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STATE CORPORATE ENTERPRISES IN CHINA: LESSONS FROM MANAGEMENT AND COMPETITIVE ADVANTAGES

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Abstract: *Although the state ownership on enterprises is densely criticized by classical economists as inefficient, nevertheless state-owned enterprises (SOEs) particularly in developing countries contribute to the creation of GDP, trade and capital flows. The system of their corporate governance is built in a bit different way than in the private sector: not only in the sphere of administrative power delegation, but also regarding the status of legal person, the rights of investors, transferability of their shares, as well as providing of competitive advantages. Lessons learned from the advantages and disadvantages of state company management in China, where they are most common, are in the focus of this article.*

Keywords: *state-owned enterprises, SOEs corporatization, competitive advantages, China.*

INTRODUCTION

Despite the active processes of privatization, which dominated in the world during the late twentieth century, some of the assets in the economies of many countries are still in the possession or under the control of the state. Under the influence of macrocyclical fluctuations in the global economy, their volumes and role are changing not only in developing countries but also in developed countries, albeit at a slower pace.

That is why the theoretical thesis circulated in the days of the of the Washington consensus dominance about the need to reduce state ownership as low-productive and low-inefficient becomes insolvent. Although in the totality of public companies in different countries, the majority does not show good results, yet the noticeable part of them has transparent accounts, strict financial discipline and good corporate reputation, and some of them are in the list of the largest world companies.

These trends, coming into conflict with the dominant ideas, encourage the rethinking of the place and role of state ownership in the economy, strengthening the mechanisms of return from them, the principles of their management and control. Corporate governance practices accumulated in the private sector through the establishment of appropriate institutional environment can be successfully extended to the public sector, helping to overcome the major drawbacks associated with non-accountability, voluntarism and corruption.

LITERATURE REVIEW

In the scientific literature, it is assumed that the globalization of world markets for several decades stimulates the convergence of national corporate governance models and unification of corporate legislation of different countries [1]. Other researchers on the contrary speak about preserving national differences in the models of corporate governance and domination of few national models in world's scale: Anglo-Saxon, Continental and Islamic [2].

SETTING OBJECTIVES

Most studies relate to private companies, for state enterprises the mainstream offers univocal recipe - privatization [3]. However, there are examples of countries that ignore these perfunctory scientific conclusions and follow their own path successfully experimenting with hybrid forms of corporate governance. One of them is the Peoples Republic of China, where the companies, owned by the state, not only demonstrate high economic performance, but also make a significant contribution to rapid economic growth. This work is devoted to extracting of positive experience in corporate governance of public enterprises in China.

RESEARCH RESULTS

To assess the contribution of enterprises controlled by the State in the national and global economy reliably is rather problematic, since statistical records of their activity are complicated by incomplete database and differences in legislation between countries. In such circumstances, analysts are turning to indirect information sources.

Thus, Kowalski and other professionals OECD [4] used the method of sample analysis of the list of 2000 world largest companies, compiled by Forbes, to determine the structural features of the type of business ownership in economies around the world. Their approach, although has some flaws[1], yet allows to capture approximately the scale of state-owned enterprises in the global economy. In this way they identified 204 businesses that are directly controlled by government institutions in 37 countries, among which 70 were Chinese, 30 - Indian, 9 - Russian, other 9 were from the UAE, 8 from Malaysia, 7 from Brazil, while all from OECD countries, there were only 41 (6 from Switzerland and Poland, 5 in France, in

1 For example, their study does not take into account the contribution of medium-sized state-owned enterprises, the number and effectiveness of which in some countries can be significant. Also, the study omits those public companies whose shares are not traded on the stock markets.

other countries - from 4 to 0). Thus, most of the large state-owned enterprises (≈ 60%) are currently concentrated in developing countries, while in developed countries their role in the economy is not low.

The combined sales of these 204 public companies in 2011 reached 3.6 trillion US$. (About 10% of that of all companies from the Forbes list or 6% of global GDP) and the level of their total capitalization was approaching to 11% [4, p. 20] of all listed companies value. This indicates their slightly higher value compared with assets of private firms on the background of proportionally identical results.

Based on Kowalski investigation, one should note some important facts concerning the performance of public enterprises: first, the low level of profitability, which suggests that the latter is not their primary objective; second, the low participation in international trade, indicating that their focus on the domestic market; third, comparability with the scale of the volume of global investment flows, which allows some countries to use state-owned enterprises as an alternative for the attraction of foreign investment.

Hence the difference between the roles and tasks performed by state-owned enterprises in developed countries and developing countries. In first they are not visible, concentrating in areas where it is necessary to remove market inefficiencies arising from asymmetric information or significant negative externalities of economic, social or environmental origin. Therefore, a high degree of state presence prevails in such specific areas as gas and power generation, refining, manufacture of tobacco products, storage and telecommunication services.

Another situation occurs with state enterprises in developing countries, particularly in BRIIKS (table1). Profitability of these businesses in an average 6 times higher than in developed countries, contribution to a total product is 10 - 15%, and the value of assets controlled is close to 60% of GNI. These data suggests an important functional burden put on state-owned enterprises in developing countries: to support economic development, but not to ensure economic efficiency. Using them, the state can create growth poles in priority economic sectors or provide for the latest cheap raw materials. At the corporate level management decisions of SOEs can have long-term or strategic nature and do not aim at profit earning.

Table 1: Sales, profits, assets and market value of SOEs included in the Forbes list of 2000 largest companies, in percentage of the gross national income of the BRIIKS countries*

Country	Sales	Profit	Assets	Market value
Brazil	12 %	1,7 %	51 %	18 %
China	26 %	2,9 %	145 %	44 %
India	16 %	4,3 %	75 %	22 %
Indonesia	3 %	0,3 %	19 %	12 %
Russia	16 %	3,0 %	64 %	28 %
South Africa	2 %	1,7 %	3 %	1 %

* Source: [4, p. 21]

Thus, the activities of public companies are naturally integrated into the growth strategies of many developing countries. Lessons from state assets corporate management of most successful among them - of PRC SOEs - can contribute with useful knowledge in the path of state companies' reform at East European countries and in the development of business relationships with Chinese companies of this type.

The industrial complex of China (and many other countries) is very difficult to structure on public and private components by the type of property. More appropriate is to speak about 1) the pure state sector, represented by state-owned (100% of stake) and enterprises controlled by the state (controlling stock), the amount of which in 2012 was 1.93% of the total businesses entities, and 2) the non-state sector, which is represented, along with domestic private players, by foreign companies and companies with state participation (minority stake). To determine which of two sectors play a leading role in Chinese economy can also be rather arbitrary. OECD researchers rated the contribution of state enterprises in China's GDP to 29.7% in 2006. US-China experts supervisory commission of economy and security are talking about 40% of GDP in 2009 [5, p. 11]. If we take into account the derivative parameters like number of employees, investments in fixed assets and the value added in industry, in our opinion, the proportions between public and private production in the country are close to the ratio of 1: 2.

While analyzing the model of country's corporate governance scientists pay attention to such options as 1) the particular acquisition of legal entity status, which reflects contracts participation responsibilities and property ownership, authority delegation and the resolving of disputes in a court; 2) transferability of shares that allows one to go out from a company, to sell one's rights in it or to transmit them to others; 3) delegation of administrative functions, that clarify mechanisms of ownership and management separation; 4) the rights of investors for the company's revenue [1]. We apply these settings to study the characteristics of SOEs corporate governance in China, adding another component - 5) created competitive advantages of the corporate form of business organization.

1. ***The status of legal entity*** Chinese state enterprises receive by the Law on state-owned assets in companies according to which the owners of such assets are "all people." But de jure from the sake of people their management is carried out by specially created State-owned Assets Supervision and Administration Commission (SASAC) following its own circulars and rules. Among the Commission's power are the appointment and dismissal of the CEO and his deputy, the head of the financial department, the head and members of the supervisory board, the offering of candidates to the board of directors in those companies where the state is a minority owner and others.

For the selection of management personnel to state companies SASAC uses a special competitive algorithm. The hierarchy of management and administrative positions is divided into 10 steps. Besides those people who at some moment occupy one of them, in the annals of the Commission there is a significant number potential applicants dossiers ("people waiting on the wings"). The success of existing and potential candidates for intermediate and senior management positions is annually monitored by Commission and evaluated with marks "A", "B" or "C". They are assigned according to job reports drawn up by the managers and anonymous survey of their peers. Top executive of state enterprise, who has received three times the low mark, is removed from his position.

Besides personnel management SASAC regulates investment decisions of largest state companies. The right to determine the main activity of these companies also belongs to

Commission and if the direction of SOE's investment does not respond to its specialization it would require additional approval by the Commission. Its circular "On promotion of the state capital management and restructuring of state enterprises" distinguish a list of industries in the national economy where Chinese leaders regard the activities of state enterprises as a) strategic and b) pivotal for development.

By the decision of the Commission defense, power generation and distribution, oil and petrochemicals, telecommunications, coal, shipbuilding industry, and civil aviation are assigned to the strategic ones. The status of strategic industries means that the state aims to control at least 50% of the shares or assets of companies operating in it. Production of equipment, automobiles, information technologies, construction, ferrous and nonferrous metallurgy, chemical and geological exploration by the decision of the Commission are attributed to the pivotal sectors of the Chinese economy where the state requires its businesses to play a leading role.

The author's analysis of revenues, consolidated by state corporations in pivotal and strategic sectors of Chinese economy shows that about 70% of them fallen the spheres of mining, processing and intermediary goods while only 30% of the production fall on the consumption goods.

2. ***Shares transferability*** of Chinese state companies is limited by the practice of their splitting on the openly exchanged on stock markets and artificially held (by the state or its representative), which are not the subject for trade. Such stock, however, may be in use out of the market through schemes of agreed sale, indirect ownership, free or by a court decision transfer or trust ownership. For a long time, the proportion of such shares held apart from direct circulation reached 2/3, which greatly hampered the market valuation of state companies. In turn, the shares traded in the stock markets of PRC, were divided into different classes depending on their availability for foreign players: class "A" stock was traded in Yuan for national operators in Shanghai and Shenzhen, class "B" was offered for the foreign investors in foreign currencies at the same yards, class "H" had the turnover on the Hong Kong Stock exchange according to separate rules [6, p. 26].

The practice of splitting and classification of shares should be regarded as deliberate government policy aimed, firstly, at maintenance of control over state assets, and secondly, on limitation of private Chinese companies access to listing that allows state companies to obtain additional resources from financial markets for cheap[2]. To attract investors attention to SOEs securities Chinese regulators used a special method of their assets separation on the attractive with subsequent transfer to subsidiaries and toxic (often associated with social obligations), which remained in the possession of the parent organization. The shares issued by subsidiaries, which but kept the names of the parent companies, were traded on the stock markets. The use of such tactics among other allows Chinese officials to fend off Western criticism of excessive state control over their economies, substituting privatization of state assets by their corporatization or portfolio rationalization.

3. ***The delegation of administrative functions*** in Chinese state companies is characterized by the existence of two parallel structures that can influence on management. From

2 According to M. Mattlin, up to 80% of companies that are listed on the Shanghai and Shenzhen stock exchanges owned by the state [6, p. 26].

outside the corporate governance structure is based on a typical three-tier structure of the shareholders' meeting, board of directors, often supplemented by the supervisory board and executive managers. But de facto decisions taken by SOEs management are influenced by party organization of the Communist Party of China, represented mandatory at a company with the party group or committee. Before making important decisions the board of directors and top management must "consult and take into account the views of the party organization," and then to inform it on the results in a written form. These decisions, as researchers observations show, include enterprise development strategy, medium- and long-term plans, production and operating policies, annual financial budget, the restructuring of corporate accounts, preparation of internal rules and regulations and, of course, key appointments [7, p. 656].

The main goal of the party organizations is to uphold the "party line" in the company, that is for in addition to the usual party committees under their control are also trade unions, youth leagues and to some extent workforce meetings. Every party member should vote according to the party line and thus express its "collective will".

Approval of candidates for management positions in the top 50 state-owned companies[3] is in the competence of the Organization Department of the CPC Central Committee, which directly appoints people to the three main posts of party secretary, chairman and CEO. On the important positions remained - vice presidents, deputy secretaries and others - the candidates are approved by SASAC in agreement with the Organizing Department. In general, the State-owned Assets Supervision and Administration Commission determine the entire management staffs in 70 other important for the country companies and their subsidiaries. If a state company plays a significant role only at the provincial level, the election of its management staff is the responsibility of the local branch of commission.

The organizing committee of the party constantly moves the party nomenclature between the highest positions in ministries, state companies, provinces, universities and the Academy of Sciences, the number of which is approximately 5000 positions [5, p. 75]. Thus, the Communist Party of China via pyramidal management structure and constant management rotation effectively controls many giant state-owned enterprises and through them impacts significantly on the national economy[4].

4. ***The right of private investors*** to participate in the dividends of state companies is limited. By the mid-2000s in China it was generally common to reinvest earned profits fully into the production expansion. Although such way to use earnings often showed low efficiency, it allowed during a decade to increase significantly the industrial potential of the country. By some estimates, the profit savings in companies reached 75% of corporate investments and 20% of GDP [6, p. 35].

One should keep in mind that the bulk of state assets in the national economy is con-

3 Their heads are ranked equally with deputy ministers.

4 The experience of being on managerial positions in state companies is an important milestone in the successful career growth of Chinese public servants: it significantly increases the probability of election for higher regional administrative positions. In 2010 23 of the 31 Chinese provinces were headed by governors or their deputies with such state-enterprise past experience [7, p. 660]. In turn, rotation to the next step - a member of the Central Committee of the CCP - is not possible without experience in managerial positions in the regions. The practice of raising to the CPC Central Committee from ministerial posts is virtually absent!

centrated in basic industries that play intermediate economic and commercial role (electric power, metallurgy, fuel and energy complex, financial services). State enterprises, successfully operating there, based on their designated monopoly, economies of scale, entry barriers, artificially reduced prices for state loans and subsidies. Researchers found that from 2003 to 2011 public non-financial corporations showed an annual revenue growth on average by 17.6%, net profit - by 25.2% and taxes - by 19.4%, well above the rate of GDP growth in this period [7, p. 647]. The size of their profitability per employee, which is found in 2.58 times higher than private enterprises also evidences about high efficiency of SOEs activity indirectly. In fact, state enterprises, using their intersectoral economic position, collect monopoly rents from the private sector, which is engaged in manufacturing of final products.

Since the mid-2000s with the rise of state companies' corporatization the need to distribute their profits among non-state shareholders increased. Chinese Ministry of Finance also demonstrated interest in excess profits of SOEs, considering them as an excellent source of replenishment. As a result of difficult and protracted negotiations between SASAC, Ministry of Finance and heads of state enterprises (antagonists of such offers) compromise was reached that 20 percent of companies year profits would be directed to the payment of dividends.

The spread of modern corporate governance practices into Chinese state-owned companies should not be considered solely in the context of their search for additional funding sources. The involvement of private capital to their disposal was also based on the assumption of the best elements of the global principles and standards of management, protection of property, providing a wide range of competitive advantages, all of which contributed to a positive image of these structures and the state as a whole.

5. ***Among the competitive advantages*** of China's state-owned corporations one should highlight the financial and economic (virtually unlimited capital raising and its easy centralization and consolidation, economies of business scale, transactional savings associated with the possibility of cost savings when making multi-channel procedure of "horizontal" market relations - finding partners, negotiating, etc.), production and cooperative (advancement through technology leadership, given the high degree of uncertainty and risk, mutual development and innovation projects of SOEs and state research institutes that allow to reduce the costs of the innovation process, the possibility of buying foreign companies at low prices with their technologies; implementation of advanced management methods, etc.), legal (perpetuity existence, low dependence on changes in the membership), organization and management (aggressive implementation of new information and communication technologies as well as equipment for data recognition and automation; experience exchanges among state enterprises, joint into corporation, on a regular basis; easy solve of the handle ability problem by distribution of executive and supervisory and control functions; artificial creation of additional competitive advantages by means of monopolistic influence on the market, demand creating and protectionist instruments use to counter competitors, etc.).

The experience gained gradually by Chinese managers as a result corporatization became useful in adaptation to strongly uncommon conditions prevailing in foreign markets. Namely, to it's the active mastering Chinese state business is now moving.

CONCLUSIONS

The model of corporate governance, emerging at state enterprises in China, is significantly different from the samples that are common in the United States, Western Europe or Japan. If the core of American model is the shareholders interests, in European approach trade unions and institutions play an important role, the Japanese model large private banks dominate, for the Chinese design the interests of Communist Party are crucial. Corporatized state companies continue to perform its stated goal - maintaining stability and ensuring economic development. Although the model has few exclusive features, however it is actively replicated in other developing countries (Russia, Brazil, Vietnam, etc.).

Corporate control over Chinese state-owned enterprises is based on the adaptation of company law to political institutions, and not vice versa, as is customary in the West. It is also based on mixing of state property with private and foreign capital through the interpenetration and cross-shareholding, but under strict and unrelenting state supervision. Restriction of shareholders rights and private control over business strategy, delegation of management functions to the officials include high corruption risks and the background for the opportunistic staff behavior, but the integration of companies top-management into the hierarchical structure of the CPC allows to neutralize these negative effects. Moreover, their coordination with the state administrative institutions is simplified by the means of party channels, reducing transaction costs. State-owned enterprises play the role of HR forge for the upper strata of the party nomenclature, greatly enhancing the quality of country's general government.

Direct government participation in business, of course, creates a powerful crowding out effect of the private sector in PRC, which is the subject of constant criticism in Western economic literature. However, the rejection of the policy of total privatization and maintenance of high share of assets under the state's control and direction allow China not only to protect economic interests and national security, but also to implement wide scale infrastructure projects, industrial restructuring and expansive foreign trade and foreign policy.

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