

## On Perfection of Governance Structure of Rural Cooperative Economic Organizations in China

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### Abstract

The rural cooperative economic organizations have become an important factor for increasing the farmers' income, maintain social stability, promoting China's rural economy and increasing the national economic, but their own development process still have obvious deficiency which impedes the development of rural economy and even the entire national economy. This paper, mainly discusses the internal problems existing in the management structure of the rural economic cooperative organizations in China through studying their development present situation, and put forward the Suggestions.

**Key words:** Rural cooperative economic organizations; Internal governance structure

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### INTRODUCTION

Since ancient times, China is a big agricultural country, initially the construction and development of the national economy is based on agriculture. While the secondary and tertiary industries have become the pillar industry of the national economy, the agriculture which is the foundation of national economy is still an integral part, the majority of the internal population is still the rural population. So as an important component of China's economy the rural economy is very pivotal.

In order to let the rural economy develops better and faster, since the 80 Sin the last century, rural cooperative economic organizations have set up around the country in China, especially in the 90s, the new organizations established and developed quickly in the developed regions, they become the important factor that increase farmers' incomes, stabilize society and promote the rural and the national economy rapidly growth.

Overall the rural cooperative economic organizations were built in the process of economic reform in order to meet the needs of rural economic development, showing great vitality. They play an important role in the implementation process of agricultural industrialization. At present there probably are 1.4 million in China, these cooperative economic organizations develop rapidly in Shandong, Henan, Zhejiang and other regions, and they promote. But generally speaking, the development of rural cooperative economic organizations is still at an early stage in China, in some areas, they still are immature and limited to protect the farmers' interests and promote rural economic growth. The problems of rural cooperative economic organizations in particular in governance structure have badly hampered the rural economy's development. Therefore, it has a vital significance to sort out these problems and contradictions, and find out way to solve them, in order to make these cooperative economic organizations and the rural areas sustained, rapid and healthy.

### 1. DEFINITION OF GOVERNANCE STRUCTURE OF RURAL COOPERATIVE ECONOMIC ORGANIZATION

#### 1.1 Overviews of Rural Cooperative Economic Organization

##### 1.1.1 Cooperative Economy

Cooperative economy is an economic form that is formed by workers combining his or others' labor, capital and

technology, and the cooperative is an economic form under the conditions of market economy. In real life, as the workers faced with the ever-changing market and fierce competition, their ultimate goal is being able to better withstand the labour risks, and enhance market competitiveness. In order to protect their mutual joint, cooperative economy was born. Essentially it seems that this economic pattern and other domestic economic forms such as State-owned, collective, private and individual sectors, foreign economic are at the same level on the concept.

Formed under the conditions of market economy and formed by the voluntary association of workers of the cooperative economy, makes an individual's ownership interest in the economy have been fully recognized and respected.

### **1.1.2 Cooperative Economic Organization**

Cooperative economic organizations are established as economic organizations and social organizations on the principle of "voluntary, equality, democracy and mutual benefit", which is a specific market participant and a community of interests, its purpose is to provide the necessary services for all members, but not to maximize the profit. For the title, in international, most countries and regions have cooperative economic organization known as the "cooperative", in our country, also called research society or association.

Cooperative economic organization mainly divided into urban and rural and community three types according to the different geographical areas. In real life, rural cooperative economic organization is more common and also the most important, and its service object is mainly the farmers.

### **1.1.3 Rural Cooperative Economic Organization**

Since the founding of the People's Republic, and especially since the reform and opening up, the farmers has began to spontaneously organize the agricultural cooperatives and other United Nations Organization which are directly served for agriculture, becoming the beginning of the rural cooperative economic organization.

At present, the People's Republic of China Law on farmers' professional cooperative (hereinafter referred to as the law on farmers' professional cooperatives) made a specific definition of cooperatives: "the farmers' professional cooperative based on rural family-owned business is producers of similar agricultural products or other agricultural production and management of service providers or users, and a voluntary association and a democratic management of the cooperative economic organization." But the definition applies only to the rural cooperative economic organizations which are engaged in professional production and management and does not include the rural cooperative economic organizations which engaged in integration services (integrated) production and management, so we use inductive thinking, rural cooperative economic organizations can be defined as follows:

On the basis of rural family-owned business, agricultural workers lawfully and voluntarily establish and manage democratically the cooperative economic organization, in order to meet the needs of its production and operation, maintain and improve their own interests.

## **1.2 Overview of Governance Structure**

### **1.2.1 Governance Structure Definition**

Governance structure is a kind of institutional framework which connect and standardize the rights and obligations among owner (shareholder), operators and the supervisor of the operation and management activities, as well as the external selection, supervision and other associated issues. In short, it is how to organize internal division of powers. It is a reflection of the Organization's own governance mechanisms, the primary objective is to maximise value, good governance played a decisive role on strengthening the Organization's efficient functioning of competitive ability.

### **1.2.2 The Main Mode of Governance Structure**

Today's corporate governance structure commonly used mainly in the following three modes:

(1) The Anglo American model. Distribution of power within the company through the articles of association, restricting the rights of companies between the different agencies and regulates the relationship between them. The modern corporate governance structure in general accord with the framework of "separation of the three powers" which are national decision-making, execution and supervision, but there are differences in the specific settings and the right assignment.

(2) The German and Japanese model. German and Japanese governance mode is based on the bank as the dominant. Commercial bank is the major shareholder of the company structure system, the bank is in the core position in the corporate governance. Secondly, in accordance with the relevant provisions, if company owned by the corporation or body corporate cross holdings, diversified ownership structure, stock equity is not the focus of the individual, but to the entire enterprise. Finally, the company also have strict shareholder monitoring mechanism, which is a kind of "active" or "warm" mode, shareholders primarily through a trusted intermediary or other person or organization to exercise the shareholder's rights for the control and supervision of the company.

(3) The family model. This model is composed of a family to direct or indirect control of the enterprise, family master company decision-making, family to become an important force in corporate governance system. In this mode, family members control the ownership of the enterprises or equity and holds the main corporate governance rights; The company hire occupation managers who run the company under the control and supervision of the family; The company implements the incentive and constraints and manage employees

by family management; The external supervision of banks is relatively weak, there is a greater constraint of government on the development of enterprises.

### 1.2.3 Main Governance Model in China

At present, the corporate governance structure mainly used in China is the Anglo American model of “separation of the three powers”, namely the decision right, management right, right of supervision belong to the shareholders’ meeting, board of directors or executive directors, board of supervisors. Through the checks and balances of power, each of the three authorities are constrained to ensure normal operation of the company.

### 1.3 The Internal Governance Structure of the Rural Cooperative Economic Organization in China

The corporate governance structure of rural cooperative economic organization in China is also used the “separation of the three powers”. Because of rural cooperative economic organizations in China with its Socialist nature and the realization form of public ownership, the governance structure of the rural cooperative economic organization is different from the company’s, it can be seen as a cross between the enterprises and corporations, namely, “The capital combination” and “The people combination” co-existence. Its decision-making, administration and oversight rights still belong to the members (representatives of) the General Assembly, the Council and the Board of supervisors. Since the balance of powers, the three authorities can successfully carry out the work and the functions and restriction to ensure the smooth operation of cooperative economic organizations.

## 2. THE DEVELOPMENT STATUS AND INTERNAL GOVERNANCE STRUCTURE OF CHINA’S RURAL COOPERATIVE ECONOMIC ORGANIZATION

With the development of market economy, the domestic market development agriculture is facing great changes in the structure, due to the increasing contradiction between the supply and demand of agricultural products (excess supply), there is a continuing conflict between small farmers and large markets, and then farmers began to creep into the market to seek opportunity. Therefore, all kinds of rural cooperative economic organizations rapidly developed.

### 2.1 Status of Corporate Governance Structure of Rural Cooperative Economic Organization in China

As for the major cooperative economic organization of farmers is professional cooperatives, here we will take this cooperatives as an example to see the recent status of management structure of rural cooperative economic organizations in China.

Due to the Farmers’ Professional Cooperatives Law

was just clearly describe the independent legal status, but failed to uniform requirements type of cooperatives, as a result of that there were inconsistent practices across the country. In the North, for example, relevant departments of Hebei province is just direct the registration of farmers’ professional cooperatives as a corporate social groups, ignored that farmers’ specialized cooperatives will also carry out profit-making activities, which resulted in that registration of legal person property did not match actual production and business operation activities seriously. In the southern part of Zhejiang farmers’ professional cooperatives had been registered as the area’s industrial (cooperation) enterprise by commercial sectors, which distinguish them from other current companies on the market, but this is not entirely correct to cooperatives provided did not solve the problem fundamentally. Furthermore, in the municipality of Tianjin, the agricultural sector in the region straightly register it as the farmers’ professional cooperatives and regard it as a cooperative corporation, but the actual operation of farmers’ professional cooperatives was still being questioned by the market, and this is due to the license issued by agricultural management cooperatives has not been recognized by other market players, leading to problems in operation of the business of the cooperative.

### 2.2 The Institutional Arrangement of Rural Cooperative Economic Organization of Internal Governance Institutions

#### 2.2.1 Member (Representative) and Responsibilities of the General Assembly

Members are decision-making bodies of the General Assembly in rural cooperative economic organizations. Move from the third and the fourth chapter of farmers’ professional Cooperatives Act provisions we can see that the quota of farmers’ professional cooperatives total size should account for at least 80%, members of the General Assembly are members of the rights of farmers’ professional cooperative mechanism instead of exercising decision-making power. If farmers’ professional cooperatives has 150 members of Congress, it can establish Member, members of Congress general meeting according to the articles of association may exercise all or part of the terms of reference. Members of farmers’ professional cooperatives will hold a meet at least once a year (on behalf of) the General Assembly. Cooperatives for election or made resolution, is all cooperatives members’ right, only over total half of members agreed the resolution, which can be through; When modify cooperatives articles or made merged, and Division, and disbanded of resolution, there should be in over total two-thirds through of situation to make decided; farmers professional cooperatives members Assembly election and vote, implemented a people a votes business, members each enjoys a votes of basic voting.

### 2.2.2 Council and Its Functions

Council is the executive body of rural cooperative economic organizations. According to the third and the fourth chapter of farmers' professional Cooperatives Act regulations can be seen that members (representatives) elected by the General Assembly Council, exercises its powers in accordance with the relevant laws and regulations of the Board, Member (representative) General Assembly Council, supposes Director a person, Director of the Agency's legal representative. Chairman or member of the Council in accordance with (on behalf of) the General Assembly decides to appoint managers and accounting staff, the Director or directors may serve concurrently as Manager. Managers in accordance with the regulations or decisions of the Council, appoint other staff. Council is composed of three or more persons for odd number of directors, for three-year terms. Under section 25 of the model regulation on farmers' professional cooperatives, it provides that Council to implement fully the principle of consensus, the Council members each have one vote, formed by more than two-thirds Council members agreed to decide on important matters.

### 2.2.3 The Supervisory Board and Its Responsibilities

The Supervisory Board is the oversight body of the rural cooperative economic organizations, according to the third and the fourth chapter of farmers' professional Cooperatives Act regulations can be seen that the Member of the Supervisory Board by the Agency (on behalf of) the General Assembly in accordance with the Related laws

and regulations Elected on behalf of all the members and they will exercise power of the Supervisory Board and staff. Primarily to monitor the financial status of executing agencies and cooperatives, and prevent abuse of powers, and safeguard the interests of members. Director-General, Director, Manager and financial accounting personnel shall not serve concurrently as a supervisor. Supervisors should attend the Council meeting, supervisory board members each have one vote, the supervisors agreed to above two-thirds on important matters to take effect.

## 2.3 The Present Situation of Development of Rural Cooperative Economy Organization in China

Currently, the cooperative economic organizations in China have about 140 million, mainly has the following features:

### 2.3.1 Rapidly Develop with Regional Differences

Some developed region such as Shandong, Zhejiang, Henan, Sichuan and other places speed up the pace of development of rural cooperative economic organization, and its strength has gradually increased. The rural economy play a role clearly. As for some areas, they are still at an early stage of development of rural cooperative economic organizations and develop less maturity, and it is limited to protect the farmers' interests and promote rural economic development, such as Hainan, Jiangxi, Yunnan and other places, but overall development of rural cooperative economic organizations made a breakthrough. Development of rural cooperative economic organizations of Yunnan in recent years showing in the following table:

**Table 1**  
**Yunnan Rural Cooperative Organization**

Vintage	2005Year	2006Year	2007Year	2008Year	2009Year
Quantity (PCs)	2576	2858	3497	4040	5645

### 2.3.2 Areas of Cooperation Expanded, More In-depth, Diversity of Industrial Model, Stronger Relying

Development of rural economic cooperative organizations begins mainly from planting and breeding, covering industry, circulation. In the process of development, in addition to mainly adhere to the planting and breeding, they should shift to other areas, such as resource development, infrastructure development and application of advanced agricultural techniques, organization from scratch, from small to large, continuously enrich the connotation, expand areas of cooperation.

### 2.3.3 Main Part Lead, Break the Regional Qualifying and Boundaries

Rural cooperative economic organizations began working in different organizations, and cooperation between companies. Meanwhile, private cooperatives are increasing, more and more rural cooperative economic organizations are supported by a large company or large family of farmers.

### 2.3.4 Obvious Advantages and Increasing Function

In the view of property, rural cooperation economic organization reflect member interests, collective, fair

and efficiency of effective combines, members have the ownership of their own social shares, and organization property of cooperation accumulated property; according to distribution, it takes implemented-public of distribution based on work, it will benefit to deal with the conducive of right processing collective and members' interests relationship; in the view of decisions, "a people a votes" reflected equal and democratic principles, which can make collective internal power fully balance, and improve organization efficiency of governance structure.

## 3. THE DISADVANTAGE OF CHINA'S RURAL COOPERATIVE ECONOMIC ORGANIZATIONS IN THE EXISTING GOVERNANCE STRUCTURE

Although in China the rural cooperative economic organizations have played an important role in increasing farmers' incomes, maintaining social stability and promoting the rural and nationwide economic growth, there still is a lot of problems that have weakened the effect.



Overall, in fact the rural cooperative economic organizations are still in the early stages of development, because the shortage of the finance, talents, technology and information. Most of the rural cooperative economic organizations' scale are small and the service range are narrow, they are unable to form an industrial belt which is on a large scale, so result in the lack of the strong market competitiveness.

Secondly, most of the rural cooperative organizations in China are low organizational degree, and have no normative operation, some even have no business. The unprompted management and the insufficient talent lead to the internal management mechanism nonstandard and incomplete, they have no clear property rights, scientific mechanism and effective management system.

Also, because the systematization degree is not high, most of the rural cooperative economic organizations often have to rely on the governments' and other social forces' support and shelter. At the same time, some grassroots governments' awareness about cooperative economic organizations is not correct, they interpose the internal affairs continually, so the rural economic cooperative organizations gradually deviate its proper trajectory and nature.

After a study we found that one of the main factors led to these conditions is the lack of legal protection in the internal governance structure in China's rural cooperative economic organizations. In the field of company law, company or enterprise governance structure refers to the legal person governance structure. Through these discusses, we know the rural cooperation economic organizations have adopted the mode which is called "separation of powers". So the internal governance structure and the operating model will directly affect the organizations' behavior and the sense of responsibility. Hereon, we summed up these insufficient about governance structure of China's rural cooperative economic organizations.

### **3.1 It is not Perfect that Specification which Relate to Rural Economic Cooperative Organizations**

Currently, it is not perfect that provisions of relevant laws of rural cooperative economic organizations. Only the People's Republic of China Law on farmers' professional cooperatives, which issued in 2006 and began execute in 2007, is just one basic law of the current rural cooperative economic organizations.

Of course, the registrations of farmers' professional cooperatives regulation, model constitutions, accounting system and tax exemption policies, which is associated with the Act, has to vary extent, promoted the development of rural cooperative economic organizations in China. However, just we said before that the Act only refer to engage in rural cooperative economic organization of professional production and management, but not include the rural cooperative economic organizations of

integration services (comprehensiveness), such as shares in cooperatives and professional associations. Domestic legislations, obviously, does not fully address the application of law of all of rural cooperative economic organizations in China, and cannot representatives the whole law system of rural cooperative economic organizations.

### **3.2 Corporate Governance Structure is not Perfect**

Although the governance structure of the most of rural cooperative economic organizations is based on the governance model of "separation of powers", and then makes regulations accordingly, it is common phenomena that the system does not work. The phenomena of powers and responsibilities are not separate often appear in the daily operation of the rural cooperative economic organizations. In rural areas, some large farmers has become an important force of rural cooperative economic organizations, and has promoted its development, by their ownership of much money, a broad sales channels and strong management capabilities and a wide range of social relations and so on. Major shareholder or representatives usually be the operator, those who make management and decision-making to cooperatives, does not comply with the relevant provisions of the law on specialized farmer cooperatives, since managers cannot be effectively controlled by owner-operator. Although provided with a member (representative) General Assembly, Council and Board of supervisors, but the governance structure of "three power balance" is just a dead letter.

### **3.3 Inadequate Internal Control Systems**

It is learnt that quite a number of internal rules and regulations by rural cooperative economic organizations, did not effectively carried out, it is always chapters do not be followed and moments cannot be complied with in daily operations, and it just as the image works. What's make us worried is that the situation of regulation implementation, because the system regulations just only to cope with the relevant department's inspections and audits, not be truly permeated. Countryside cooperate economy organization's decision makers and implementers did not realize the necessity and importance of the system of internal control, so the making rules loses its supposed seriousness, and only is a mere formality.

### **3.4 Inadequate Financial Systems**

At present, a great number of rural cooperative economic organizations are in the inadequate financial systems and unreasonable interest distribution mechanism. The fifth chapter of "the law on farmers' professional cooperatives" expressly stipulate the financial system, however, due to the internal governance structure of the rural cooperative economic organizations is defective, some organizations did not achieve a fair distribution of profits. Benefits and risks cannot be achieved synchronously increase the operating costs and business risk of the cooperative economic organizations.

### 3.5 Lack a Strong Oversight

A strong internal oversight will ensure that the internal management implement with the regulations, and obtain good performance to adapt to the new situation anytime. At present, in China, most of the rural cooperative economy organizations have established a Board of supervisors, but they seldom perform their duties responsibly.

## 4. PROPOSALS FOR IMPROVING THE STRUCTURE OF RURAL COOPERATIVE ECONOMIC ORGANIZATION

Due to the current legal system of rural cooperative economic organizations in China is still not perfect, to a large extent, obstacle to the function of a new type of rural cooperative economic organizations, therefore, seek to solve the problem of internal governance strategies is essential.

### 4.1 Improving the Legal System

To sum up domestic and international development of rural cooperative economic organizations, there is a basic experience, through the “rule of law” as a way to promote the development of rural cooperative economic organizations. In recent years, although China enacted “the law on farmers’ professional cooperatives” and its matching policies, but it has many limitations and shortcomings. Rural cooperative economic organizations in China have a variety of categories, but the law only engaged in the professional production and management of rural cooperative economic organization and does not include integration services production and management of rural cooperative economic organizations, such as Stock cooperatives and professional associations, there was still no legal basis. Therefore, we should proceed from China’s national conditions, and to improve rural cooperative economic organizations in the legislative system as the goal, regulate market access, complete set of laws and regulations. By the law means of rural cooperative economic organizations, promoting health and safeguard farmers’ legitimate rights and interests and guarding the healthy and sustainable development of rural economy.

### 4.2 Strengthen Management Consciousness, Strengthening of Internal Controls Within the Organization and External Oversight

Strengthening the internal control of management, so that owners and operators realize that strengthening the construction of internal control system, is not only conducive to the interests of the organization to obtain, can make the organization better and more stable development. In improving the internal and external oversight system, rural cooperative economic organizations should first pay attention to the supervision and inspection of internal control, establishing and perfecting the internal auditing and oversight system, equipped with a high-quality audit and related business-savvy professionals. Secondly, the

Government should take the lead in urging the authorities to establish rural cooperative economic organizations credit record system, to monitor the credit behavior of the cooperative economic organization, monitor their credit, credit for development of the rural economy to create a good environment.

### 4.3 Improving Financial and Accounting Systems

Cooperation economic organization’s financial mess, it provides convenience for the operator, leading to emergence of any disposition of the property. So it should be comprehensive and reasonable at the national level to serve the rural cooperative economic organization of accounting, financial management system consisting mainly of financial systems and improve the information disclosure system. Rural banks, credit cooperatives and other rural financial institutions as important to rural cooperative economic organizations to provide financial support for institutions, promote the healthy and orderly development of rural cooperative economic organizations. Currently China only commercial banks method and village Bank provisional provides involves rural financial institutions, and both in actual operation in the are exists with not reasonable of place, as village Bank provisional provides on rural Bank of established of conditions too demanding, elevation rural financial institutions of market access threshold, became rural economic organization of support measures of implementation obstacles. Therefore, only amend and improve existing laws and regulations to address the institutional arrangements of unjustified obstacles to the development of rural cooperative economic organizations, ensuring the steady and rapid development of cooperative economic organizations.

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