1. Introduction

China’s economic reforms commenced in December 1978 when the Third Plenum of the Eleventh Central Committee issued a communiqué calling for a reduction in the degree of centralization of economic management and reform of the commune structure. The initial reforms focused on agriculture, but in the 1980s spread to the state-owned enterprise (SOE) sector. In the first period of SOE reform, lasting from 1984 to 1993, SOEs were made responsible for profits and losses in the market and contract arrangements were introduced that rewarded managers for meeting specified performance targets. These reforms had some success in reducing government intervention in the management of SOEs, but the rights and responsibilities of SOE managers remained ill-defined. The second period of SOE reform, which commenced in 1993, and is on-going, has focused on establishing a modern corporate governance structure in China’s large and medium-sized SOEs and enterprise groups.

After a decade of havoc wreaked by the Cultural Revolution (1966-1976), when the Third Plenum of the Eleventh Central Committee met in 1978 China was on its knees. In the period since, China’s economic landscape has undergone substantial changes. The reforms initiated by Deng Xiaoping have generated a massive improvement in the living standards of the Chinese people. Estimates by the consulting group, Consensus Economics, published in 2005, suggest that by 2015 China will overtake the United States as the world’s largest economy (Eslake, 2006). This is just the beginning. An article in the New York Times predicted that the 21st century would be China’s century...
given its potential to evolve into a major economic superpower (Fishman, 2004). However, in spite of what the reforms have thus far achieved, and promise for the future, China’s SOE reforms are at a critical stage as the central government embarks on restructuring its large and medium-sized SOEs and privatizing its smaller SOEs.

The purpose of this chapter is to examine the outcomes of the latest stage of China’s attempts to corporatize its SOE sector and consider some of the major challenges that exist for further economic restructuring of China’s large SOEs three decades on from the Third Plenum of the Eleventh Central Committee. To realize our objective, we draw on a case study of Fushun Petrochemical Company (FPC) which is a large state-owned enterprise in Liaoning province under the control of China National Petroleum Corporation (CNPC). Drawing on interviews with managers and local government officials, we use the economic restructuring of FPC that commenced in 1999 to illustrate how the reforms have been implemented on the ground and some of the major difficulties that further economic restructuring poses. We also examine how Li Ruoping, who is the current General Manager of FPC and an example of a successful manager in a large SOE, has used an emerging environmental awareness in China in the lead-up to the Beijing Olympics, to promote a positive image of FPC.

2. Major Issues in Reforming China’s State-owned Sector Since the 1990s

2.1. Enterprise and Industrial Restructuring

Following the Fourteenth Communist Party Congress in 1993, the Chinese government commenced transforming large and medium-sized SOEs into joint stock companies (gufen youxian gongsi) and limited liability companies (youxian zeren gongsi) on a trial basis. The Chinese government also started divesting small SOEs on an experimental basis in pilot areas. These ownership reforms gathered momentum at the Fifteenth Communist Party Congress in 1997 where the Chinese government endorsed the slogan zhuada fangxiao (‘grasp the big and let go of the small’). The result was the establishment of several large enterprises and business groups (qiye jituan), formed through mergers and acquisitions. Senior government officials sometimes spoke in terms of ‘grasping’ 500 or 1000 large enterprises, but in the end settled for 520 ‘key-point’ enterprises (Yusuf et al., 2006). Many of these ‘key-point’ enterprises were members of 57 business groups promoted by the central government (Nolan, 2001). The structure of these business groups varies, but tend to fall somewhere between a highly integrated conglomerate and a more loosely connected series of firms similar to the Japanese keiretsu (Nolan, 2001; Yusuf et al., 2006).

Foreign investors have participated in the mergers and acquisition process (Norton & Chao, 2001), although at the end of 2006 the chair of the State Assets Supervision and Administration Commission of the State Council (SASAC), Li Rongrong, identified seven industries of strategic importance where the central government would maintain sole ownership or an absolute controlling stake. These seven industries - defence, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation and shipping – contain many of the largest and most profitable SOEs and state-controlled business groups. In these industries, foreign investors and the private sector will be restricted to either participating in developing downstream products, such as petrochemicals, or value-added services, such as telecom products (Mattlin, 2007). Outside of the 520 key-point enterprises, an estimated 8700 large and
medium-sized enterprises have had to fend for themselves or seek assistance from provincial level governments. Several provincial level governments have promoted smaller enterprise groups at the sub-national level. Meanwhile, small SOEs were closed, sold outright, leased or converted into shareholding cooperatives. In the decade following the Fifteenth Communist Congress an estimated 120,000 small SOEs were privatized, closed or otherwise divested (Yusuf & Nabeshima, 2006).

Running parallel with the creation of large business groups, in the late 1990s, several large state-owned conglomerates in strategic sectors were reorganized. For example, in aircraft manufacturing, Aviation Industries of China (AVIC) was split into two fully-integrated conglomerates: AVIC I and AVIC II (Goldstein, 2006). Other restructuring occurred along geographical lines. In the steel sector, the central government orchestrated a number of takeovers with the aim of having Baosteel, Angang, Wugang and Pangang as the four ‘national champions’ in East China, Northeast China, Central China and Southwest China (Sun, 2007). In the oil and petrochemical sector, prior to restructuring SINOPEC was mainly engaged in oil processing while CNPC was mainly engaged in oil production. Following restructuring, both state-owned business groups integrated development, drilling and refinement of petroleum with production of petrochemical products. CNPC has a number of oil and petrochemical subsidiaries in the north and west of China, while SINOPEC overseas the oil and petrochemical sector in the south and east (Smyth & Zhai, 2001). In the shipping industry, China State Shipbuilding Corporation (CSSC) was restructured into two large state-owned groups – CSSC and China Shipbuilding Industry Corporation (CSIC) – with CSIC controlling the shipyards in the north and CSSC controlling the shipyards in the south of China (Smyth et al., 2004).

The reorganization of strategic sectors, paved the way for separation of production and service companies and equity-for debt swaps (EDS). This also commenced in the late 1990s, in preparation for listing large SOEs on the stock market. The separation of production and service companies in core enterprises or subsidiaries within business groups such as CNPC and CSIC was a means to divest the core enterprise of non-core businesses together with large swathes of surplus labour. The non-core businesses and surplus labour were hived off to service companies. There were two main categories of service companies; namely, companies with independent accounting arrangements that were to be responsible for their own profits and losses and companies with internal accounting arrangements that were not capable of surviving in the market on their own. The production company was typically given the enterprise’s best assets following the separation to make it attractive to potential investors with the objective of listing the production company on the stock market.

The EDS reforms were allied with the separation of production and service companies and were designed to prepare the production companies for listing. The EDS was announced in 1999 and the first swap occurred in 2001. Under this scheme, the long-term debt of selected SOEs owed to the state-owned banks was swapped for equity controlled by four asset management companies (AMCs) affiliated with each of the banks. Ostensibly the EDS had two objectives. One objective was to improve the debt asset ratio of participating SOEs and reduce the bad debts of the state-owned banks. The second aim was to improve the decision-making structures within the SOEs. The first objective was realized, at least initially. In the first EDS 601 selected enterprises swapped RMB400-500 billion, which was equivalent to about 50 per cent of the
outstanding loans of the banking sector at the end of 1997 (Huang, 2001), although bad debts have since started to again accumulate. The available evidence from case studies conducted in the period 2000 to 2003 is that the second objective was not being realized, with the AMCs reluctant to interfere with the management of the firm even where they have the controlling shares (Smyth et al., 2004a; Steinfeld, 2001).

2.2. Reduction in Surplus Labour

In 1997, the State Commission for Economic Restructuring estimated that the number of surplus workers in SOEs was 54 million, close to half the total workforce (South China Morning Post, May 7, 1997; cited in Morris et al., 2001, p.69). Fieldwork conducted between 1995 and 1997 suggested that firms intended to reduce their core workforce between 15 and 50 per cent over the course of the Ninth Five Year Plan (1996-2000) (Hassard et al., 2006). However, the reduction in surplus labour has been far less than these forecasts. Case studies of large SOEs in the South-West and North-East of China in the late 1990s and early 2000s suggested surplus labour was still between 20 per cent and 60 per cent of total employees (Morris et al., 2001; Smyth & Zhai, 2003; Smyth et al. 2004). The government and trade unions have been reluctant to let SOEs cut ties with their surplus workers because of the potential for demonstrations and social unrest, the lack of alternative employment opportunities, particularly in smaller cities, and the embryonic nature of the social security system.

Instead SOEs have taken measures to disguise the true reduction in surplus labour. One common approach has been to give surplus workers the administrative label xiagang, meaning they are ‘on leave’ from the enterprise. These xiagang workers retain their ties to the SOE and the SOE is obliged to pay them a subsistence allowance. Sometimes, alternative labels to xiagang, such as changxiu (“long-term rest”) or li gang (“left their posts”) are used. At the municipal and district levels these terms are often used interchangeably to mean the same thing. In Fushun where our case study below is located, the municipal labour bureau uses the term xiagang, while the district level bureaus use myriad of categories including changxiu and li gang to mean the same thing. According to official figures, 26 million employees were given these labels over the period between 1998 and 2002 (Armitage, 2003).

Another, approach to reducing the workforce is to ask workers to take semi-retirement (neitui) (Morris et al., 2001). The arrangement for semi-retirement varies across industries and locales. However, in one large shipbuilding SOE in the North-East males aged 55 and females aged 50 can apply for semi-retirement. In this SOE, workers who are semi-retired receive 50-70 per cent of their position wage, but no bonuses (Smyth et al., 2004). Following separation of production and service companies, a third approach to reducing surplus labour was to shift employees off the books of the production company into one of the service companies. Some large SOEs have gone further and created a diversified network of subsidiaries to employ redundant workers. For example, the Shougang Group, set up businesses in real estate and the services sectors in order to minimize lay-offs and repair eroding profit margins (Nolan & Yeung, 2001). Other leading Chinese companies such as Haier and Lenovo have followed a similar approach to stem falling profit margins (Yusuf & Nabeshima, 2006). Steinfeld (2004) criticises this tendency, arguing that by investing in commodified products where profit margins are already thin, these leading manufacturers are not building corporate strength. The alternative argument, though,
which has its origins in the late industrialization literature, is that the technological stage of China’s development forces firms to operate in markets for commodified products with narrow profit margins (Khanna & Palepu, 2007).

2.3 Managerial Reform

Studies of SOE management up to the mid-1990s suggested that political interference in managerial decisions was a persistent phenomenon (Child, 1994; Chen, 1995). More recent studies have reported that managers in SOEs continue to complain about political interference in forcing unwanted mergers with loss-making firms and putting caps on forced redundancies (Hassard et al., 2006). However, there is evidence that the level of political interference in senior and middle-level management has fallen over time. Our previous research, based on case studies of large SOEs in Liaoning, suggest that increasingly it is the General Manager who is responsible for the success or failure of the enterprise rather than party committees (Smyth & Zhai, 2003). The proportion of managers with tertiary qualifications in SOEs has increased over time and the criteria for promotion has become more performance based (Smyth et al., 2004). The bonus system, which had been abolished in the Cultural Revolution, has had a positive effect on managerial performance. Several econometric studies using data since the 1980s suggest that bonuses for managers are positively associated with productivity (Groves et al., 1994, 1995; Li, 1997; Li & Wu, 2002; Yusuf et al., 2006).

With a few exceptions, such as Shougang, in the early to mid-1990s demoting managers for poor performance was rare. However, by 2000 demoting managers for poor performance was common in large SOEs in Liaoning (Smyth & Zhai, 2003; Smyth et al., 2004). In one large SOE, the annual turnover of management in 2002 and 2003 was about 30 per cent with 10 to 15 per cent of turnover due to poor performance. This high proportion, however, was linked to more general restructuring of the firm at that time associated with the separation of production and service companies, an EDS and the introduction of semi-retirement arrangements for managers (Smyth et al., 2004). In other SOEs turnover has been much lower. In some SOEs managers are employed on three year contracts. The contracts of these managers can be terminated if the managers do not meet specified performance criteria. Hassard et al. (2006) point out, though, although managers can have their contracts terminated at the end of the three year period, this does not mean that they will. Their research suggested in one SOE every effort was made to reduce the number of surplus managers by 25 per cent. As part of this process generous incentives were offered to take semi-retirement, move into self-employment or take up a comparable position with one of the enterprise’s service companies, but in the end, the SOE only managed to reduce its surplus managers by 10 per cent.

3. Case Study of Fushun Petroleum Company

3.1 Background and Methodology

In this section we explore the above issues through a case study of FPC, which is located in Fushun, a city of approximately 2.3 million people, situated about 45 kilometres north-east of Shenyang in Liaoning. Fushun was traditionally a coal city and is badly polluted. It also has a state-owned heavy industrial base. In the late 1990s in Fushun the state-owned sector contained 90 per cent of enterprises in the city and employed in excess of 85 per cent of the city’s workforce. FPC was founded in 1982
and became a subsidiary of CNPC in 1998 following the restructuring of CNPC and SINPEC. On the eve of restructuring, in 1996, FPC ranked 25th among the 500 largest industrial enterprises in China on the basis of pre-tax profits and 60th on the basis of net assets (ZGSYHGZGSNJ, 1997, pp. 601-602). FPC consists of eight subsidiaries: Fushun No. 1, 2 & 3 Oil Refineries, Fushun Detergent Company (FDC), Fushun Ethylene Company (FEC), Fushun Acrylic Fibres Company, Fushun Plastics Company and Fushun Oil Storage and Transportation Company.

The information in this section is based on interviews conducted between June and August 2000 and in November 2007, supplemented with primary and secondary materials on FPC. Between June and August 2000, at the height of the restructuring, we interviewed senior managers in three subsidiaries of FPC, which were FDC, FEC and Fushun No. 2 Oil Refinery (FOR) as well as local government officials. FDC, FEC and FOR are representative of FPC’s subsidiaries. FOR is a typical Chinese state-owned refinery that was built in the 1930s. It processes Daqing crude oil and produces a range of fuels and petrochemicals. FDC and FEC were built in the seventh five year plan (1986-1990) and have relatively modern plants. In November 2007 we interviewed Li Ruoping, the present General Manager of FPC, to update our information on the restructuring and discuss his management philosophies.

3.2 Enterprise Restructuring in FPC

Prior to restructuring FPC faced many of the same problems as other large SOEs. The debt-asset ratio in FPC as a whole was 78 per cent, while the debt-asset ratio in the newly-established subsidiaries of FDC and FEC were in excess of 90 per cent. This was much higher than the international oil majors such as EXXON and Shell, in which the debt-asset ratio is about 50 per cent. FPC had a large number of surplus workers. The proportion of surplus workers in Fushun in the late 1990s was higher than in most other parts of China, reflecting the importance of the state sector in the local economy. In the interviews conducted in 2000, one senior local government official told us that, in his view, the surplus labour force in the state sector in Fushun was as high as 70 per cent. Prior to restructuring, FPC was also saddled with a range of ‘non-productive’ social welfare functions such as hospitals, schools, cafeterias and restaurants. In addition, FDC and FEC both had their own hotel, which did not charge a room rate, but instead were used to house visiting foreign experts.

Between June and October 1999 each of the subsidiaries of FPC were separated into production and service companies. When the restructuring process was completed at the end of 1999, the production company of FPC issued H-shares in Hong Kong and N-shares in New York as part of the listing of CNPC. To address the issue of the high debt-asset ratio several avenues were pursued. First, most of FPC’s debt was left with the FPC production company and CNPC used some of the equity raised through the stock market listing to reduce the debt level. Second, the central government waived some of the interest owing on the loans by FDC and FEC and converted some of the FDC and FEC debt into equity under an EDS. Third, the FDC and FEC service companies received tax relief following separation from the production companies.

Prior to restructuring FPC had about 38,000 employees. Following restructuring, FPC had 36,000 workers; of which just 13,000 were employed in the production company, while 23,000 were employed in the service company. Thus, as a result of restructuring the overall workforce was reduced by just 2000. This figure, though, only represents
those workers who cut their ties with the enterprise. It does not include workers who no longer worked at FPC, but still retained links to the enterprise such as workers classified as *li gang* or *xiagang*. The three subsidiaries of FPC that we visited in 2000 had few workers labelled *xiagang*. FDC claimed to have none, in FEC 3 per cent of its workforce were *xiagang* and FOR had about 300 *xiagang* workers. In FDC the label *xiagang* is given to a specific group of workers: ‘the poorest performing workers who are sent for retraining’. The term *li gang* is more commonly employed in FPC. Following the restructuring, FPC had 7500 workers who were classified as *li gang*. These workers receive 80 per cent of their position wage until they reach the retirement age. Because these workers were still officially employed by FPC, they were listed among the 23,000 employees of the service company. Thus, following restructuring, the service company actually had fewer employees than on paper.

As part of the separation of production and service companies, the local government assumed responsibility for a range of social welfare functions, such as funding for an elementary school, middle school and hospital. The cafeterias, restaurants and hotels were divested to the service companies. The objective was to make the service companies as self-sufficient as possible. This objective entailed marketing services to the public wherever possible. An example is the FDC service company, which was given the hotel, previously employed exclusively for visiting foreign experts. The FDC service company commenced charging a room rate and made the hotel available to foreign tourists. However, in the period since the restructuring most of the service companies struggled to survive. This reflects the fact that the best assets were left at the production company. Take the FDC hotel for instance. While it started accepting foreign tourists, it was always going to be difficult for a hotel in Fushun, which is not a place frequented by many (or hardly any) tourists, to break even.

By 2006-2007 the production company was profitable. It had raised large sums of money on the stock market and was benefiting from booming oil prices (China Petroleum Newspaper, 2007). On the other hand, the service company was making losses. In June 2007, the FPC production and service companies were again merged. The merger between the production and service companies of FPC was replicated in other CNPC subsidiaries in Daqin, Dalian, Jilin, Lanzhou and Liaoyang in 2007. In mid-2007 the merger of the listed and unlisted parts of the Daqin oilfields was also under consideration. These mergers have been largely met with indifference by the employees in the relevant CNPC subsidiaries. For example, one ordinary employee who had worked in the FPC production company told us the merger made no difference to him because his income and working conditions remained unchanged. Some middle level managers in Liaoyang Petrochemical Company expressed disquiet that following the merger there will be less opportunity for promotion because there will be fewer managerial positions (XinhuaNet, 2007). The objective of the mergers may be to streamline managerial positions, but as of the time of our interviews at FPC in November 2007, no plans for managerial restructuring had been announced.

The merger between the production and service companies of FPC was reported in the press as being for ‘the harmonious development of the company’ (Fushun News Network, 2007). This description can be interpreted as the profitable production company being harnessed to assist the loss-making service company. Mergers of profitable and loss-making enterprises in China over the last decade have been criticised by many observers. For example, Yusuf and Nabeshima (2006, p. 37) note
that such mergers “can burden successful firms with unwanted baggage rather than creating larger and more dynamic entities. It is much better to let market forces do their job, and manage development with the help of a sound competition policy”. The merger is a concession that the experiment to separate the production and service companies did not work. However, merging the production and service companies of FPC cannot be viewed as the same as merging profit-making and loss-making companies that have no shared history. The financial position of the service company at the time of the merger in 2007 was path dependent in the sense that it reflected the fact it had subsumed all of FPC’s non-core activities that made the listing, and ultimately the financial success, of the production company possible. Indeed, while FPC was separated into production and service companies, FPC never stopped being one company in the eyes of CNPC senior management.

While the service company did not become self-sufficient, viewing the experiment as a failure is misleading. The merged FPC of 2007 is a different entity to the company that existed prior to the separation of the company in the late 1990s. In 2006, prior to the merger, the service company had about 18,000 workers and the production company had about 10,000 workers. The workers that li gang (left their post) in the late 1990s have since reached the official retirement age and have largely not been replaced, so the merged firm has approximately 10,000 less workers than it had prior to the separation. The debt-asset ratio has been substantially lowered using funds from the stock market listing and the enterprise is no longer responsible for a whole raft of social welfare responsibilities that have been transferred to the local government.

While CNPC is listed on the stock market, the Board of Directors and shareholders have little, or no, role in the managerial appointment process at FPC. The General Manager of Beijing CNPC appoints the senior management of FPC. The General Manager of FPC appoints the senior management in each of its subsidiaries, with some input from the Party Secretary of FPC. Most candidates are from inside FPC with few outside candidates given consideration. Managers that we interviewed at FPC were adamant that selection was based primarily on performance and that there was no political interference in the selection of managers. Promotion is tied to performance and non-performing managers can be demoted. Demotion is based on performance in an annual written exam. At FPC each middle-level manager contributes five questions to a database. An annual written exam is administered to middle-level managers based on questions randomly drawn from the database. Managers who score the lowest on the test are pinpointed as candidates for demotion the following year. If these managers do not improve their performance in the written exam the following year they will be demoted. However, while it is possible to be demoted for poor performance on the exam, few managers are in fact demoted.

3.3 Role of Li Ruoping

Li Ruoping is an example of one of the emerging, relatively young, dynamic leaders of large SOEs in China. Li was born in 1963 and graduated from the Fushun Petroleum Institute in 1985, majoring in engineering. He received an EMBA from Northeastern University in 2006 where he is currently studying for a Ph.D on a part-time basis. Li joined FEC as an engineer in 1987 and, after exhibiting exceptional performance, was invited to join the Communist Party in 1991 (CCP News, 2007). He later became a workshop head and department head in FEC before becoming General
Li Ruoping’s philosophy on social responsibility is that people with skills, but no sense of social responsibility are not talented, while companies that earn profits, but lack social responsibility, are not good companies. On the one hand a company is responsible for creating wealth, on the other it has to take responsibility for society as a whole. The ultimate objective of the company is to maximize the value of the whole society. Establishing an harmonious society is not only the task of the Chinese Community Party and government, but also a task for companies as well (People’s Daily, 2007).

The final sentence of this passage is important because it links Li’s conception of corporate social responsibility to the Hu-Wen concept of an harmonious society that stresses societal balance rather than economic growth per se. For Li, an important
component of corporate social responsibility is promoting the environmental friendliness of FPC products. The article in the *People’s Daily* proceeds to state:

Li Ruoping said energy conservation and pollution reduction is a strategic objective of the State. It is also an important part of the company’s social responsibility. The leadership and staff of FPC have stressed the importance of environmental protection. Li said the focus of FPC is on ensuring harmony between the economy, energy and the environment (*People’s Daily*, 2007).

In an interview in the lead-up to the Seventeenth Communist Party Congress, Li stated “economic growth on its own is not real growth; only green growth is real growth” (*China Petroleum Newspaper*, 2007b). Between 2002 and 2007 energy intensity in FPC decreased 8 per cent per annum and discharge of pollutants fell by 50 per cent (*China Petroleum Newspaper*, 2007b). Li’s emphasis on environmental protection taps into an emerging environmental awareness among China’s leadership. While much has been made of what *Economy* (2006, p. 171) describes as “the environmental dark side of China’s economic boom”, China is now rapidly, although still somewhat haphazardly, developing a system of environmental governance (Mol & Carter, 2006). China’s leadership is starting to promote concepts such as green gross domestic product and national environmental model cities (*Economy*, 2006). Li’s vision is not just for FPC, but for Fushun as a whole. Li wants to transform Fushun from a coal mining city and old industrial base to a modern petrochemical manufacturer that produces clean energy. FPC is negotiating with the Fushun municipal government to develop a ‘petrochemical development zone’ which will house 70 projects with total investment of 9.5 billion RMB (Li, 2005). The focus of FPC on being environmental friendly under Li’s leadership, particularly in an old coal city such as Fushun where pollution is extreme, has made FPC stand out from other large petrochemical firms. The prominence of FPC under Li in terms of building an ‘harmonious society’ is reflected in the fact that FPC has been certified as one of the hundred best environmental protection companies in China and has been endorsed as one of the main providers of clean energy for the 2008 Beijing Olympics.

4. Remaining Challenges Confronting China’s State-owned Sector

4.1. Developing World-Class Industrial Companies

While firms like FPC have developed internationally competitive products such as detergents and waxes, China lacks world-class industrial companies. Yusuf and Nabeshima (2006, p.35) suggest that with the exception of Haier and possibly Huawei and Lenovo, no Chinese industrial enterprise or enterprise group has the size, management skills and mix of capabilities to operate on a global scale. In the late 1990s, some, albeit heterodox, observers of China’s transformation pinned their hopes for China to build internationally competitive enterprises on the late industrialization paradigm (Lo, 1997; Nolan, 1996; Nolan and Wang, 1999; Smyth, 2000). These commentators pointed out that state sponsorship of big business groups has support from the experience of advanced capitalist economies in Europe and the United States in the eighteenth and nineteenth centuries and the successful late industrialization programs pursued by Japan and South Korea in the 1950s and 1960s.
China, however, is attempting to realize in a few decades, the managerial and organizational changes that occurred in the United States over the course of a century. China has been largely unable to replicate the success of industrial policies in post-World War II Japan and South Korea because the institutional framework of the Chinese state differs from its counterparts in Japan and South Korea. Sun (2007) presented a detailed study of industrial restructuring in the Chinese steel sector from the late 1980s to the early 2000s and found that the fragmented and uncoordinated Chinese bureaucracy substantially impaired the implementation of industrial policies. One of the most sobering evaluations of the achievements of China’s industrial policies on the eve of China’s accession to the World Trade Organization in 2001 was presented by Peter Nolan, a long time supporter of China’s approach and the relevance of the late industrialization paradigm to China’s transformation. Based on decades of case studies conducted under the auspices of the China Big Business Program at the Judge Institute of Management at the University of Cambridge, Nolan (2002, pp.130-131) concluded: “The micro-level evidence of case studies suggests that, in most key respects, China’s industrial policies of the 1980s and 1990s failed. … The blunt reality is that after two decades of reform, the competitive capability of Chinese firms is still extremely weak in relation to the global giants”.

4.2. Corporate Governance and Managerial Depth

There is much evidence that firm performance is affected by corporate governance. Internationally, the importance of corporate governance has been highlighted in the fall out from scandals such as Enron and HIH. The collapse of Enron suggests that meaningful corporate governance depends on the composition, chairmanship and independence of the board of directors so as to provide oversight on accounting practices, auditing standards and business strategies (Yusuf & Nabeshima, 2006; Gillan & Martin, 2007). Large and medium-sized SOEs in China, including those listed on the stock market, are subject to weak and idiosyncratic governance. Where the parent company is not listed, but the subsidiaries are, the corporate governance relationship is often muddied. Jian and Wang (2005) document that a group-controlled firm in China is more likely to use related transactions to manipulate earnings and tunnel firm value. Chen et al. (2006) find that various corporate governance shortcomings in China are associated with the incidence of fraud. Liu and Lu (2007) find evidence of tunnelling in State-control listed firms and conclude that agency conflicts between controlling shareholders and minority investors account for a significant proportion of earnings mismanagement in Chinese listed firms.

The relationship between production and service companies following separation is also muddied by poor corporate governance. As discussed earlier the evidence from case studies of EDS swaps in the early 2000s, suggested these were not effective in improving managerial accountability. However, by 2006 there were over 1200 SOEs listed on China’s two stock markets and the formation of limited liability companies and limited liability shareholding companies were starting to have an effect on managerial accountability with attempts to strengthen minority shareholder rights (Yusuf et al. 2006). This was starting to extend to the large SOEs in strategic sectors with subsidiaries of the 159 ‘central enterprises’ under the control of SASAC, constituting one-third of the value of China’s domestic stock markets (Mattlin, 2007).

Many large and medium-sized SOEs have dynamic leaders who are successful production managers who are achieving good results (Yusuf & Nabeshima, 2006). A
few of the large and outward-looking SOEs as well as those that have entered into joint ventures are setting the pace. Companies such as Haier, the Jialing Group, the Meidi Group and the Guomei Group have sought to introduce new management approaches including matrix management (Hu & Bao, 2003). The problem is at the middle management level where those with the professional expertise are lacking. The absence of managerial depth shows up in the structure of large and medium-sized SOEs. While the trend worldwide is towards flatter hierarchies, large firms with national or international operations must have the organizational resources and managerial hierarchies to deal with complex and widely ramified operations (Yusuf & Nabeshima, 2006). Lack of managerial depth is not specific to China. South Korea and other economies, higher up than China on the development ladder, have also struggled to find good professional managers (Yusuf & Nabeshima, 2006). Since 2005, one response to solve the dearth of good professional management in the state sector has been to hire foreign managers in large SOEs (Yusuf et al., 2006).

4.3 Labour Redundancies and Social Unrest

In 2005 SASAC estimated that there were approximately 1.6 million redundant workers to be disposed off in SASAC-supervised large SOEs (SASAC, 2005, p.69). Assuming, the average cost of a redundancy package is three to four times annual salary or in the range 60,000-80,000 RMB, Imai (2006) estimates that the cost of ongoing labour restructuring will amount to between 90 and 130 billion RMB, equivalent to 10 to 15 per cent of the annual expenditure of the central government. China has to go slow on redundancies because of the potential for social unrest and the embryonic nature of China’s social security system. Even in a city such as Shanghai which has resources at its disposal that are the envy of many other cities, studies suggest that 70 to 80 per cent of firms do not comply with minimum prescribed social insurance contributions (Nyland et al., 2006; Maitra et al. 2007).

Further undermining confidence in the embryonic social security system are scandals such as that which unfolded in Shanghai in the later half of 2006. Leading Party and state officials in Shanghai, including the Party Secretary Chen Liangyu and the Director of the Ministry of Labour and Social Security in Shanghai, Zhu Junyi, were sacked for allowing the misappropriation of some 10 billion RMB in total from Shanghai’s municipal pension and social security funds as capital investment in speculative real estate deals. It is likely that if there were large-scale redundancies in the state sector, the current state of the social security system is such that many workers would have neither unemployment insurance nor adequate pensions and many would lose housing, schooling and medical benefits (Yusuf et al. 2006).

Demonstrations by workers laid-off from the state sector are becoming increasingly commonplace in China, particularly in the iron rustbelt cities of Central and Northeast China. Aggrieved workers have become much more vocal in reminding the state of its socialist claim to legitimacy and of promises of egalitarianism made during the Maoist past. One famous example is the case of Wang Shanbao, a retrenched 55-year-old worker whose protest in 2001 took the form of drawing sketches of Chairman Mao on the pavement outside his factory, which drew daily crowds until the factory managers gave him back his job (Forney, 2003). Hassard et al. (2006) go as far as to suggest that the only thing averting a major crisis in urban China is that the unrest is still largely localized and sporadic in nature and that attempts to organise independent trade unions have only been successful for a short period and on a small scale.
5. Conclusion

The China of today would be virtually unrecognizable to the leaders who met at the Third Plenum of the Eleventh Central Committee in 1978. The market reforms have had a considerable effect for the better on the lives of millions of ordinary Chinese. Most of China’s high growth over the last three decades is attributable to the rapid expansion of the non-state sector. Observers such as Qian (2002) have noted that the state-owned sector is an area where the reforms have yielded relatively meagre returns. The outcomes of attempts to build large state-owned enterprises and enterprise groups that can compete in global markets have not been as successful as hoped would be the case. The process of gradually improving the accountability and efficiency of SOEs through corporate governance reform and streamlining worker numbers has been a slow one. Progress has been impeded by a lack of depth of managerial talent and the need to go slow on redundancies because of the underdeveloped nature of the social security system and fear of social unrest.

China is at a critical juncture in reforming its state owned sector. The importance of reforms to SOEs is crucial not only because of the traditional importance of the state sector in the former planned economy, but because of the intimate link between enterprise reform, financial reform and social security reform. Informed scholars of China’s domestic economic and political interface such as Fewsmith (2002) have speculated that if the Hu-Wen administration can make substantial progress on reforming SOEs, this will act as a catalyst for finalizing associated financial and social security reforms. Yusuf et al. (2006 p.5) echo these sentiments suggesting: “It would not be an exaggeration to say the future level of growth in China will depend on completing the prolonged transition of the enterprise sector from a planned system to a market-based economy”. China is starting to make progress in improving the standard of management in the state-sector. Recent attempts to improve minority shareholder rights in listed companies is starting to have an effect on improving managerial accountability and recent moves to bring in foreign professional managers will add to managerial depth. With the fourth generation of leaders now at the helm, and continuing commitment to SOE reform confirmed at the Seventeenth Communist Party Congress, it is important that the process that was kick-started by their forbearers at the Third Plenum of the Eleventh Central Committee be completed.
REFERENCES


