology. As Marx (2004) pointed out, “In contradistinction therefore to the case of other commodities, there enters into the determination of the value of labor-power a historical and moral element.” Piketty’s research also revealed that social norms in different countries significantly impact the executive compensation system. State-owned enterprises (SOEs) hold a unique position in China, and the SOE system before China’s reform and opening up differed significantly from its current situation. It was after years of reform and development that a relatively mature system of modern SOEs with Chinese characteristics took shape. Within a relatively short period, the reform of SOEs underwent several significant adjustments, leading to a disconnect and lag between the changes within the SOEs themselves and the evolving perceptions of the public toward them. This has resulted in contradictory views among the public regarding SOEs. On the one hand, there is a demand for SOEs to be independent market entities, participating equally in market competition, with resource prices aligning with market forces. On the other hand, it is argued that senior executives in SOEs are working for the country and, therefore, should receive lower compensation rather than market-based high pay. Consequently, the compensation of senior executives in SOEs often sparks social concern, largely due to the existence of this contradiction.

According to Marxist theory, the influence of social factors such as “history and ethics” on the SOE executive compensation and the long-term nature of these social factors’ changes must be acknowledged. Targeted measures should be formulated to promote the development of SOEs. Firstly, the current public awareness and expectations regarding the compensation of SOE executives should be respected. Although SOEs have a leading position in many countries in terms of scale, and their executives contribute more in terms of management labor in quality and quantity, SOE executive compensation should not become a representation of the highest salaries in the industry. Otherwise, it may trigger strong public skepticism. Secondly, SOEs and relevant competent departments should proactively guide social opinion, influence public awareness and adequately publicize the achievements of SOEs’ development and their market-oriented operational mechanisms, promoting the social recognition of SOE executives’ management capabilities and competence. This effort would raise the public psychological threshold for accepting the remuneration levels of state-owned enterprise executives, thereby providing sufficient room for compensation adjustments to effectively incentivize the SOE executives and attract outstanding managers for the healthy development of SOEs.

To this, the author has endeavored to establish a theoretical framework for understanding executive compensation in SOEs through the lens of Marxist economics, which upholds the fundamental principles of Marxist political economics and incorporates findings from other existing theories. Based on this theory, the author posits that the continuous upward trend of executive compensation in SOEs, is consistent with the trend of SOEs’ ongoing expansion, which reflects a continuous improvement of SOE executives’ management labor in both quality and quantity. Regarding the quantitative disparities in executive compensation among SOEs at different levels, the author argues that the higher executive compensation at central enterprises than at local SOEs can be attributed to the varying management labor of executives commensurate with the diverse scale of enterprises in operations. However, the phenomenon that executive compensation in SOE subsidiaries is generally higher than those in central and local SOEs contradicts theoretical logic, which may be attributed to the direct application of SOE

regulatory policies, such as the “salary cap regulations”, on supervised enterprises without affecting their subsidiaries. Theoretically, this does not fully embody the principle of distribution according to work, with a lack of reasonable evaluation of the management labor contributed by SOE executives. This kind of pay inversion will severely impact the executives’ motivation and hinder the stability of the talent pool of SOEs. Therefore, the author proposes that policies such as the “salary cap regulations” should focus more on regulating unreasonable compensation structures and improving the executive compensation determination system rather than directly capping the total amount of compensation, taking into account the specific circumstances of different enterprises. In August 2014, the Political Bureau of the Central Committee of the Communist Party of China reviewed and approved the “Reform Plan about Salaries of Top Management at Central-owned Companies” and the “Opinions on Reasonably Determining and Strictly Regulating the Compensation and Business Expenses of Heads of Central Enterprises” at the meeting, where the guideline of “appropriate level, reasonable structure, standardized management, and effective supervision” was proposed, clarifying the basic direction for further advancing the executive compensation reform in SOEs. In conclusion, it is necessary to start with Marxist economic theory and scientifically study the issue of SOE executive compensation, adhere to the principle of distribution according to work in the context of a socialist market economy and implement the specific guideline of the Party Central Committee; only in this way can the long-term healthy development of SOEs be promoted continuously.

#### Note

1. All data have been adjusted for inflation. Source: Mishel and Wolfe (2019), *CEO compensation has grown 940% since 1978*, Economic Policy Institute, August.

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