THE NATURE AND FUNCTIONING OF CHINA'S STATE ENTERPRISES

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THESIS SUBMITTED IN FULFILMENT OF THE REQUIREMENT FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

FACULTY OF ECONOMICS AND ADMINISTRATION

UNIVERSITY OF MALAYA

KUALA LUMPUR

2014

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ABSTRAK

China telah muncul semula dalam peringkat antarabangsa. Ia telah mencapai pertumbuhan ekonomi yang mengagumkan di bawah sistem politik dan menggunakan strategi yang agak berbeza daripada negara-negara lain. Tidak mengiktiraf sifat tersendiri dan menganggap bahawa sistem yang lazim "demokrasi" kerajaan memperkenalkan pelbagai samaran yang menjadi norma sejagat, ramai pengulas berfikir bahawa sistem politik China akan runtuh dan juga reformasi pasaran di bawah sistem ini tidak akan berjaya. Tetapi setakat ini, model China bukan sahaja menentang ramalan ini tetapi telah dijalankan dengan baik.

Oleh kerana China mengikuti pertumbuhan ekonomi yang diketuai oleh kerajaan, perusahaan milik negara adalah instrumen utama dalam strategi ini. Para pengulas sama yang disebut sebelum ini juga menuduh kerajaan China menunda ekonomi.The realitinya adalah sejak penubuhan Republik Rakyat pada tahun 1949, perusahaan milik negara ini telah telah melalui banyak perubahan. Sesetengah fungsi dimansuhkan dan yang lain dipelihara. Akan tetapi perusahaan hari ini di China sangat berbeza daripada perusahaan China semasa peralihan pada tahun 1978.

Persoalan utama kajian ini adalah sama ada model pembangunan China ini boleh dikekalkan dengan perubahan dalam perusahaan utama di sesebuah ekonomi. Dalam menilai soalan ini, kajian ini mempertimbangkan dua persoalan kajian tertentu: apakah peranan dinamik yang dimainkan oleh negeri China dan perusahaan milik Negara dan apakah perbezaan berbanding dengan teori yang dihujahkan oleh perusahaan barat? Adakah kombinasi pemilikan kawalan yang berbeza memberi kesan kepada hasil prestasi?

Terdapat empat teori perusahaan awam - teori agensi, teori hak harta, teori pilihan awam dan neo-liberalisme - berhujah bahawa penglibatan kerajaan dalam ekonomi perlu dikurangkan untuk merealisasikan prestasi yang lebih baik. Walau bagaimanapun,

terdapat kekangan dan terhad dalam mengaplikasikannya di Negara China. Empat teori alternatif iaitu (peranan sejarah, embeddedness ekonomi, pasaran sosialisme dan pembangunan negara) yang menekankan kepentingan peranan kerajaan yang mungkin mempunyai aplikasi yang lebih besar.

Khususnya, tiga dimensi telah dikaji.Pertama, kajian ini menilai sifat kerajaan daripada perspektif seluruh negara. Kedua, ia mengaplikasikan rangka kerja di atas untuk perusahaan milik negara dalam sektor-sektor strategik yang dimiliki sepenuhnya oleh kerajaan. Ketiga, ia meneliti perusahaan milik Negara yang beroperasi dalam "komersial" sektor dengan pemilikan negeri separa dan kawalan.

Penemuan dalam kajian ini dari segi seluruh Negara adalah bahawa peranan kerajaan dalam perusahaan masih besar dan peranan ini telah menyebabkan banyak perusahaan ini berjaya menyesuaikan diri dengan persekitaran persaingan yang semakin meningkat, tetapi pada kos yang mengenepikan kawalan keselamatan sosial. Daripada analisis perusahaan strategik, adalah rasional bagi pemilikan penuh melampaui strategik termasuk sebab-sebab sejarah. Negeri adalah sedar tentang kos pengekalan pemilikan yang telah dibuat. Bagi perusahaan komersial, terdapat faktor pemisahan antara pemilikan dan kawalan, tetapi pemisahan antara negeri dan swasta adalah kurang jelas. Berapa rapat pengurusan atasan dengan perkara-perkara yang melibatkan kepimpinan politik.

Secara keseluruhannya, fokus keputusan kajian ini adalah perlunya untuk mengubah suai perspektif teori barat untuk China. Ia juga menunjukkan bahawa hujah-hujah yang dibuat oleh keseluruhan ekonomi hanya boleh membawa sebahagian dariapda penjelasan kelakuan negera China dan perusahaannya.

ABSTRACT

China has re-emerged at global centre stage. It has achieved impressive economic growth under a political system and using strategies quite different from other countries. Not recognizing its distinctiveness and assuming that the prevailing system of "democratic" government in its various guises must be the universal norm, many commentators think that the Chinese political system must collapse and even market reform under this system cannot work. But so far, the Chinese model not only defies this prediction but has done very well.

Because China follows state-led growth, its state enterprises are the central instruments of this strategy. The same commentators referred to earlier also accuse them of holding the economy back. The reality is that since the establishment of the People's Republic in 1949, these enterprises have been going through many changes. Some functions were shed, others preserved. The enterprises today are very different from those when China began its transition in 1978.

The central question for this study is whether China's development model can be sustained with reformed state enterprises leading the economy. In assessing this question, this study posits two specific research questions: what is the dynamic role of the Chinese state and its state enterprises and how different is it from what western public enterprise theory argues? Do different ownership-control combinations affect performance outcomes?

Four public enterprise theories – agency theory, property rights theory, public choice theory and neoliberalism – argue that state involvement in the economy must be reduced to realize better performance. However, these may have limited applicability to China. Four alternative theories (economic embeddedness, market socialism, developmental state and the role of history) that stress the importance of the role of the state are likely to have greater applicability.

Specifically, three dimensions are analysed. First, this research assesses the nature of the Chinese state from a national perspective. Second, it applies the above framework to state enterprises in strategic sectors that are wholly owned by the state. Third, it examines state-holding enterprises operating in "commercial" sectors with partial state ownership and control.

The study's findings from its country-wide review are that the state's role in these enterprises has remained substantial, that this role has resulted in many of these enterprises adapting successfully to the growing competitive environment, but at the cost of jettisoning their social safety net role. From the analysis of strategic enterprises, the rationale for full ownership goes beyond strategic to include historical reasons. The cost of ownership retention represents a conscious choice the state has made. For commercial state enterprises, there is de facto separation between ownership and control, but the separation between state and private is less clear-cut. How close its top management is with the political leadership matters.

Overall, the results of this study point to the need to modify western theoretical perspectives for China. It also shows that totally economic arguments may lead to only partial explanation of the behaviour of the Chinese state and its enterprises.

ACKNOWLEDGEMENT

It would not have been possible to write this doctoral thesis without the help and support of the kind people around me, to only some of whom it is possible to give particular mention here. Foremost, I would like to express my sincere gratitude to my supervisor Dr. Cheong Kee Cheok for the continuous support of my study and research, for his patience, motivation, enthusiasm, and immense knowledge. In particular, I am grateful to him for introducing me to the topic of my research. His guidance helped me throughout my research and writing of this thesis. I could not have imagined having a better advisor and mentor for my study.

Besides my supervisor, my sincere thanks also goes to Professor Datuk Dr. Ghauth Jasmon who was the former Vice Chancellor of University of Malaya. He brought me this opportunity to study as a Candidate under Department of Economics, University of Malaya. I would like to acknowledge the financial, academic and technical support of the University of Malaya and its staff, particularly in the award of the Bright Sparks Scholarship which provided the necessary financial support during my study period.

The good advice, support and friendship of the Dean of Faculty of Economics and Administration, Professor Dr. Rajah Rasiah has been invaluable on both an academic and a personal level when I was in trouble, for which I am extremely grateful.

I would also like to thank the rest of my thesis examiners: Professor Dr. Goh Kim Leng, Associate Professor Dr. Yap Su Fei, Dr. Yew Siew Yong and Professor Dr. Tan Eu Chye, for their encouragement, insightful comments, and hard questions. My sincere thanks also goes to Dr. Wong Chan Yuan, for offering me to work as a research assistant in his project and leading me working on diverse exciting projects.

Last but not the least, I would like to thank my friends in University of Malaya and my parents, for their help and spiritual support.

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ABC	Agricultural Bank of China
AFC	Asian Financial Crisis
BOC	Bank of China
BoCom	Bank of Communications
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CDB	China Development Bank
CEB	China Everbright Bank
CEO	Chief Executive Officer
CIRC	China Insurance Regulatory Commission
CSRC	China Securities Regulatory Commission
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GFC	Global Financial Crisis
HKSCCNL	Hong Kong Securities Clearing Company Nominees Limited
HKSE	Hong Kong Stock Exchange
HSBC	Hong Kong and Shanghai Banking Corporation
ICBC	Industrial and Commercial Bank of China
MITI	Ministry of International Trade and Industry
NPL	Non-Performing Loans
PBC	People’s Banks of China
PCBC	People’s Construction Bank of China
PCT	Patent Cooperation Treaty
R&D	Research and Development
SABCSF	Sino-American-British Currency Stabilization Fund
SAFE	State Administration of Foreign Exchange
SASAC	State-owned Assets Supervision and Administration Commission
SRC	Soviet Republic of China
SSE	Shanghai Stock Exchange
TVE	Township-Village Enterprise
WTO	World Trade Organization
WIPO	World Intellectual Property Organization
ZTE	Zhongxing Telecommunication Equipment

CHAPTER 1 INTRODUCTION

1.1 Background

Over a century after its eclipse, China has arrived again at the center stage in the world[1], drawing increasing attention from economists and other scholars. This attention derives in large measure from the fact that China has achieved impressive economic growth under a political system and using strategies which are quite different from most other countries. Chinese economic growth is built on a political system that has collapsed in many other countries including the Soviet Union. Its economic policies also differ from what most other countries do. The dominant institutional framework is what the Chinese leadership calls "socialism with Chinese characteristics" which keeps Chinese Communist Party playing the central role. But the reality is that China has a mixed economy in which the state had a major guiding role but with detailed economic decisions being to a large extent decentralized.

China's emergence as an economic power has brought increased scrutiny of the manner of its rise. That this rise has relied on state power and is at variance with the approach favored and followed by advanced countries has led to criticism of the state and its institutions over which it exercises authority through ownership or control. Criticism leveled at the Chinese state takes two forms. The first is that its political order of authoritarian rule is unsustainable and will ultimately be overtaken by forces for democratization. Because the dominant political system in the world is democratic government in its various forms, many believe China must converge to this norm. Thus, Pei (2006) notes: "… *if current trends continue, China's political system is more likely to experience decay than democracy… the very policies that the party adopted … are*

[1] Based on Gross Domestic Product (GDP) by World Bank, China was the second largest country in the world. The average annual GDP growth rate was 9.26% in 5 years from 2008 to 2012 (World Bank, 2012).

compounding the political and social ills that threaten its long-term survival" (Pei, 2006b). The second is that authoritarianism cannot coexist with a true market economy. Hence, efforts to graft Western institutions onto an authoritarian structure also will not succeed. So commentators think that the Chinese political system must collapse and even market reform under this system cannot work. For instance, Chang (2010) concluded that: "China cannot make much progress toward (the rule of law), at least as long as the Communist Party is around (Chang, 2010)." The second criticism, by extension, challenges the efficacy of China's numerous state enterprises, which have historically played a major role in the economy, and they need to be reformed through privatization or liquidation (Lal, 2006).[2]

Yet China's experience since the late 1970s has defied these predictions. It had achieved rapid economic growth for over three decades, through a model of growth that, though not quite approaching that of the developmental state, can nevertheless be described as state-led. Unlike the rest of the world, China follows state-led growth, not private sector growth. State enterprises are at the heart of this model.

State enterprises remain major players in the economy. They are not only the largest enterprises but also growing larger; while the number of state enterprises in 2009 has been reduced to just under one-eighth of that in 2000, their shares of output and employment have fallen to one-third and one-fifth respectively (Table 1.1). However, as shall be elaborated below, these numbers understate the size and reach of the state sector. (Szamosszegi & Kyle, 2011) also noted that "the observable state sector, which consist of state enterprises and the enterprises they directly control, accounts for approximately 40 percent of the Chinese output under reasonable assumptions".

[2] In Gordon Chang's book The Coming Collapse of China (Chang, 2001), Chapter 3 was titled 'State Enterprises are Dying' and Chapter 7 'The State Attacks the Private Sector'.

Table 1.1: Selected Statistics of Chinese State Enterprises (2000-2009)[3]

Year	No. of State Enterprises as % of All Enterprises	State Enterprise Output as % of Total Output	State Enterprise Employment as % of Total Employment
2000	32.8	47.3	53.9
2001	27.3	44.4	49.2
2002	22.6	40.8	43.9
2003	17.5	37.5	37.6
2004	12.9 (2.0)[4]	35.2 (15.3)	29.8 (13.7)
2005	10.1	33.3	27.2
2006	8.3 (5.3)	31.2 (14.9)	24.5 (15.1)
2007	6.1 (3.4)	29.5 (13.7)	22.1 (12.9)
2008	5.0 (2.6)	28.4 (13.1)	20.3 (11.4)
2009	4.7 (2.5)	26.7 (12.5)	20.4 (11.1)

Source: China Statistical Yearbook, various years.

As key institutions of Chinese state, China's state enterprises had occupied a central position in discussions of the role of the state. This was largely because although they contribute declining numbers of China's enterprises, industrial output and exports, these enterprises have remained major players in the economy. They are central to China's state-led growth strategy, but they have also been accused of holding the economy back. In reality, China's state enterprises have been going through many changes, and the state enterprise of today bears little resemblance to that in the 1990s.

1.2 State Enterprises as Central Institutions: A History of Major Transformation

China's state enterprises have been key instruments of the state's control of economic activities as well as institutional reform. In these processes, they have themselves been historically transformed to various forms since the economic reform and opening up in 1978. Before 1978, the state controlled over the whole economy very strictly and grasped so much centralized power that it resulted in the lack of incentives for the employees; thereby most state sectors fell into a situation of poor performance – low profit or even

[3] Includes state enterprises which are wholly or majority-owned by the government only. Enterprises in which the government has minority ownership are excluded.
[4] 2Includes state enterprises wholly owned by government only.

loss-making, so state enterprise reform was felt by the leadership to be imperative.

Recognizing that an enterprise's ownership structure can affect governance and performance, the state started to reform state enterprises through both governance and ownership reform. The governance reform began with enlarging operational autonomies to provide adequate incentives to managers. This was done in two main ways. One was increasing autonomies of production plans which gave managers more rights in setting prices and wages, hiring and firing employees, investing of fixed capital and in foreign trade through profit retention scheme. And another way was linking profits or losses of state enterprises to employees' benefits, and managers were allowed to share part of profits.

In the 1980s, because of increasing losses incurred by state enterprises, the state started to transfer funds to newly founded state enterprises in the format of loans instead of appropriations ("loan replacing appropriation"). In 1983, tax reform was undertaken that enabled the state to obtain fiscal revenues from the state enterprises by "taxes replacing profits turn-in".

Organizational reforms were also initiated. The 3rd Plenary Session of the 12th China Communist Party National Congress in 1984 saw the dissociation of state enterprises from the government and the separation of ownership rights and control rights. Managerial positions in state enterprises were delinked from government hierarchical positions. Since 1987, a dual-track price system was adopted in which state-guided pricing and market pricing coexisted. Efforts to strengthen corporate governance structure were also launched in 1994. Specific measures like manager/contract responsibility system were introduced. Pilot state enterprises were started to apply the "modern enterprise system" as one of the measure of governance reform. In the same year, the Company Laws of People's Republic of China was promulgated to regulate state enterprises.

During the 1990s, however, as operating losses of state enterprises mounted under the "loan replacing appropriation" system, massive amounts of non-performing loans (NPLs) accumulated in the big-4 state-owned commercial banks. Funds from the big-4 banks were insufficient to keep the state enterprises solvent. To remedy this situation, the 3rd Plenary Session of the 14th China Communist Party National Congress proposed that state enterprises should raise finance by public listing in capital markets. But In order to prepare for public listing, state enterprises had to corporatize to comply with the requirements set by the Company Laws mentioned above. Domestic capital and international capital markets were all targeted. Also, in 1994, the policy of "taxes replacing profits turn-in" was adopted which meant state enterprises could retain all after-tax profits.

Simultaneously, ownership reform proceeded. In 1986, the state introduced the joint-stock system to state enterprises. The Shanghai and Shenzhen Stock Exchanges were founded in 1990 and 1991. Separately, the system of split-share issue became an institutional feature in China. Under this system, shares in listed enterprises were separated into tradable shares and non-tradable shares. The state and legal persons[5] were holders of non-tradable shares which could not be traded in the stock market, so that the government retained absolute control over the listed enterprises. By contrast, tradable shares were public shares that could be traded in the two Stock Exchanges and owned by institutional and individual shareholders. As will be explained later, this was to create problems for China's capital market development.

[5] "Legal person" is a concept relative to a natural person, which refers to legal organizations including state, corporations, institutions, etc. to execute rights and obligations in law.

Another major reform initiative was taken in 1995, when a policy called "grasping the large (state enterprises), letting go the small" was launched to have the state retain ownership/control of the largest state enterprises while smaller enterprises were to be either sold or privatized. As a result, a large number of small and medium-sized state enterprises were privatized, merged, or shut down while about 1,000 were treated as large and owned by the state. This policy was implemented in a number of steps.

The first step was taken when the 3rd Plenary Session of the 14th China Communist Party National Congress promoted the idea of direct financing of enterprises by public listing in capital markets (Ifeng Finance, 2013). This was followed in 1999 when the 4th plenary session of the 15th China Communist Party National Congress announced plans to transform large and medium state-owned enterprises into joint-stock enterprises through listing or through directing purchase of equity by foreigners or private parties (People Online, 2013).

However, conflict between holders of non-tradable shares and tradable shares came to a head. Because the earnings of non-tradable shares were not influenced by the share price and the firm value, the managerial incentives put in place could not induce managers to act in the best interest of the enterprise and hence also of the holders of tradable shares. Controlling shareholders who were politically appointed preferred to perform well for the government. Problems of diversion of enterprise assets and profits for their own interests also emerged (Jiang & Habib, 2012). To deal with the problems arising from the split-share issue, a pilot program with two batches of 46 pilot enterprises was launched. To advance and supervise split-share reform, the State-owned Assets Supervision and Administration Commission (SASAC)[6] formulated specific suggestions to guide state-holding listed enterprises.

[6] In 2003, SASAC was established under the State Council to supervise and manage state assets by representing the state's interests.

By then, it was clear that holders of tradable shares and non-tradable shares had to come to a compromise. This took the form of holders of tradable shares getting additional complementary shares from holders of non-tradable shares. SASAC also insisted that for state enterprises, there was to be a minimum state share proportion. That was because the state would need to retain ownership of state enterprises in strategic sectors considered crucial to the country's national and economic security. Strategic industries included financial, mining, steel, telecommunications, transportation, utilities, oil, and military-related production. If state enterprises operated in strategic industries, the state should be in a controlling position (State-owned Assets Supervision and Administration Commission, 2006). State shareholders could purchase additional tradable shares through capital markets to consolidate their control.

At the same time, the state-owned/controlled shares were not to be offered for sale within the restricted trade period. The release of these shares for sale was a gradual process, with no more than 5% of the general capital allowed to be traded after 12 months, 10% after 24 months and 37.41% after 36 months (State-owned Assets Supervision and Administration Commission, 2005). The increasing number of shares in the market might make the share price instability and the share price fluctuate. However, the shares became valued by the market and the original problem of non-tradable shares was overcome. And holders of non-tradable shares have managerial incentives to make the bank act the best performance. Hence, the function of the stock market was to weight the value of state-owned assets and provide performance measurement criteria. With these institutional arrangements in place, the trend towards more tradable share accelerated, so that by 2013, only a tenth of state enterprise shares were non-tradable (Table 1.2).

Table 1.2: Tradable and Non-Tradable Shares in China’s Share Markets (2004-2011)

Year	Total Issued Shares (Billion)	Tradable Shares (Billion)	% of Shares Tradable
2004	714.94	257.71	36.05
2005	762.95	291.48	38.20
2006	1489.76	563.78	37.84
2007	2241.69	1033.15	46.09
2008	2452.29	1257.89	51.29
2009	2616.29	1975.95	75.52
2010	3318.44	2564.2	77.27
2011	3609.55	2885.03	79.93
2012	3839.50	3133.96	81.62
2013	4056.91	3674.42	90.57

Source: Securities market yearly data by China Securities Regulatory Commission (CSRC), from http://www.csrc.gov.cn/pub/csrc_en/marketdata/.

The third step occurred in 2007, when state enterprises under SASAC had to submit a part of their profits to the Ministry of Finance according to newly issued regulations (Ministry of Finance of the People's Republic of China, 2007). In 2013, the submitted profit rate was raised. Most of the summited profits were to be used for the redevelopment of state enterprises. These uses included strategic mergers and reorganization of central enterprises which are administrated by the central government; strengthening the controlling power of these enterprises in strategic industries; enhancing their capacity for independent innovation, energy conservations and promoting the development of education, agriculture, culture and other related industries; foreign investment and foreign economic and technological cooperation (Ministry of Finance of the People's Republic of China, 2013).

This account makes it clear that the corporation reform of state enterprises has been transformative. On one hand, the state conducted governance reform to cut down its control. On the other hand, ownership reform was conducted simultaneously through directly transferring a part of state ownership to the public (private, foreign). Mixed ownership forms of state enterprises have also emerged with the state, state legal persons (state enterprise), other legal persons (other enterprises), and natural persons (individuals) as owners.

The above reforms have produced what official sources refer to as three types of state-owned enterprises today, only one of which fits the public enterprise stereotype in mainstream Western economics. According to the National Bureau of Statistics of China (National Bureau of Statistics of China, 2008), state enterprises are classified as follows. The first type consists of enterprises wholly owned by the state – referred to as "state-owned enterprises" – consisting of state-owned corporations and state legal person joint ownership enterprises. The second type, referred to as "state-holding enterprises", are those in which the state has majority ownership (more than 50%), or has the highest ownership among other shareholders even if it is a minority shareholder (less than 50%), or where the state exercises control through other state-controlled shareholders. The third type, referred to as "state joint-stock enterprises", consists of those in which the state has minority ownership and exercises no control.

Those definitions stressed two important themes, i.e. the state's ownership and control of the enterprise. However, after state enterprise reform, the state's ownership and governance of a state enterprise has taken diverse forms. If a study intends to define a state enterprise, it has to reference these two features of state ownership and control.

However, to make things more complex, the government also classifies state enterprises by the institutions under which they functioned (Ministry of Finance of the People's Republic of China, 2013). Firstly, "*Yangqi*" (central enterprises) are controlled and supervised by the state through SASAC. "*Yangqi*" cover strategic industries producing public goods like national defense, power grid, telecommunications and water, natural monopoly products like petrochemical, gas, coal and mineral, and competitive products like civil aviation, shipping, architecture and trade. As of 2014, there are 113 "*Yangqi*". Most are 100% state-owned. The subsidiaries of "*Yangqi*" were classified as primary, secondary, tertiary and lower subsidiaries (State-owned Assets Supervision and Administration Commission, 2013).

Secondly, the other strategic sector – that of financial institutions – is supervised by the People's Bank of China (PBC), China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), China Insurance Regulatory Commission (CIRC) and the State Administration of Foreign Exchange (SAFE).

Lastly, a group of state enterprises is supervised by other departments under the State Council or organizations belonging to collectives like tobacco, gold, railway, port, airport, radio and television, culture, publishing and other industries. What are called "social service organizations" are under this categories. They were engaged in education, technology, health, culture, etc., and were set up by the state to provide social welfare and were funded by state assets. According to regulations from the State Council, a social service organization could not be defined as non-governmental organization or non-profit organization. First, it was not just initiated but also supervised by government institutions. Second, it could set up for-profit organizations based on Corporate Law (The State Council of the People's Republic of China, 2004).

Figure 1.1 shows the sequence of state enterprise reform. This reform proceeded through a process of trial and error, in line with the central government's intention to incorporate the private sector according to the objective of constructing a socialist market economy. However, many problems were encountered so that one state enterprise reform called for further reform. At the same time, given the importance of state enterprises, the impact on them of reform also determined the success or failure of China's economic transition.

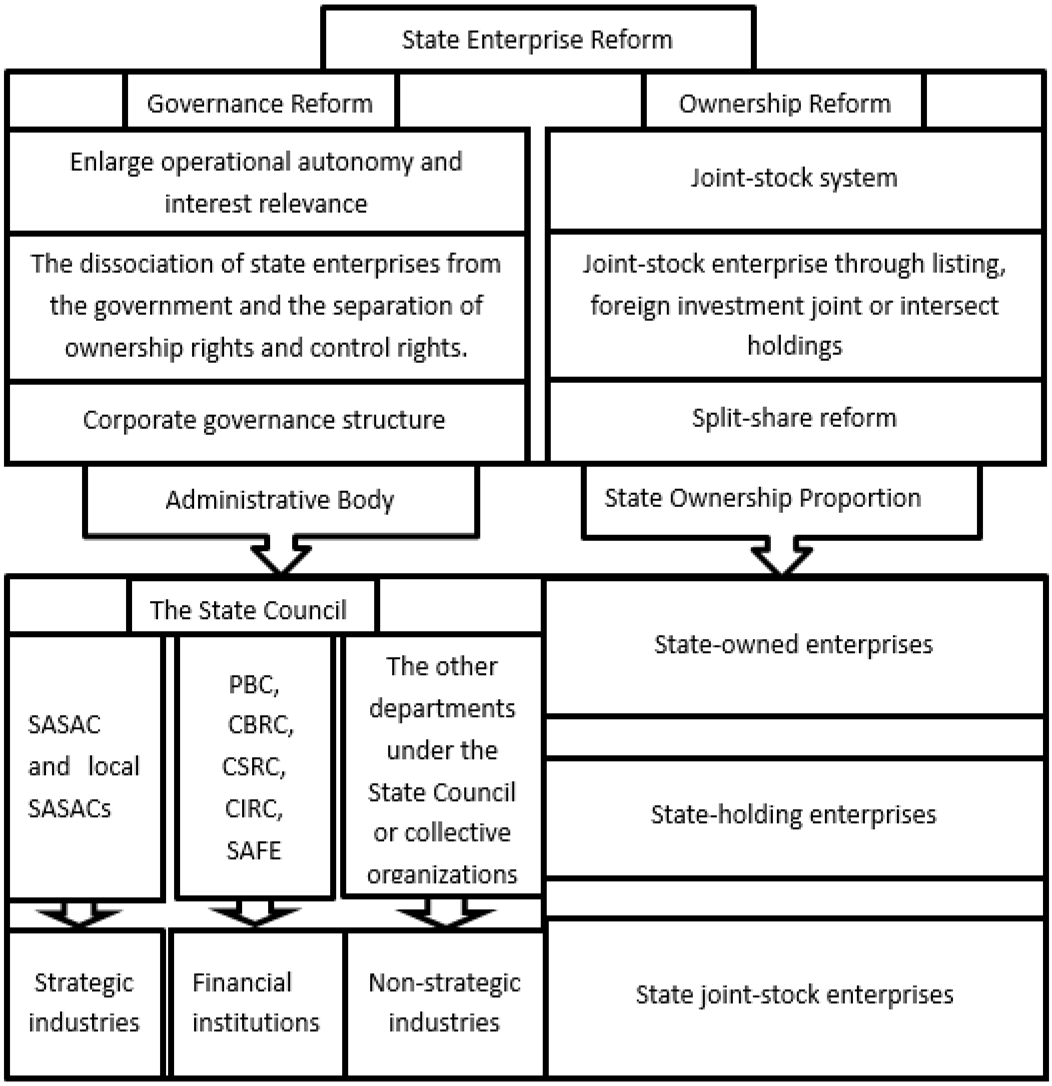

Figure 1.1: Transformation of China's State Enterprises
Source: Author

1.3 Motivation of Study

The central question for China's continued development is whether its development model could be sustained with state enterprises leading the economy even with reforms. Some economists argued that this was impossible: China's state enterprises were like other countries, and needed further reforms through being denationalized under a market mechanism (Qi, 2012). They said this was because they were inefficient, badly run, loss making and relied on monopoly power to survive. Some even argued the present state enterprises situation could not be sustained.

Throwing light on the above question is the overall motivation of this study. In doing so, we are conscious of the fact that many scholars were looking at China and its state enterprises through mainstream (Western) theoretical perspectives and assumed that conclusions from these perspectives were the only valid ones to draw. Since China had so many state enterprises that likely impact the country's development, we need to determine if this is indeed the case. While it was true some state enterprises were loss-making, we need to look deeper to its causes. For instance, if they were originally forced to undertake social responsibilities that are now no longer required, does discarding these responsibility and producing performance improvement for these enterprises also translate to gains for the country as a whole, when all that happened was to transfer these responsibilities elsewhere, or, as has happened in China, to discarding them (see Chapter 4)?

Several specific issues are ripe for further study within the broad framework outlined above. One is the transformational impact of the nature and role of China's state enterprises through state enterprise reform, the characteristics (control modes of the state, performances and roles of state enterprises in the economy) of today's state enterprises. Another is whether there exists variation in state enterprise behavior and performance among different types of state enterprises, however delineated. A third is the robustness of these enterprises through changes in external conditions, such as the Asian and Global Financial Crises of 1997-1999 and 2008 respectively which would have tested the efficacy of state enterprise reforms. A fourth is the extent to which China's state enterprises is fulfilling other strategic roles demanded of them by the state.

A final issue this study hopes to address is the lessons of the China's state enterprise experience for other countries despite the fact that Chinese circumstances differ from those of most other countries. The first is that state enterprises can exist in many forms, depending on the manner in which they are owned or controlled. Second, how state ownership and control is exercised has implications for the performance of these enterprises. Third, it also affects relations between the state and the private sector. Fourth, to the extent that state enterprises play multiple roles, preeminence given to particular roles would affect how effectively other roles are played. Finally, context matters in any assessment of state enterprise efficacy and performance – the specific circumstances facing a country not only shape the role of state enterprises but also how well the function.

1.4 Problem Statements

In the China context, the above discussion gives rise to a number of research issues, framed here as problem statements. These statements make reference to gaps or limitations in the existing literature on this subject.

Problem Statement 1: Ownership and Control

Although there was no shortage of literature on China's state enterprises, characterizing today's state enterprises still faces several major challenges due to their complexity. The defining distinction between state and private enterprises based on ownership, encounters, for a country as decentralized as China, problems of clarifying which part the state is the owner. How much state ownership exists is also hard to tell since some state enterprises are not directly owned by the state, but may be owned by an enterprise not with complete state ownership, or by multiple such enterprises. And in terms of governance, problems like which part of governance state power extends to, or how much state involvement is in operations, or how much does the state figure in providing a tilted playground for state enterprises, or how many state's strategies to follow also need to be solved. Therefore, specific state-control modes of China's state enterprises need to be examined.

Problem Statement 2: Roles

Most economists suggested that China's state enterprises should be privatized to prevent them from using their monopoly position to dominate markets while turning in below-average performances. However, China's state enterprises are still required to pursue and fulfill both commercial and non-commercial responsibilities and obligations. Therefore it needs to be further discussed that China's state enterprises have functions in supporting the Chinese economy, like spurring technology innovation to strengthen Chinese international competiveness, to help the state overcome crises, and to protect public interests. The appropriate role of state enterprises and how well they play this role is the second problem to be studied.

Problem Statement 3: Performance

Most existing literature sought to verify the relatively poor performance of China's state enterprises by using quantitative methods and comparing them with non-state enterprises, sometimes assumed to be synonymous with private enterprises. State ownership and state involvement were considered as factors leading to inefficiency. However, as indicated earlier, when we examine state enterprises' performance, we should look beyond profitability to take into account other indicators, like the competitive environment they were facing and technology innovation they developed. A more comprehensive set of indicators of performance needed to be discussed.

1.5 Research Questions and Objectives

The problems as stated above raise several important questions. Each research question begets a corresponding research objective, which may be further subdivided into sub-objectives.

Research Question 1:

After state enterprise reform, what is the dynamic role of the Chinese state and its state enterprises in terms of ownership structure and governance mechanism (state-control mode)? How is it different from state enterprises envisaged in mainstream public enterprise theories (agency theory, property rights theory, public choice theory, and neoliberalism)?

Research Objective 1:

The first objective is to characterize the ownership structure and governance mechanism of China's state enterprises before, during and after reforms, and thereby to analyze the dynamics of change and then to understand the extent and nature of control through ownership and governance.

A first sub-objective is to analyze the dynamics of change by looking at how the state enterprise has evolved in line with state enterprise reform policies. This evolution can be shown to affect performance and to lead to further reforms.

A second sub-objective is to grasp the role of the state in state enterprises by examining the state's control through ownership and governance. As indicated above, there are several ownership forms (state-owned, state-holding and state joint-stock). This role is examined through reviewing the governance of state enterprises by looking at hiring practices, incentives for performance, transparency of reporting, bureaucrats or professional hires, reporting channels, state involvement in decision making, and the extent of state support and preferential policies.

Research Question 2:

As key instruments of the state, what roles do China's state enterprises play to drive the growth in the economy, and how different are these roles from those envisaged by mainstream public enterprise theories (agency theory, property rights theory, public choice theory, and neoliberalism) of state enterprises?

Research Objective 2:

The second objective is to examine the roles that state enterprises play in representing the state at the macro-level. Specifically, what roles do they play, in major events like China's World Trade Organization (WTO) admission, Global Financial Crisis (GFC), and overall economic growth?

The first sub-objective is to access the extent to which they are successful in meeting these objectives.

A second sub-objective is to find out whether they are trade-offs in meeting various state objectives. For instance, how does the profitability objective conflict with the objective of social protection?

Research Question 3:

The third question is to relate the above issues of ownership structure and governance mechanism to performance by asking, how do state enterprises perform in terms of profitability, competition and innovation and also how well does this performance accord with existing mainstream public enterprise theories (agency theory, property rights theory, public choice theory, and neoliberalism)?

Research Objective 3:

The third objective is to find out the performance indicators and evaluate them for different types of state enterprises.

To answer this question there are three sub-objectives.

Firstly, it is to examine if state enterprises make profits or losses through standard profitability indicators like net profit margin, return on assets, and return on equity.

Secondly, it is to examine the extent to which China's state enterprise face competition from other state enterprises, non-state enterprises (private and foreign) in their markets.

Lastly, it is to find out if China's state enterprises engage in innovation, and whether such innovation is comparable to that undertaken by private enterprises.

1.6 Structure of Study

The study is structured as follows. In the next chapter, theoretical and empirical literature on the Chinese state and state enterprises would be reviewed. This would be followed by a chapter on the research methodology applied and upon which a conceptual framework is built data sources would also be identified chapters 4, 5, 6 are three analytical chapters. Chapter 4 reviews China's state enterprises and their relationship with economic growth and distribution. Chapter 5 focuses on a strategic industry – China's banking sector. Chapter 6 then analyzes another major type of state enterprise – "commercial" state enterprises – through a case study (Zhongxing Telecommunication Equipment (ZTE) Corporation). The conclusion chapter would synthesize the findings and draw implications for the study of state enterprise.

CHAPTER 2 LITERATURE REVIEW

2.1 Introduction

Much has been written about China's state enterprises through its several phases of reform. As the economic landscape for these enterprises shift with each and each phase of reform, so the nature of critiques and assessment of their performance have also changed. By and large, however, most studies have been framed by Western theories of and applicable to public enterprise, so that conclusions were drawn and assessments made assuming these theories hold. But although seldom deployed, alternative theories also have relevance for China's state enterprises.

With respect to empirical studies, these have been undertaken at different stages of state enterprise reforms. As a result, judgments about their efficacy and performance have also evolved. Given the size of the state enterprise sector, few studies have been able to claim more than partial coverage whether in geographical or institutional terms.

The situation above speaks to the need to undertake a review of literature that deals with both the theories applicable to China's state enterprises as well as empirical studies that cover state enterprises over time and space. This chapter aimed to review the existing debates on China's state enterprises that emanate from both theoretical studies and empirical studies.

This chapter has four sections: the next section presents all Western theories on public enterprises. They are agency theory, property rights theory, public choice theory, and neoliberalism. Section 2.3 is going to do further discussion of alternative theories with relevance to Chinese state. They are theories of economic embeddedness, market socialism and developmental state, the significance of history to the Chinese state. Section 2.4 will present empirical studies regarding the performance of China's state enterprises.

Conclusion part will be drawn in section 2.5.

2.2 Theoretical Studies on Public Enterprises

A number of theories apply to state enterprises all of which argue for their inferior performance compared to enterprises in the private sector. These are agency theory, property rights theory, public choice theory and neoliberalism.

2.2.1 Agency Theory

Agency theory was put forward by Jensen and Meckling in 1976 (Jensen & Meckling, 1976). Agency theory referred that there would be conflicts between the principal and the agent if their interest diverged (Bebchuk & Fried, 2004). If the agent became the principal of enterprise resources, one would take actions for one own interests (Dharwadkar, George, & Brandes, 2000). It stressed the relationship between the provider and the user of enterprise resources. As the principal, the provider was also the owner of those enterprise resources. The manager who was in charge of those enterprise resources were the agent. If the manager was the owner of those enterprise resources, one had the residual claim over those enterprise resources, and one would work hard for one own interests. Thus, there was no agency problem. However, if the manager increased enterprise assets through stock issuing or debt financing and then one did not owned all of those resources. And then the manager would have the motivation of perquisite consumption and work intensity reduction. There were significant differences from that the manager had all enterprise resources. The principal delegated authorities to the agent and the interest of the principal would be affected by the choice of the agent. There were possibilities the agent might behave against the interest of the principal. There were three agency costs: monitoring costs, bonding costs and residual losses. Monitoring costs referred to costs that external shareholders spent on monitoring the manger's perquisite consumption and work intensity reduction. Bonding costs referred to costs that the manager spent on selfdiscipline for acquiring the principal's trust. Residual losses referred to other costs resulting from interest conflicts between the principal and the agent. Agency theory tried to solve objective conflict problem when the principal let the agent to take action for the principal's interest and the agent used the principal's enterprise resources (Eisenhardt, 1985, 1989). Agency problems were related to the type of ownership. The principal determined the objective of an enterprise. If state ownership was transferred to private hands of a state enterprise, the objective of that state enterprise would change from state's wishes to private owners. Private sector was more efficient than state sector since its objective was more considering the profit maximization instead of political issue and monitoring (Estrin & Pérotin, 1991).

2.2.2 Property Rights Theory

Property rights are determining how the property is used and owned (Alchian, 1987). The property can be used by individuals, associations or governments (Guerin, 2003). Property rights theory implied that the more direct and strengthened were the rights to the property, the better assets would be used (Alchian & Demsetz, 1973). To define the property rights could enable the principal exercise his/her rights to realize the optimal utilization. Rights included ownership right, possession rights, control rights, use rights, earnings rights, and disposition rights. There was no transaction cost as the property boundary was clear. The efficiency of resource allocation was decided by the distinctiveness of the property boundary (Coase, 1937, 1959, 1960; Stigler, 1971). In an enterprise, the relationship between the principal and the agent could also be considered as a contract transaction. Therefore property rights within the enterprise were related to the efficiency of that enterprise. The principal excised his/her property rights and affected his/her properties. The principal had residual claims for his/her properties, then he/she had more incentive motivations to improve the efficiency of that enterprise. If state ownership was transferred to private hands of a state enterprise, private hands acquired state property rights the private would exercise their rights to realize maximized profits on their properties (Alchian & Demsetz, 1972; Demsetz, 1967). If the state was the owner of property, the boundary of property rights was not clear compared to private owners. The private sectors would exercise their rights to realize maximized profits on their properties.

2.2.3 Public Choice Theory

Public choice theory argues that Individuals' interests were given priority over public interests (Buchanan, 1954; Buchanan & Tulllock, 1972). The divergence between the state and bureaucrats occurred when bureaucrats focused on their own interests instead of public interests. Public interests could not be reflected well by the state, and the state's intention also could not be reflected well by bureaucrats. Accordingly, they imposed on state enterprises' goals that could lead them to acquire political interests which had conflicts with efficiency. The wrong motivation led to the inefficiency of state enterprises. Private individuals would focus on their own interests to make the enterprise better. It suggested state enterprises changing from state-owned to private-owned with less political intervention and increasing search for efficiency. The bulk of bureaucrats, however, were civil servants whose jobs and payments were protected by a civil service. This image was often compared with that of an enterprise owner whose profits were determined by the success of production and sale, who aimed to maximize profits, and who could hire and fire employees at will. Public choice theory referred that when politicians and government officials represented the state to manage public resources, the divergence occurred when politicians and government officials focused on their own interest instead of the public interests in state enterprises (Tullock, 1987). And public interests could not be considered well by the state, while private individuals considered their own interests to pursue the efficiency. A group's objective could not represent everyone's interest well.

2.2.4 Neoliberalism

Neoliberalism supports economic liberalizations, free trade and open markets, privatization, deregulation, in other words, neoliberalism stressed private interests or private sector within modern society (Collins English Dictionary, 2003). That is to say to reduce the government control in the economy (Boas & Gans Morse, 2009). It focused on the concept of free market. There was no bond imposed by the state and no state control, which led to total freedom of movement for capital, goods and services. Minimization of the state involvement would create the condition of marketization and perfect competition. The state could not involve in economic activities. Neoliberalism was a label for economic liberalism that emphasized the efficiency of private enterprises, liberalized trade and relatively open markets, and therefore sought to maximize the role of the private sector in determining the political and economic priorities (Harvey, 2005; Shearmur, 1992). The development of pro-corporate political policies restrict the public arena (Chomsky, 1999). Neoliberalism emphasizes the efficiency of private enterprises since private sectors had more liberalized trades and relatively open markets which lead to efficiency. With interventions imposed by the state, the state enterprise could not be run efficiently. Hence, according to this theory, state enterprises should be privatized.

2.3 Theories Relevance to Chinese State

There are a number of contextual issues that affect the relevance of the above theories. Alternative Western theories have some relevance to the Chinese case and that China has borrowed from models that are alternatives to Western mainstream theories of public enterprise. These issues also relate to China’s history and cultural traditions.

2.3.1 Economic Embeddedness

Human economy was always embedded in society. The economic activity is intervened by non-economic institutions (Plattner, 1989). Even in market societies, economic activity is not separated from society (Granovetter, 1985). The term "embeddedness" expressed the idea that the economy was not autonomous as it must be in economic theory, but subordinated to politics, religion, and arid social relations. It centered on the role of the state in the economy. Even though the economy was supposed to be self-regulating, the state must play the ongoing role of adjusting the supply of money and credit to avoid the twin dangers of inflation and deflation. It became utterly impossible to sustain market liberalism's view that the state was "outside" of the economy (Polanyi, 1957). As the state was embedded in society, market liberalism might not work as expected. Accepts system that was neither market liberalism nor Marxist (Polanyi, 1944). Viewing of embeddedness was more in line with Chinese concept of the state, which, as explained in section 3.1, represent just the top tier of an orderly hierarchy.

2.3.2 Market Socialism

Market socialism refers to the notion that a socialist state would own the means of production but the prices of commodities are determined by the free market for equilibrating markets (Buchanan, 1985; Gregory & Stuart, 2004). A socialist state would play a guiding role in adjusting market-determined prices to facilitate movement to market equilibrium. In a socialist market economy, the state owned, managed and administered the means of production while the market distributed resources and economic output. The state influenced the level of aggregate investment to be allocated by an investment board. The prices of commodities were market-determined (Lange, 1936, 1937; Le Grand & Estrin, 1989). China is referred to officially as a socialist market economy which stemmed from the Chinese economic reform and was introduced by Deng

Xiaoping. It was also called “socialism with Chinese characteristics” (Deng, 1984). It was defined as “a multi-ownership-oriented basic market economic system, with the public ownership in the dominance” (People's Daily Online, 2007). And as Deng noted in his 1984 speech cited earlier, “the socialist sector is the mainstay of our economy”. When China began its reform, it felt that it could combine socialism with elements of the market economy. The socialist mode of production had to adapt capitalist techniques to thrive (Bremmer, 2009; The Economist, 2012). Chinese state had a major influence both on the amount and the nature of investment in China, particularly in infrastructure and in the selection of key sectors for development, as well as in human capital formation and in the direction of scientific and technological research (Tisdell, 2009). When state ownership was becoming less and less important in China, the means of production were not necessarily owned by the state. Except for strategic state enterprises which the prices were mainly determined by the state, other state enterprises had state ownership and market-determined prices. Thus the free market pricing system had not fully been adopted in China.

2.3.3 Developmental State

A developmental state is a state that follows a state-designed development path. And it had been favoring state interventionism over a liberal open market (Leftwich, 1994). The developmental state was conceptually positioned between a liberal open economy and a central planned model. So it was neither capitalist nor socialist. In developmental state countries, the state followed a state designed development path. And it had been favoring state interventionism over a liberal open market. The developmental state was conceptually positioned between a liberal open economy and a central planned model. So it was neither capitalist nor socialist. The state has major role, guiding the private sector through pro-active industrial policy (Wade, 1990; Woo-Cumings, 1999). The China model of development also relies heavily on a proactive state role. This role is not unique to China, being an essential characteristic of the developmental state like Japan (Leftwich, 1995). Ministry of International Trade and Industry (MITI) of Japan caused the Japanese “miracle” during 1920s-1980s. The institutional foundations of Japanese industrial policies were manipulated by Japan's bureaucratic elites. The Japanese government could perform its countless duties due to its objectives (Johnson, 1982). What is different for China is that the respective states (Japan, Korea) intervened in the market to promote private sector enterprises (The Economist, 1997), the Chinese state supported its own enterprises to promote growth – the so-called “state-led model” (Yip, 2012). Yip contrasted the Chinese model with the neoliberal model by characterizing the former as “the state controls the capital” and the latter as “capital controlling the state”, a clear reference to state capture by capitalist vested interests. Underlying this assumption is the Chinese understanding, as stated earlier, that the state and civil society are not mutually exclusive but the state is part of society.

2.3.4 History of Chinese State

Scholars, especially historians, have argued that China, while adapting to new circumstances, always looks back to its own history in seeking solutions to problems and challenges. Wang (2014) described how the May 4th Movement of 1919 became a reference point for subsequent movements and reforms (Wang, 2014). This is because the Chinese state has existed for over two millennia, predating the conceptualization and emergence of the now dominant nation state. Although bearing a close resemblance to a nation state, and despite transitions from imperial rule through republicanism, Leninism and to the ‘market socialism’ of today, all within a century, the modern Chinese state is the outcome of centuries of evolution. Kuhn (2002) argued that this state has been “shaped decisively by the flow of its internal history”, although external models of governance have left their mark (Kuhn, 2002). Nevertheless, the Chinese state remains more the product of its own history than of foreign influences.

What are the salient characteristics of this indigenously evolved state? First, its prime objectives are defense of the realm and guardianship of its civilization and its people, including economic modernization and society transformation (Jacques, 2011; Shambaugh, 2000). These objectives, together with the need to modernize post-Qing Dynasty China, give the state a far larger role than that of a nation state. Pye (1992) famously writes that China is a civilization pretending to be a state (Pye, 1992). Jacques (2012) and Hsiung (2011) refer to China as a civilization state, wherein lies the entire civilization (Hsiung, 2012; Jacques, 2011). Zhang (2012) goes further to characterize the country as a 'civilizational' state, which combines the essential qualities of a civilization state with features of the modern nation state (Zhang, 2012). This role is reinforced by China's modern history, in which the chaos that reigned just after the establishment of the 1911 republic could only be solved by strong leadership backed by the apparatus of state (Zhou, 2010) . Second, the relationship between the state and Chinese society is much closer than in Western societies. Indeed, the state is at the apex of an orderly hierarchy in which layers of society make up the rest of the pyramid. Not only is there no mutual exclusivity between state and society, the state, a product of and deriving its strength from Confucian thinking for much of China's history, is very much part of society, deriving its authority from its missions above (Li, 1997).

That the Chinese state, viewed in its historical context, is materially different from what the West believes to be the Western norm for a modern state should lead us, first, to question the belief that China's future depends on its convergence to Western norms of state and governance. The assimilation of new concepts of state governance is not necessarily a wholesale endorsement of these concepts but rather responses to adapt to a changing world, and consistent with what China has done throughout history. The Chinese state remains, to borrow from Kissinger "singularly" Chinese, defined by its long history and cultural identity (Kissinger, 2011). Second, China's missions for its state imply a role that goes well beyond what is expected of a nation state. Fairbank noted the small size of the Chinese state in relation to its considerable mandate (MacFarquhar & Fairbank, 1987). Hence, from a historical perspective, neither the size of the state sector nor the Chinese model of state-led growth, also referred to as state capitalism, should surprise. These salient features must be borne in mind as we examine the magnitude and role of state enterprises.

2.4 Empirical Studies

A great deal of empirical research had been done on China's state enterprises. Some support the predictions of mainstream Western theories, others refute them, while yet others are inconclusive. In some ways, as the state enterprise sector has been undergoing reform, comparing studies of different time periods may not be fully valid. It is also true that few studies have examined how state enterprises have changed over time. Those below are findings that support mainstream public enterprise theories. Findings that do not support mainstream public enterprise theories will be discussed in Chapter 4.

When the state transferred responsibilities in output decision-making to China's state enterprises and the profit retention rate was raised, managers were paid more bonuses, hired more workers and invested for the enterprise. As a result, increased autonomies led to higher productivity (Groves, Hong, McMillan, & Naughton, 1994). As state enterprise managers were selected and supervised by government bureaucrats, those bureaucrats might have incentive problems. With the state sector, agency problems resulted in soft budget constraint (SBC) problems (Bai & Wang, 1998). With greater influence from the central state and community governments, township-village enterprises (TVEs) aimed to achieve community governments' goals of increasing government revenues, rural employment and incomes but they did not compete well due to employment and local public goods supply quotas that distorted the market signals they received, so compared to private enterprises, they were inefficient (Jin & Qian, 1998).

Empirical analysis of China's state enterprises showed the firms' profitability positively related to legal person shares but negatively related to state shares. And labor productivity also correlated negatively with state shares. These results suggested the inefficiency of state ownership (Xu & Wang, 1999). Till 1996, China's state enterprises were in a serious crisis in terms of their poor performance. The root of this crisis was their high agency cost. This high agency cost stemmed from collusion among state agencies (local official and state enterprise managers) and an obsolete managerial incentive scheme, which was a crucial factor that led to the inefficiency of state enterprises. A better managerial incentive scheme for state enterprises managers and less political intervention and informational asymmetry were encouraged to monitor state enterprises effectively (Mi & Wang, 2000).

By cross-country empirical analyses on 29 provinces, municipalities, and autonomous regions during 1978-1989, conclusions were drawn that private and semi-private enterprises contributed to China's economic growth; in contrast, China's state enterprises damaged growth (Chen & Feng, 2000). Reform of state enterprises in China was considered central to restructuring the construction industry. Lack of autonomy and unclear boundary of property rights contributed the poor performance, but reform measures to solve this inefficiency were not sufficiently bold (Sha & Lin, 2001).

It was also argued that China needed to privatize state enterprises for maintaining and accelerating economic development. In order to achieve successful privatization, transfers of technologies by the state were encouraged (Ding & Motwani, 2001). That China's state enterprises' environmental performance (pollution control performance) was worse than private enterprises and foreign enterprises was the conclusion of the survey of China's 1000 industrial enterprises of three provinces and based on enterprise-level information in 1999 (Wang & Jin, 2002). Through investigating a sample of state enterprises during 1980-1994, in terms of state enterprises' financing sources for fixed investment, it was found that bank finance was linked more to profitability than direct government transfers, since getting bank finance enabled state enterprise managers to take greater risks (Cull & Xu, 2003).

Through evaluating 634 listed state-owned enterprises' that were privatized during 1994-1998, conclusions were drawn that earning ability, real sales and workers' productivity were improved and state ownership negatively affected the performance of those enterprises while foreign ownership did not show significant impact on their performance (Sun & Tong, 2003). By examining the Chief Executive Officer (CEO) compensation of China's state enterprises during the 1980s, it was found that compensation was less sensitive to enterprise performance, but more sensitive to managerial return (Mengistae & Xu, 2004). In socialist and transition economies with serious informational asymmetry, policy burdens from the state would result in moral hazard for state enterprise managers and soft budget constraint problems, which led to state enterprises' low efficiency. The control power of state enterprise managers also resulted in the inefficiency of state enterprises (Lin & Li, 2004).

Along with profound ownership changes in China's state enterprises since 1979, management of state enterprises was also transformed from central planed into new forms, with variations across ownership forms and localities. But reform of state enterprises took time because of historical legacies, organizational inertia and continued government interference (Hassard, Morris, & Sheehan, 2004). Corporate financing choices and dividend distribution decisions were impacted by the extent of political interference, managerial entrenchment, and institutional control affects. This result from political costs approach suggested a better governance structure in China's state enterprise reform with less state involvements (Su, 2005).

Based on a sample of 5284 partially privatized state enterprises in China during 1991-2001 to examine if the firm value was affected by the ownership structure, state shares were negatively correlated with Tobin's Q (referred to as the firm value) as foreign shares were positively related to that Q (Wei, Xie, & Zhang, 2005). Among China's listed enterprises, different types of controlling shareholders had different uses of incentive pay. If the controlling shareholder was a state agency, performance related pay was not used. If the controlling shareholder was a private block holder or state enterprise, the CEO's pay was related to the increase in shareholders' wealth or increase in profitability. But the effectiveness of the incentive system was low since CEOs' pay-performance sensitivity was low (Firth, Fung, & Rui, 2006).

The panel data of 165 rural and urban enterprises of Nanjing city and its environs, privatization policies were adopted to weakest unban enterprises, and the private ownership contributed to the improvements in terms of productivity and profitability (Dong, Putterman, & Unel, 2006). With the state continuing to control China's state enterprises even after the privatization and listing in the stock market, it was found that economic efficiency and financial performance were not improved much (Chen, Firth, & Rui, 2006). The long-term managerial incentive problem and the management selection problem arose from the fact that managers of state enterprises were selected by bureaucrats rather than entrepreneurs. These built-in problems of state ownership cannot be solved by state-dominated corporatization but only by privatization (Zhang, 2006).

Chinese leadership gave top priority to building a "harmonious society" which implied reducing income and regional disparities. But they found that the faster the economic growth the greater the income disparities and the lower the possibility of achieving social justice by income redistribution. Hence greater economic efficiency could be realized by privatization but at the expense of social justice. Since governments controlled the key industrial sectors and maintained monopolies on sectors which were profitable, wealth flowed to the state and the people became poorer. Moreover, due to the state monopoly in these sectors, private sectors had to struggle even as it was asked to play an increasing role in China's economy (Zheng & Chen, 2007). When trying to find out if corporate ownership was related to enterprises' equity risk (measured as the volatility of enterprises' stock returns) and stock returns in China, results emerged that state ownership led to higher stock volatility and lower stock returns. State ownership increased agency conflicts because of diverse incentives of bureaucrats and state agencies in the process of maximizing the firm value (Zou & Adams, 2008).

Generally speaking, it was also found that state-owned banks in China were less cost-efficient and profit-efficient than joint-stock banks (Ariff & Can, 2008). Foreign banks were also found to be more efficient than the big-4 state-owned banks in China. Even the minority foreign ownership within big-4 state-owned banks in China had a significant positive effect on the performance in terms of efficiency (Berger, Hasan, & Zhou, 2009). The big-4 state-owned commercial banks had the worst performance in terms of profitability, efficiency and asset quality than private and foreign banks in China. However, foreign acquisition or public listing could be the positive factor to improve their performance (Lin & Zhang, 2009). A joint-stock structure was verified to be more profitable for Chinese bank compared to state ownership (Jiang, Yao, & Zhang, 2009).

Another study found that the privatization of China's state enterprises resulted in higher sales, labor productivity and profitability, the last because of decreases of the managerial expenses to sales. The impact of privatization was more sustainable when state ownership was reduced from majority to minority in an enterprise (Bai, Lu, & Tao, 2009). By examining how much a sample of 461 publicly listed manufacturing enterprises' corporate governance practices affected their productive efficiency during 1999-2002, conclusions were drawn that state ownership and state legal person negatively affected efficiency because of political interference. The greater the transfer of state ownership and control to private hands, the more efficiencies were achieved in corporate in China (Lin, Ma, & Su, 2009). As bank management of China was appointed by the government, with little managerial expertise and ineffective incentive schemes, it was hard for them to maximize the shareholders' interests. Diversification in loans, deposits, assets, and geography were associated with worse performance and lower efficiency. But foreign ownership could play a mitigating role in the diseconomies of diversification (Berger, Hasan, & Zhou, 2010).

When controlling shares were transferred from the state to private owners, the performance was improved significantly in a sample of 127 Chinese listed enterprises. This result suggested that the Chinese state should continue to reduce its controlling ownership to enhance operating efficiency and profitability (Huang & Wang, 2011). The central government's control also had negative significant influence on the performance of privatized state enterprises (Yang, 2012).

Li (2013) argued that the 4 trillion stimulus plan to combat the Global Financial Crisis accelerated the credit dilation of the banking sector and increased risks associated with NPLs. Under the Basel Accords III, the refinancing of banks was aimed at banks meeting the specified capital adequacy ratio. Because of lower interest margins, banks would exaggerate the size of their balance sheets to keep profits (Li, 2013). The corruption problem of state enterprises were gradually exposed during recent years, and to a certain extent, or for a specific area, it showed a high trend, and the problem is increasingly serious (Zhu, 2014). The government intervention through political incentives and the uncertainty of executive appointment damaged the performance of state enterprises. Abandoning the administrative selection system of the state enterprise executives was considered key to improving efficiency and speeding up compensation reform (Wang & Wei, 2014). State enterprise monopoly, on the other hand, had negatively impacted performance (Du, Tian, Zhang, & Li, 2014). Reducing the policy burdens of state enterprises with was a way to improve the performance. The measurement for the policy burdens was enterprise staff redundancy rate (Chen & Tang, 2014).

Findings, to be elaborated later, that do not support mainstream public enterprise theories studies that challenge the conventional arguments do so from several standpoints. One is that what to do with state enterprises was not a black-and-white case of privatization but depended on state enterprise performance itself. Another is based on the many non-economic objectives state enterprises had to achieve.

2.5 Conclusion: A Critique of Existing Literature

Theories related to public enterprises were reviewed. Western models have been extensively applied to China's state sector. These models, agency theory, property rights theory, public choice theory and neoliberalism, argued against state involvements in state enterprises. The role of the state in state enterprises was considered as inefficient. However, in China's case, we could not look only in this angle because of contextual differences between China and other states. Additionally, other theories relevant to Chinese state have been ignored.

Secondly, since reform has transformed these enterprises over time, any time series analysis that includes major reform changes would capture neither the situation before nor the situation after these changes. The relevance of such results can be called into question.

Thirdly, in reviewing the transitional process of China's state enterprises, it should first be noted that the state's control in state enterprises varies. From enterprise to enterprise, the nature of China's state enterprises transforms all the time. What needs to be researched is how to capture the latest changes. China's state enterprises represent a new complex ownership and governance form, requiring clarification of the extent of the state's involvement is. This means that cross-section studies capture not a homogenous group of enterprises but a large variety of enterprises in various states of transformation and with varying degrees of state ownership. How ownership power is exercised also varies from enterprise to enterprise. Like time series analyses, the generalizability of findings from these studies would thus be compromised. Further, given the limitations of both time series and cross sectional data applied to state enterprises in China, the use of panel data only compounds these limitations.

Fourthly, the Chinese state may have other objectives not highlighted in Western theories. The focus on efficiency and profitability obscures an important role of state enterprises to take on positive externalities, chief among them being the provision of a social safety net for workers. So the role of state enterprise in much of the current discussion is not complete. To be fair, the internalization of externalities is very much a part of mainstream economic theory of the role of government. It is this preoccupation with efficiency, perhaps abetted by neoliberalism, which is to blame.

The most important conclusion to emerge from this literature review is that given the complexity of China’s state enterprises, multi-firm or sectorial analysis, even if yielding important findings, must be complemented by in-depth studies of major enterprises, with the choice of enterprises made to cover different enterprise types. This brings us back to the challenging task of classification of state enterprises. Nevertheless, a good starting point is the official classification into three broad types – strategic/central enterprises wholly owned by the state, state-holding enterprises in which the government is the majority or largest single shareholder, and state joint-stock enterprises which the state exercises no control. This is the approach adopted in this study.

CHAPTER 3 METHODOLOGY

3.1 Introduction

In Chapter 2, four mainstream theories applicable to public enterprises – agency theory, property rights theory, public choice theory and neoliberalism were reviewed, which could be theoretical pillars for this research to examine China's state enterprises. Besides these four mainstream theories, another four alternative theories could also be considered to explain the role of China's state enterprises as vital institutions of the Chinese state. These were economic embeddedness, market socialism, developmental state, and the history of the Chinese state. Indicators like control modes of the state, roles and performance of state enterprises in the economy, also discussed in Chapter 2, could be used to measure the performance of China's state enterprises. The conceptual framework for this research would be built up from these discussions. Based on this conceptual framework, three analytical chapters flesh out the main aspects of the nature of Chinese state and China's state enterprises. This chapter sets out the theoretical framework, the research methodology and the data used to support arguments in these three analytical chapters.

The next section lays out the theoretical framework for this research. This is the basis for the conceptual framework in section 3.3. Section 3.4 presented the design for the whole research. Section 3.5 describes the qualitative methods chosen and the rationale for their use, together with specific examples to show how their use is appropriate.

3.2 Theoretical Framework

The starting point for developing the theoretical framework is the set of four theories applicable to public enterprise outlined above and the main conclusions they arrived at. This framework is shown in Figure 3.1. As already discussed, agency theory postulated that there would be interest conflicts between the principal and the agent if their interests diverged (Bebchuk & Fried, 2004). Property rights theory implied that the more direct and strengthened were the rights to the property, the better its assets would be used (Alchian & Demsetz, 1973). Public choice theory then argued that when politicians and government officials represented the state to manage public resources, they would give priority to their own interests instead of public interests that state enterprises were to cater to (Tullock, 1987). Finally, neoliberalism emphasizes the efficiency of private enterprises since private sectors face competition and open markets both of which lead to efficiency.

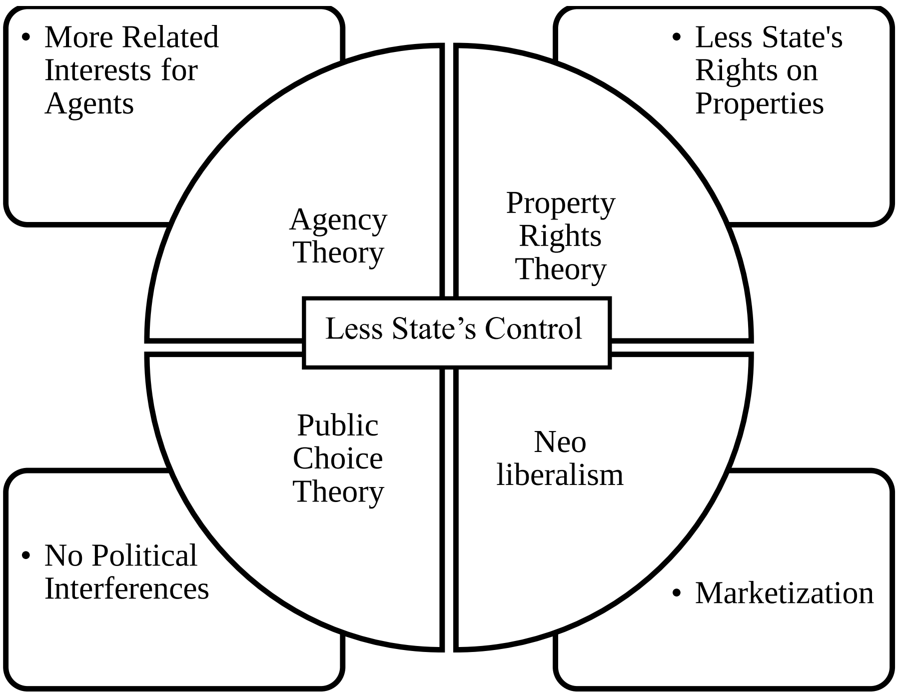

Figure 3.1: Theoretical Framework: Four Public Enterprise Theories

The above four economic theories suggested privatization of state enterprises as the appropriate strategy in the economic development of a nation. Figure 3.1 showed that if privatization was adopted by the state enterprise according to above theories, the enterprise would be much more efficient. Thus, mainstream theories combine to argue for decreased state involvement in order to realize better enterprise performance.

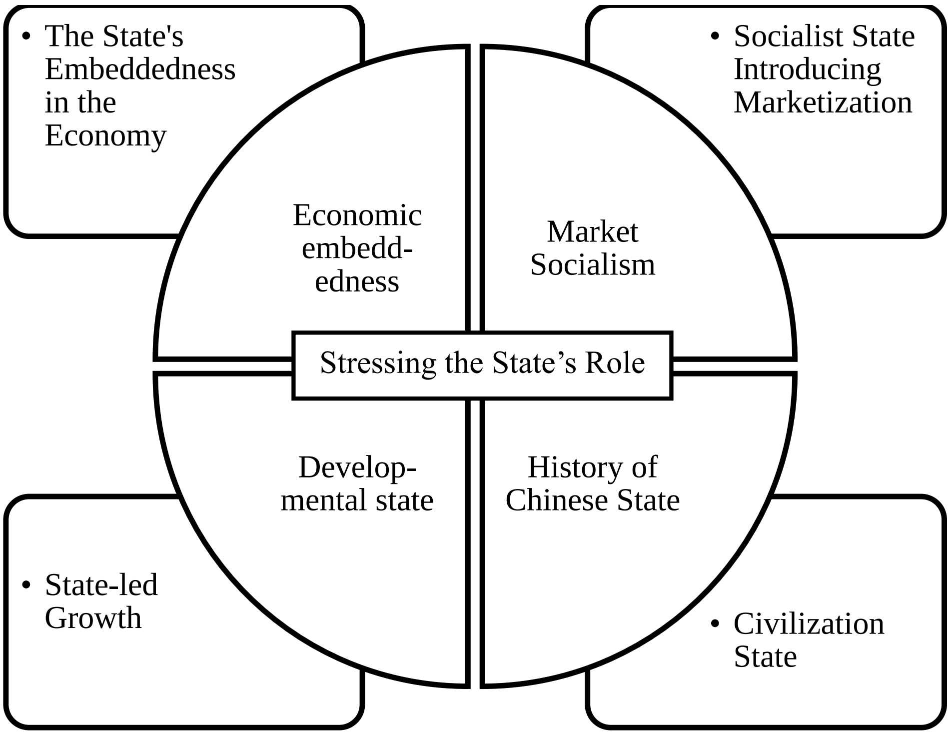

Figure 3.2: Theoretical Framework: Four Relevance of Theories to Chinese State

However, the four preceding theories have limited applicability to China, which has lived under a social and political system quite unlike the modern (Western) notion of a nation state against which these theories had been framed. Other Western theories also have partial relevance for China's state enterprises. As already discussed, one is related to the concept of "economic embeddedness" in which it is argued that human economy was always embedded in society (Granovetter, 1985). The term "embeddedness" expresses the idea that the economy was not autonomous as it was assumed in economic theory, but subordinated to politics, religion, and social relations. Another is market socialism. Features of the developmental state also apply to China, as does Lange's market socialism, although it comes "with Chinese characteristics".

Scholars, especially historians, have argued that China, while adapting to new circumstances, always looks back to its own history in seeking solutions to problems and challenges. As an example, Wang (2014) described how the May 4th Movement of 1919 became a reference point for subsequent movements and reforms (Wang, 2014). Thus, as described earlier, recognizing China's context is vital to any understanding China's institutions and policies.

Like the four theories before them, the above four theories of the Chinese state stress the importance of the role of the state and argues for the preservation of that role. Clearly, the Chinese assumption is diametrically opposed to that of mainstream Western theories considered applicable to public enterprises.

3.3 Conceptual Framework

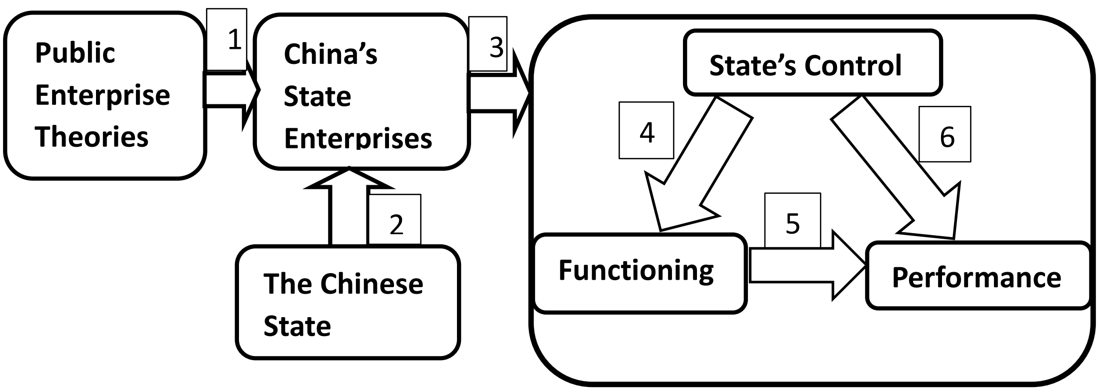

Figure 3.3: Conceptual Framework

These theories are brought together in the conceptual framework for this study. The latter is shown graphically in Figure 3.3. Based on this conceptual framework, this research is developed in the following sequence:

1. A critical review is undertaken of prevailing theories relating to the role of the state and its enterprises in the Chinese context (already undertaken);

2. An alternative set of theories that recognizes a more positive role of the state is postulated that, while not totally relevant, can provide a better assessment of the role of the Chinese state (already undertaken);

3. The modified framework is applied to state enterprises to examine the nature of Chinese state and state enterprises. Initially, by examining the ownership structure and governance

mechanism, this study could find out what the state's role in state enterprises is and how the state exercises this control after state enterprise reform. Three dimensions of the role of these enterprises are analyzed next.

4. For strategic state enterprises, the functioning of state enterprises would be interpreted to inspect the state's dominating role in the state-led growth strategy adopted by China;

5. In addition to supporting the state, state enterprise reform has also incorporated the profit motive. To what extent can these objectives be reconciled is an important area of enquiry;

6. For state enterprises competing in the market, it is interesting to see how the state's control affects their performance;

3.4 Analytical Framework

The three dimensions above are the substance of three analytical chapters (Figure 3.4). Initially, this research would assess the nature of Chinese state and its enterprises through a country-level analysis. Understanding China's state enterprises should be based on analyzing the Chinese state in historical context. And then indicators like ownership, governance and performance would be used to characterize China's state enterprises. Performance measurements included profitability, competition and innovation. Then this research would correlate state enterprises with both economic growth and social welfare. The first analytical chapter would provide a general framework for a more detailed examination of major types of state enterprises.

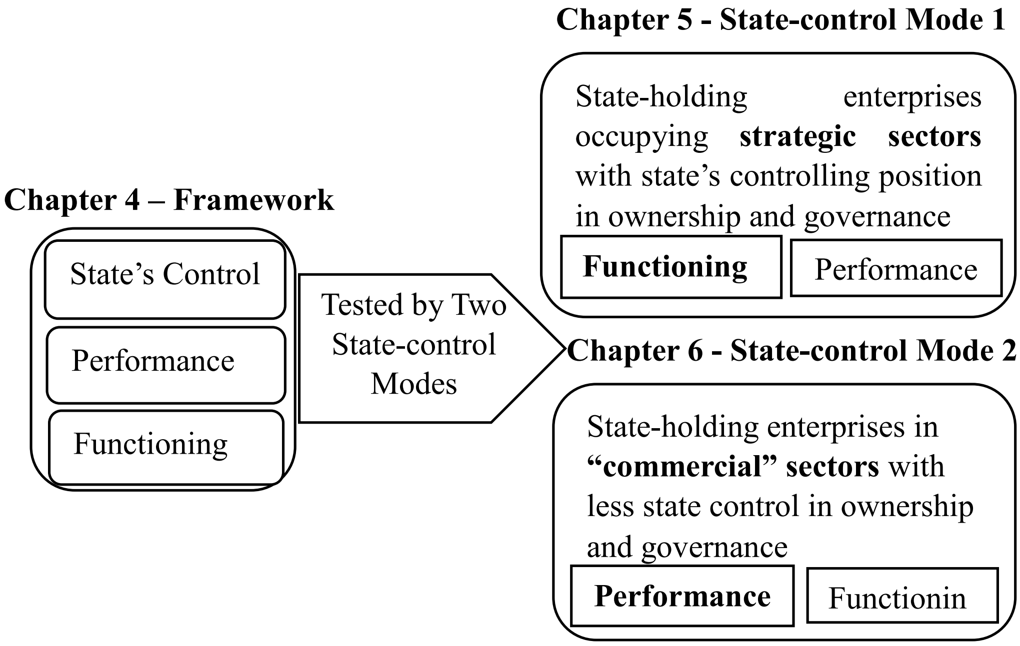

Figure 3.4: Analytical Framework

Then this study would fit this framework into two different state-control modes. The first one referred to state-holding enterprises occupying strategic sectors. Those state enterprises are referred to as strategic state enterprises. In strategic industries like financial, mining, steel, telecommunications, transportation, utilities, oil, and military-related production which were crucial to country's safety and the lifeline of national economy, the state should be in a controlling position. The banking sector is chosen as representing these enterprises since it is always crucial to the national economy. Lessons of history for Chinese state will be drawn by looking back to the history of Chinese state and China's banking sector to identify the prime directives for the Chinese state. After the banking sector was restructured by state enterprise reform, the controlling role of the state was undiminished. The prices they charged were determined primarily by the state. But state control did not extend to day-to-day operations. What motivated this retention of ownership and at what cost to the state?

The second example was of a state-holding enterprise with reduced state ownership as a result of state enterprise reform, but without commensurate diminution of state control.

This control ensured that the state strategies were followed. But this control did not extended to day-to-day operations since corporate management had been left in professional managers' hands. And the state offered preferential benefits or those state enterprises for their technology development and private enterprises also enjoyed the same treatment. Under this state-control mode, their performance and functions for the state would be examined.

3.5 Specific Methodology

This study uses four qualitative methods: the historical narrative and case study as two main methods with ethnography and phenomenology as the other two supporting methods. It uses secondary data analysis to support the four qualitative methods.

3.5.1 Why Qualitative Paradigm?

By reviewing empirical studies that assess China's state enterprises' ownership, governance, performances and roles since the beginning of state enterprise reform, it was found that the main methodologies applied were quantitative. Researchers usually used a sample of state enterprises within a specific period or in specific areas to run regressions to estimate the relationships among variables. But since China's state enterprises were transformed all the time under state enterprise reform, the condition facing these enterprises was not static. As a result, conclusions reached were of little use for generalization. Another feature of China's state enterprise reform over the years is that every state enterprise was transformed at its own pace, which means that they could not be neatly put into groups. Throughout the reform, the state ensured that its strategies are followed, but how much or to what extent the state enterprise has been transformed through alternative methods the state enterprise chose, was hard for the state to control effectively. In addition, state ownership in a state enterprise has also become very hard to measure. Thus, while most state enterprises are joint-stock entities, the ownership forms are diverse and complex and also the state usually owns a state enterprise indirectly and through many hierarchies.

Due to the complexity of China's state enterprises and the environment under China's economic framework, those empirical studies could not claim comprehensiveness of coverage. Given those challenges, the qualitative research approach makes for a better understanding of the complex rationale, through identification, description and interpretation. It also focused on the identification of inconsistencies.

Qualitative research is the study of the empirical world from the viewpoint of the person under study. It has two underlying principles. The first is that behavior is influenced by the physical, socio-cultural, and psychological environment – this is the basis for naturalistic inquiry. The second principle is that behavior goes beyond what is observed by the investigator. Subjective meanings and perceptions of the subject are critical in qualitative research, and it is the researcher's responsibility to access these (Schmid, 1981). Kirk and Miller (1988) suggested a working definition of qualitative research that reflects these two principles. They defined it as "a particular tradition in social science that fundamentally depends on watching people in their own territory and interacting with them in their own language, on their own terms" (Kirk & Miller, 1988). Qualitative research encompasses many methods and approaches. The next section discuss four of these and explain why and how these are applied in this study.

3.5.2 Historical Narrative

Historical research has been defined as the systematic and objective location, evaluation and synthesis of evidence in order to establish facts and draw conclusions about the traces that past events left behind (Gardner, 2006). In historical research, the investigator studies documents and other sources that contain facts concerning the research theme with the objective of achieving better understanding of present policies, practices, problems and institutions. Historical studies attempt to provide information and understanding of past historical, legal and policy events (Howell & Prevenier, 2001). The objective of historical research is to find out solutions to current problems which have their roots in the past, to use the past to predict the future or to test theories and hypotheses about the past. Its characteristics are not just a compilation of facts but involves explanation, interpretation of, and nuances, persons, ideas influencing events; data collection and analysis with multiple foci – events, changes, concepts, people, institution (Garraghan, 1946; Shafer & Bennett, 1969).

The historical approach has particular relevance for China. The Chinese have always relied on learning from the past; to them, the past has never been a foreign country. Thus Chinese leaders and their advisers today are not only looking at the globalizing world outside but also inwards to the Chinese past for ideas to help them think about the future (Wang, 2014). So referring to Chinese history provides lessons for the Chinese state of today. China cannot blindly copy what other countries have done but has to refer to its history to make decision.

This method for achieving better understanding of present policies, practices, problems and institutions by past events is adopted in Chapter 4 to talk about the history of Chinese state and in Chapter 5 to speak of the history of China's banking sector. Through describing the history of the Chinese state, one section of Chapter 4 stresses that the Chinese state is shaped decisively by the flow of its internal history, but not the currently prevalent nation state and state concept is very strong. In Chapter 5, the description of the history of China's banking sector is used to explain how the previous governments had tried to keep control of this crucial sector and why the state's role is regarded as important since Qing Dynasty.

3.5.3 Case Study

Case study is a research method to do descriptive, exploratory or explanatory analysis of a person, group or event. Causation is explored to find underlying principles for an explanatory case study. The case can be chosen from historical records or as it becomes available, that is, case studies could be retrospective or prospective (Jon & Greene, 2003; Yin, 2009). This method focuses on analyzing persons, events, decisions, periods, projects, policies, institutions, or other systems. The subject of the inquiry of the case provides the objective of the study (Thomas, 2011). The case study method is most appropriate in situations where it is impossible to separate the phenomenon from its context, in other words, it studies complex phenomena within their contexts. Case study is a valuable method for researchers to develop theory, evaluate programs, and develop interventions (Baxter & Jack, 2008). The method includes single and multiple case studies, and multiple sources of evidence also can includes quantitative ones. Case study research can be based on prior development of theoretical propositions (Siegfried, 2005).

In the context of this research, determining the extent of state ownership is important for understanding the role of the state in China's state enterprises. However, as already indicated, the state's ownership was also hard to grasp since the ownership forms were diverse. In terms of the state's control over a state enterprise, it is even harder to capture. The control methods included intervention in day-to-day operations, presence on the board of directors, preferential treatments and so on. Due to such diversity, doubts existed as to whether comprehensive analysis is possible. Thus, to do deep analysis, it would be better to examine the above questions through the lens of specific cases.

This method for understanding complex issues will be adopted in Chapter 5 to use the Bank of China (BOC) as a brief case study and Chapter 6 to use ZTE Corporation in an era of reform as a single case to do in-depth investigation. In Chapter 5, a case study of the BOC was undertaken to see how the Chinese government has tried to improve the efficiency of the banking sector while at the same time ensuring that it follows and supports the government's strategies/policies. This case is embedded in the historical approach described earlier, and illustrates the complementary application of both main approaches.

Also, in Chapter 6, this study would use a case – ZTE Corporation – to verify the success of one of the state-control mode. ZTE Corporation has been transformed by China's state enterprise reform. This chapter shows how ZTE Corporation followed the state's strategies to restructure and what alternative reform measures it adopted. Its ownership structure was complex while state ownership was decreasing to an unobvious level.

3.5.4 Ethnography

The research method ethnography is designed to explore the cultural phenomena stemming from the researcher's observation of the society from the point of view of the subject of the study. It writes about the culture of a group (Hobbs, 2006; Sanjek, 1996). The results of a case represent the system of meanings in the lives of a cultural group (Geertz, 1973, 1994; Philipsen, 1992). As the empirical data is from human societies and cultures, ethnography is popular in the social science when people explore particular ethnic groups. A comprehensive ethnography study includes the history, the terrain, the climate and the habitat, and contributes to the understanding of humans' social life and records all observed behavior (Ember & Ember, 1977; Heider, 1997). Data collection is to grasp the social meanings and ordinary activities of people in naturally occurring settings (Brewer, 2000).

This study also uses ethnography as a support research method because of its belief in the importance of culture in shaping Chinese institutions, beliefs and behavior. This method will be reflected in Chapter 4 by the history of Chinese state, stressing the role played by

Confucianism. Confucianism can be dated back over two millennia and it is the abiding cultural-political ideology for the entire history of imperial China as the basis of the view of the state. Despite the official repudiation of Confucianism by the leadership led by Mao Zedong in the earlier years of the People's Republic, a value system heavily influenced by Confucianism remains intact while the philosophy itself has reemerged to be endorsed by the leadership, with the establishment of Confucius Institutes worldwide the most obvious manifestations of this endorsement (Paradise, 2009).

3.5.5 Phenomenology

Phenomenology investigates the phenomenon which people experience or think about (Marton, 1986). Phenomenology illuminates and identifies phenomena through how they are perceived by the actors in a situation. It gathers deep information and perceptions by inductive, qualitative channel like interviews, discussions and participant observation, and representing it from the research participants. It is based on personal knowledge and subjectivity and stresses the personal perspective and interpretation (Lester, 1999).

This study will used this method as a supporting method to use specific events. This would be reflected in Chapter 5 by stressing the role and performance of China's banking sector in China's joining WTO and during and after the GFC.

3.5.6 Data Sources

These qualitative research methods are supported by secondary data analysis. Data sources include primary data and secondary data. Primary data came from in-depth interviews through open-ended discussions with government officials, and state enterprise's key persons. This study uses data from interviews with selected state enterprises' key persons which formed the basis of case studies. Secondary data consist of online databases such as China Statistical Yearbook and CEIC Database, existing literature, and annual reports of selected state enterprises, historical facts, and event analysis. Especially for listed state enterprises, information was abundant in their official websites. Such information included shareholder structure, assets, and profits. Disaggregate data sources for Chapter 4, 5, 6 are as follows.

In Chapter 4, an overall analysis would be developed based on evidences from existing literature on the Chinese state and China's state enterprises, as well as online databases. Data like selected statistics of Chinese industrial state enterprises during 2000-2009 from China Statistical Yearbook and selected macroeconomic indicators of China's economic growth and income distribution during 1980-2009 from World Bank database would be looked at.

In Chapter 5, the data sources are online sources and existing literature, like Statistics of China Banking Regulatory Commission and Statistics and Analysis Department, the PBC. This chapter analyzes the ownership structure of China's big-5 banks today by looking their latest annual reports to find out how much is each bank's state ownership. This chapter also uses the banks' annual reports and information from interviews and discussions with individuals knowledgeable about those banks.

In Chapter 6, the main data sources are interviews with key persons in ZTE Corporation and government officials. The data on tradable and non-tradable shares in China's share markets during 2004-2012 are from the CSRC. Data on ownership structure, change in state ownership of ZTE Corporation during 1998-2012, and financial performance during 2001-2012 were from annual reports of ZTE Corporation. Data for the global top five Patent Cooperation Treaty (PCT) applicants and the number of international applications during 2008-2012 are from PCT Newsletter by World Intellectual Property Organization (WIPO).

CHAPTER 4 CHINA'S STATE ENTERPRISES, ECONOMIC GROWTH AND DISTRIBUTION

4.1 Introduction

China's arrival at centre stage has made it the focus of attention among Western and Western-trained commentators in general and economists in particular. As China's impressive economic advance has been achieved under a political system and via strategies that are both antithetical to dominant Western thinking, this attention has at times been hostile.[7]

The sustainability of China's existing political order and the economic model it has deployed are the two themes that run through the discourse on China. Pei (2006)'s observation on the first theme is representative:

> *"Beijing's brand of authoritarian politics is spawning a dangerous mix of crony capitalism, rampant corruption, and widening inequality ... if current trends continue, China's political system is more likely to experience decay than democracy ... the very policies that the party adopted to generate high economic growth are compounding the political and social ills that threaten its long-term survival" (Pei, 2006b).*

The premise of statements of this genre therefore is that China does not embrace democracy, specifically Western-style democracy, and liberal market economics. The first theme then begets the second – which an authoritarian regime is incompatible with a true market economy. Thus, Chang (2010) notes:

> *"A true market economy, for example, requires the rule of law, which in turn requires "institutional curbs" on government. Because these two limitations on power are incompatible with the Party's ambitions to continue to dominate society China cannot make much progress toward them, at least as long as the Communist Party is around" (Chang, 2010).*

[7] Two examples from credible sources suffice to prove the claim. John Mickleth wait opined that "the country's rulers are acutely aware that their government does not serve ordinary Chinese well". This judgement was based on a single person's view, and the article was not even entirely about China (The Economist, 2011). Arthur Kroebar (2012), in explaining China's continued resilience to the global finance crisis, ended his article with the account of China's "second-rate society" being built upon inequality, and this is ironic considering the revelations about what unfettered capitalism had produced in 21st-century United States (Kroeber, 2012).

Only liberal democracy, expressed in political and economic terms, has a future; efforts to graft Western institutions onto an authoritarian structure will also not succeed.[8]

The Chinese model not only defies this prescription but goes beyond mixing political authoritarianism with market economics. It espouses state-led growth. State enterprises are central to this strategy. However, many commentators argue that China's state enterprise sector is a drag on the economy and needs to be reformed through privatisation or liquidation (Kwan, 2010; Lal, 2006), and that these enterprises would not have survived had it not been for the government's role in tilting the playing field in their favour.

This chapter presents an alternative view of Chinese state enterprises, arguing that these enterprises are part and parcel of the role of the state that has been historically at variance with that of most other nation states. It delves deeper into the discussion beyond the arena of economics that economic studies of the Chinese state and its enterprises largely neglect. Direct application of Western theories relating to state enterprises with their built-in assumptions is therefore a flawed approach.

Lacking a national data set and limited sector-wide statistics, this chapter bases its analysis on empirical work undertaken by numerous researchers. The discussion is therefore anecdotal and subjected to the same limitations this body of work is saddled with. Since empirical research deals with specific aspects or particular geographic areas, any macroeconomic implications drawn are necessarily tentative.

In the next section, the Chinese state is placed in its historical context as a basis for a more balanced assessment of its state enterprises. The section 4.3 reviews the role of state enterprises within the framework of the Chinese state. The 4.4 and 4.5 sections examine, at the sectoral and macroeconomic levels, the possible links between the state enterprise

[8] In referring to China's "trapped transition", Pei (2006) goes further to question the Chinese leadership's motives for reform, noting that "the ruling elites have little interest in real reforms. They may pledge reforms, but most such pledges are lip service or tactical adjustments aimed at maintaining the status quo" (Pei, 2006a).

sector and China's economic growth and income/wealth distribution, followed by the conclusion in the section 4.6.

4.2 Understanding State Enterprises – The Chinese State in Historical Context

In economic terms, the dominant Western view of the role of the state is that of an internaliser of externalities and a provider of public goods. In support of this view, a range of theories – public choice, agency, organisation and property rights – also seek to explain the differences between state and private enterprise performance. Their conclusion, that private enterprises perform better than state enterprises, speaks of the importance of ownership, and is premised upon the clear distinction between state and private sector activity, or, more broadly, between state and civil society.

Since state enterprises are institutions of the state, their role depends on the larger role of the state. There is now increasing recognition that the latter role is at variance with the role of the state envisaged by Western economists for at least two reasons, both of which have historical and cultural roots (Hsiung, 2012; Jacques, 2009; Zhang, 2012). First, the modern Chinese state has been largely shaped by its long history rather than by principles that under-pin the prevailing nation states, the history of which is much more recent. Despite transitions from millennia of imperial rule through republicanism, Leninism and to "market socialism" today, the Chinese state has endured being "shaped decisively by the flow of its internal history"(Hsiung, 2012; Kuhn, 2002) rather than by external models of governance, which were, however, eventually absorbed by the indigenously developed Chinese state.

Regardless of the influences that impact the Chinese state, continuity and perpetuation are ensured by its enduring missions, which, as stated by Jacques (2011) (Jacques, 2011) and Shambaugh (2000) (Shambaugh, 2000), are in defence of the realm and guardianship of its civilisation and its people, including economic modernisation and social transformation. The second mission in the guardianship of its civilisation gives China's its distinctiveness – in the state lies the entire civilisation, leading Jacques to call it a civilisation state which is distinct from a nation-state.[9]

The dominant role of the state in China is not hard to understand from a historical perspective. For thousands of years, China was under imperial rule, it being accepted by Chinese society that the emperor as the Son of Heaven and the father of the people has absolute authority to rule under the Mandate of Heaven. This Mandate was derived not from laws or rules but from moral authority. This authority was further embedded by the state's and society's embrace of Confucianism. Confucian philosophy held that there existed a natural order in the universe and that this order should be reflected in human relations, including that between the emperor and his subjects.

This moral authority was exercised through officials, referred to as "*fu mu guan*" (parental officials). The state played its role by engaging in public works that enhanced or guaranteed the welfare of subjects, the Great Wall of China and the Grand Canal being outstanding examples (Parker, 1908). An even better example is the state's role in taming the Yellow River over the last four millennia. This river, seen as the cradle of Chinese civilization, has been both a source of sustenance but also of immense destruction. Connell (2013) noted:

> *"The productivity made possible by the Yellow River has provided the economic surpluses that have supported brilliant civilizations in the region since the second millennium BCE, but its periodic breakouts and changes in direction as it threads across more than five thousand kilometers of western and northern China have caused some of the worst disasters in recorded history" (Connell, 2013).*

Modern Chinese history is also conducive to the growth of a strong state. Zhou (2010) argues that there was a need for a strong state in post-Qing dynasty China as the country

[9] This term is used also by Hsiung (2012) (Hsiung, 2012). Zhang Weiwei (2012) calls China a civilisational state with "its own intrinsic logic of evolution and development" (Zhang, 2012).

attempted to maintain social stability and modernise rapidly, following the example of Japan's *Meiji* era (Zhou, 2010). An alternative explanation for China's current brand of market socialism being a variant of modern capitalism focuses on the country's recent history as it makes the transition from a command economy (Gabriele & Schettino, 2012). Gabriele, a proponent of this explication, argues that China's recent history makes for an important state role. Although rife with faults, China's market socialism may evolve into a more sophisticated form with no diminution in the size of the state. Thus, history has produced a role for the Chinese state that goes well beyond the mandate of the nation state, which is legalistic and political. This is well recognised by Western historians and political scientists, if not by economists (Kuhn, 2002; Shambaugh, 2000; Wong, 1997).

Second, the concept of state and civil society as being mutually exclusive – regarded largely as the norm of Western societies – has also been challenged by some scholars for being inapplicable to China (Huang, 2008; Wakeman, 1993). These scholars view the relationship between the state and civil society in China as non-mutually exclusive – that is, the state, albeit a large discrete part of it, is very much a part of society and works closely rather than in competition with the civil society. Thus, the debate about the appropriate size of the government is immaterial for China.

Historians have recognised that Confucianism, which dates back over two millennia and was the abiding cultural-political ideology for the entire history of imperial China, forms the basis of the Chinese view of the state. The resilience of Confucianism is demonstrated by the fact that it is experiencing a revival under the current regime. According to Confucius, the state is rooted in the Chinese civilisation and constitutes the highest hierarchy in the social order, below which are the family and the individual.[10] Li (1997) argues that the values of a hierarchical paternalistic system are not necessarily compatible

[10] "Yu zhi qi guo zhe, xian qi qi jia" *(欲治其国者，先齐其家)* (To rightly govern the state, it is necessary first to regulate one's own family) (Dawson, 2005).

with the Western notions of democracy, which stress the exercise of personal rights (Li, 1997). Instead of equal rights entitlement as protection for the weak, Confucianism relies on "*ren" (仁)*, an attribute loosely translated as benevolence, imposing limitations on the stronger ones. Thus, this explains why liberal democracy as understood in the West is alien to China for much of its history. While this is also true even for many Western European countries, the dominance of Confucianism as the accepted code of conduct in China's society throughout its history sets the country apart from other countries. The "*ke ju" (科举)* system of examinations is based on Confucian principles for professional advancement in government service, and the state was the primary source of employment and career progression, thereby ensuring the state's pre-eminence in Chinese society.[11]

The dominance of Confucianism in Chinese politics and society notwithstanding, it is not the only philosophy that was important in China's history. Legalism (*Fa jia* (法家)), which gained preeminence during the time of *Shi Huangdi* and also during later parts of Chinese history, was, in its emphasis on rules and institutions rather than relationships, antithetical to Confucianism (Zhou, 2011). Yet not only did it not challenge imperial rule, it advocated absolute power for the ruler and was associated with harsh, authoritarian rule by the state (Fu, 1996). In addition, it is materially different from Western concepts of the rule of law in that its argument advocating the observance of law is to ensure fidelity to the monarch (He, 2011). It is thus true that the objective of fidelity to the monarch and hence the state remained preeminent in Chinese society.

Those who know of an existence of a Western style civil society in China acknowledged that Chinese civil society is either different from that in the West, or that it is small in presence. Thus, Goldman (2000) noted that diverse views and activities that sought to

[11] James Hsiung (2012) noted that "the state, as the certifying agent of social mobility, in what became a 'one-career society', invariably became larger than society itself (Hsiung, 2012)."

influence state decision-making in early 20th-century China were shaped chiefly by "Chinese collectivist views" than by individual rights. "Political rights," Goldman (2000) added, "were seen, as they are today in China, not as individual or group claims against the state so much as a limited arena of legitimate interests within the state (Goldman, 2000)." In the same year Goldman's article was published, Zhou (2000) wrote that Chinese society was both fragmented and restricted by the Chinese state, consumed by the need to maintain social stability while undertaking rapid modernisation (Zhou, 2000).

This characterisation of the Chinese state has three implications, all of which are significant to the discussion of its role and institutions. First, the assimilation of new concepts of state governance should not necessarily be seen as a wholesale embrace of these concepts but as responses needed to fulfil its missions in a world in which these concepts have gained ascendancy. This means that the belief that China's future depends on its convergence to Western norms of state and governance is misplaced. As Huang (2008) noted, "China's present cannot be, and China's future should not be, equated simply with the modern Western path of capitalism, liberal democracy, and the nation-state (Huang, 2008)." Second, China's missions for its state go well beyond the mandate of the Western nation state, and hence define a far larger role. From a historical perspective, the Chinese model of state-led growth, also referred to as state capitalism, is therefore not surprising. Finally, the nature and attitude of Chinese society are such that the distinction between the Chinese state and its civil society is nowhere as sharp as Western theories of public enterprise assume it to be.

4.3 Characterising China's State Enterprises: Ownership, Control and Performance

As key institutions of the Chinese state, state enterprises are central to the discussion of their role in it. Although there has been a decline in the state enterprises' contribution in terms of China's number of enterprises, industrial output and exports, they remain as major players in the economy. Table 4.1 reports statistics of industrial state enterprises that are wholly owned and majority-owned by the government. These figures understate the government's corporate ownership in this sector because enterprises in which the government is a minority shareholder are excluded. Worth noting is the fact that while the number of state enterprises in 2009 was reduced to just under one-eighth of that in 2000, their share in output and employment has only been halved and fallen to two-fifths respectively, suggesting that these enterprises have become larger over time. Data from the second national economic census, conducted in 2008, confirmed this development. State enterprises in the industrial and service sectors held RMB 63 trillion out of RMB 208 trillion, or 30 per cent of total assets, which translate to about 13.4 times the size of non-state enterprises in terms of average assets.[12] The decline in the proportion of wholly owned state enterprises is less than that of majority-owned enterprises.

Table 4.1: Selected Statistics of Chinese Industrial State Enterprises (2000-2009)[13]

Year	No. of State Enterprises as % of All Enterprises	State Enterprise Output as % of Total Output	State Enterprise Employment as % of Total Employment
2000	32.8	47.3	53.9
2001	27.3	44.4	49.2
2002	22.6	40.8	43.9
2003	17.5	37.5	37.6
2004	12.9 (2.0)[14]	35.2 (15.3)	29.8 (13.7)
2005	10.1	33.3	27.2
2006	8.3 (5.3)	31.2 (14.9)	24.5 (15.1)
2007	6.1 (3.4)	29.5 (13.7)	22.1 (12.9)
2008	5.0 (2.6)	28.4 (13.1)	20.3 (11.4)
2009	4.7 (2.5)	26.7 (12.5)	20.4 (11.1)

Source: China Statistical Yearbook, various years.

[12] The census enumerated 154,000 state enterprises that are wholly or majority owned by the government, representing only 3.1 per cent of the total number of enterprises in the industrial and service sector (Gao, 2010). The appearance of China's state enterprises in the Fortune 500 list of companies is another indicator of the enterprise size. In 2011, China had 61 companies in this list, compared to 19 in 2005. The Sinopec Group is ranked fifth (23rd in 2005), China National Petroleum sixth (39th) and State Grid seventh (32nd) (Fortune Online, 2011).
[13] Includes state enterprises which are wholly or majority-owned by the government only. Enterprises in which the government has minority ownership are excluded.
[14] Includes state enterprises wholly owned by government only.

The rich historical discourse on China's state and state-civil society relations seems to have completely evaded the economic debate on Chinese state enterprises. Thus, viewed through the Western economic lens, Chinese state enterprises have been characterised as "technologically inefficient", "moribund" or "very poor relative to the non-state sector", which are stereotyped traits of weaknesses of Western state enter-prises (Broadman, 1999; Mai & Perkins, 1997). The state enterprises are therefore blamed for increasing economic vulnerability, damaging the private sector and retarding the country's long-term economic growth. As for the commentary on the state, the debate over state enterprises is framed in terms of private versus government ownership, with privatisation the ultimate goal in reform.[15] The question about whether these judgements on the Chinese state enterprises hold true for the Chinese state hinges on addressing two related questions. First, which are the Chinese state enterprises and in what ways are they similar to the generic state enterprises in Western public economics? Second, how has the state enterprise sector performed in fulfilling its mandated functions since the economic transition in 1978? This section will focus on the discussion of the first question. The subsequent sections will deal with the second question. There is no shortage of literature on China's state enterprises, but characterising today's enterprises is challenging because to distinguish between public and private enterprises using a set of generic attributes – the most evident of which are ownership, control and performance – becomes problematic in the case of China. Ownership is the first defining attribute that differentiates state enterprises from private enterprises. Control is the second attribute related to institutional capability and governance. The third attribute, performance, arises from several theories about state enterprises that distinguish them from private enterprises.

[15] This state-private dichotomy is encapsulated in catchwords such as "China state enterprises advance, private sector retreats" (Chovanec, 2010).

4.3.1 Ownership

This attribute that defines state enterprises however presents problems. First, in common with other countries, though China defines state enterprise by ownership (full and majority), decentralisation and interlocking holdings often make it difficult to tell which part of the state – the central, provincial or local – is the owner. Further, due to numerous reform experiments, state ownership of enterprises ranges from 100 per cent (for strategic enterprises) to minority shareholding, is differentiated according to administrations (central, provincial and local governments) and also includes quasi-state entities whose ownership is ambiguous (Hu, 2005; Scissors, 2011).[16] There are overlaps too in central enterprises (*Yangqi*), which currently number at 129 enterprise conglomerates and are controlled by the central government, including both strategic enterprises and those in which the government holds more than 50 per cent of the stocks. At the same time, non-state enterprises are not entirely private sector enterprises because township and village enterprises that are collectives are also included.

4.3.2 Control and Governance

Ownership ambiguities have prompted attempts to distinguish enterprises by their exercise of control (Chen, et al., 2006). In this regard, the appointment of CEOs of state enterprises by the government reflects the latter's control of these enterprises (Fan, Wong, & Zhang, 2007). This, as has been argued, is inimical to performance of state enterprises. However, much has changed in the state enterprise sector. Since the formation of the SASAC in 2003, CEO appointments for the central enterprises were conducted by SASAC mainly from within the ranks of these enterprises (State-owned Assets Supervision and Administration Commission, 2008). For state enterprises in general, a

[16] Marshall Meyer argued this was the case with Haier (Knowledge@Wharton, 2001).

growing body of literature also points to such appointments being made on commercial rather than political grounds (Knowledge@SMU, 2012; Li, 2005).

Nevertheless, appointment of the top management level matters much less than governance. To the extent that exceptions to the state enterprise stereotype abound among China's enterprises, the nature of governance cannot be easily categorised. Guthrie and Wang (2007), in reviewing various enterprise structures, concluded that many state enterprises are managed and run like private firms (Guthrie & Wang, 2007). In terms of reward for performance, state enterprises that are listed on international stock exchanges compete for talent and link executive compensation to corporate performance like any other private enterprise. Some state enterprises have attracted foreign investors and hence have multinational representation on their boards. The level of compensation is now sufficiently high to attract top managers and executives from the private sector.[17] Listing on the international stock exchanges like Hong Kong and New York, which bring in private and foreign investors, clearly also subjects these enterprises to market discipline, as well as improved corporate governance and some degree of shareholder influence. China also embarks on an international talent hunt for high-calibre executives, including foreigners and Chinese *émigrés*, for its leading state enterprises to ensure they achieve international competitiveness. Thus, state enterprises pit against the domestic private sector and even multinational enterprises in the talent hunt. By offering attractive employment terms, state enterprises have an edge in recruiting talent. Evidence has also shown that the global managerial labour market is a strong determinant of compensation of state enterprise CEOs (Li, Moshirian, Nguyen, & Tan, 2007).

[17] A recent research report by Jiang (2011) found that employee salaries paid by state enterprises are 13 per cent higher than that in the non-state sector, while the management level in central state enterprises earns over 60 per cent higher than the private sector on average (Jiang, 2011).

Further, Kato and Long (2004), who studied executive compensation in firms listed in China's stock markets, concluded that Chinese enterprises tend to associate executive compensation (in cash) and firm performance much more strongly than enterprises in the United States and Japan, although state enterprises manifest a much weaker link (Kato & Long, 2004). Corroborating these findings, Conyon and He (2011) concludes that the factors determining executive compensation in China were no different from those in the US, and that China's corporate governance reforms were reasonably effective in aligning managerial with shareholder interests (Conyon & He, 2011).[18] Thus, it should not be surprising if state enterprises such as Baoshan Iron and Steel, Legend Computers (now Lenovo), China International Marine Containers Corporation, the Pearl River Piano Group and Guangzhou Metro Corporation were said to be among the best managed firms in China since as early as 2001 (except Guangzhou Metro Corporation) (Knowledge@Wharton, 2001; Tse, 2006). In reconciling the weak link between cash compensation and corporate performance despite strong management performance of state enterprises, Cao et al. (2010) argued that political incentives can offset any shortfall in economic incentives which disadvantage managers of state enterprise (Cao, Lemmon, Pan, & Tian, 2010).

4.3.3 Performance

The third attribute is enterprise performance, which state enterprises are expected to fare below par.[19] Public enterprise theory measures performance by taking into account enterprises' economic inefficiency and/or poor profitability. State enterprise inefficiency arises from the monopoly power of enterprise in the market and the obligation to satisfy multiple and conflicting objectives. The latter factor, together with bureaucratic

[18] Their findings echo those of Fung, Firth and Rui (2003) that show corporate governance has a significant impact on CEO compensation among partially privatised state enterprises in China (Fung, Firth, & Rui, 2003).
[19] "Enterprise performance" in this context refers to performance at the (microeconomic) enterprise level.

management, accounts for poor profitability. The inability to innovate, a critical attribute in the discourse on economic convergence and technology catch-up, is also a contributory factor to poor performance.

Studies undertaken for the period up to the 1990s have confirmed the theoretical hypotheses about loss-making state enterprises, citing factors such as employment costs, market competition, social welfare costs, power relations with different levels of government, government policies during economic transition as well as historical factors (Holz, 2002; Hu, 2005). Principal-agent problems, exacerbated by the reforms in the 1990s, also emerged as a result of asset-stripping especially at the subnational level (Smyth, 2000). However, with reforms undertaken since the early 1990s, the situation reversed in the mid-1990s (Tian & Estrin, 2008). A research project completed recently by the Unirule Institute of Economics on China's state enterprises reported that the net profit of state-owned and state-holding enterprises in 2008 was more than three times higher than that in 2001 as a result of subsidies, lower tax burdens and financing cost, compared to non-state enterprises (Jiang, 2011).

Are state enterprises technological laggards? The China Chemical National Corporation (ChemChina), created from a merger between China Blue Star Chemical Cleaning and other state enterprises affiliated with the Ministry of Chemical Industry, has upgraded its technology through international acquisitions (Koch & Ramsbottom, 2008). In the clean energy sector, state enterprises such as State Grid Corporation, which dominates China's electricity supply, are said to be a leader not only in China but also the rest of the world in clean energy research and development (R&D) and the technology's eventual commercialisation.[20] Local jurisdictions like Shanghai have also supported the national strategy through creating environments for innovation. These initiatives have reflected

[20] The developments and growing technological capabilities described here are reported in a number of studies (Ren, Zeng, & Krabbendam, 2010; Tong & Zhu, 2009; Wu, 2007).

that large enterprises, many of which are state-owned, take up a dominant pie in R&D funding and expenditure, and that China's R&D expenditure as a share of GDP is now comparable to those in developed countries. There is also evidence that enterprises rather than the government are increasingly driving innovation, a positive outcome of the Chinese government's strategy launched in 2006 to promote indigenous enterprise-based innovation (Ren, et al., 2010; Zhang, Zeng, Mako, & Seward, 2009). Further, Zheng, Liu and Bigsten (2000) find that large state enterprises are more likely than non-state enterprises to generate technical progress while Yang also reports that state enterprises did respond to technological catch-up (Gong, 2004; Zheng, Liu, & Bigsten, 2000). Thus, some Chinese state enterprises are currently at the forefront of innovation in an environment that still faces many challenges.

Despite their good performance, state enterprises are still subject to criticism that their success is attributable to their reliance on state power, or the preferential treatment being granted as a monopoly or near-monopoly and for being in heavily regulated sectors with little competition from the private sector. In fact, state enterprises found in intensively competitive industries are also facing competition from both the domestic and foreign private sectors as well as other estate enterprises.[21] The stiff competition was attributed to the large number of state enterprises (except the central enterprises which number slightly over a hundred) owned by different levels of government operating in China's fragmented market. These enterprises face tough competition as they move beyond their local market (Knowledge@Wharton, 2006), resulting in some highly competitive state enterprises. The automobile and steel industries are such examples. Under competition, Chinese automobile makers are beginning to achieve original capabilities and R&D (Li, 2009). The government has also promoted competition by introducing a bidding process

[21] However, Geng, Yang and Janus (2009) argue that asset accumulation was the highest among what the state considered strategic industries (Geng, Yang, & Janus, 2009).

for enterprises attempting to make acquisitions abroad. Dyer and McGregor (2008) cited the case of Chinalco's share acquisition of Rio Tinto being approved by the government after it won the bid against other state enterprises (Dyer & McGregor, 2008). They also noted that China Airlines' success in beating Singapore Airlines over the intended purchase of China Eastern Airlines is not simply an exercise of raw state power. As a matter of fact, China Airlines had to pay a higher price than Singapore Airlines to take over China Eastern Airlines. Given these developments, Woetzel (2008) notes that while the playing field remains in favour of the state enterprises, especially in terms of access to finance, the competitive conditions facing state and private enterprises were converging (Woetzel, 2008). Internationally, state enterprises face the even greater handicap of being viewed with suspicion by foreign governments.[22]

The role of reform and privatisation are central to the existence of Chinese state enterprises. Privatisation has taken different routes in implementation and resulted in different corporate entities. For instance, the state enterprise reform introduced a decade ago had promoted greater autonomy in not only enterprises but also various levels of government. The various routes to privatisation include privatisation of control with no ownership change, leasing, mergers, sale to employees to form joint stock companies, as well as ownership participation from individuals, groups of individuals, including foreign investors. Profitable enterprises have been listed on international stock exchanges while enterprise groups were formed with a view to develop national champions. The myriad experiments – many were unsuccessful but others do rise to become behemoths that are looked upon with suspicion by the West today – simply illustrate the dynamism of a sector that has been labelled as "dying" and "a dinosaur".[23]

[22] Even the sale of telecommunications equipment by Huawei, an employee-owned enterprise, to America's AT&T in 2009 was scuttled by the American fear of the Chinese use of such equipment to spy on the US (Pomfret, 2010).

[23] By the mid-1990s, Mai and Perkins (1997) made this conclusion that "most SOEs are now able to operate, to a greater or lesser extent, in a market environment. Economic reform has enabled them to make their own production plans, set prices, purchase inputs and sell outputs within a market structure (Mai & Perkins, 1997)".

The existence of these specific cases leaves open the criticism that besides state favouritism,[24] cases of successful state enterprises represent exceptions to a subsector wallowing in failing and failed enterprises. However, as noted earlier, successful enterprises account for a tiny fraction of the total enterprises. These enterprises are, nevertheless, often among the largest in the country, if not in the world, and they still account for a sizeable share of industrial output.[25]

More importantly, the crux of the above discussion is not about the argument that the state enterprise sector as a whole is efficient, competitive and innovative, though this is to a certain extent true for some enterprises but that the general characterisation of the sector as moribund, loss-making, or inefficient is no longer appropriate. Nor is it easy or meaningful to draw a contrast between private and the state sectors, given how some state enterprises are managed. Indeed, as Scissors (2011) notes, the contrast perpetuates a mistaken notion that what China officially refers to as "non-state" is synonymous with private (Scissors, 2011).

Even more importantly, the above discussion illustrates the limited applicability of the state-private dichotomy that has served as the implicit assumption in many studies. Further, what the world fathoms is a form of enterprise, neither fully public nor private, that defies stereotyping, which however fits well with the historical and sociocultural development of China. Given the special environment in which they exist, these enterprises bear little resemblance to the Japanese keiretsu and Korean chaebol, which are private entities albeit with extensive government intervention.[26] They are public-private hybrids. While their closeness to government and political leadership has given

[24] As the boundary between public sector and private sector becomes indistinct for many enterprises, the key to government support appears to hinge upon whether the leadership of the enterprise has close ties with the government, regardless of whether it is classified as public, private, or in-between.

[25] In as early as 1997, Li and Putterman (2008) estimated that small state enterprises accounted for no more than 16 per cent of total state enterprise output (Li & Putterman, 2008). This share in output would have fallen further with the government strategy of "retaining the large and releasing the small", since the bulk of state enterprise closures are likely to be small enterprises owned by local and provincial jurisdictions.

[26] The large Chinese state conglomerates have been compared with their Japanese and Korean counterparts (The Economist, 1997).

them the advantage to tap state resources, they do enjoy sufficient autonomy to be managed like private enterprises at the same time.

4.4 The State Enterprise Sector and Economic Growth

Given the size of the state enterprise sector, commentary on its sectoral and/or macro-economic role has also been framed in terms of its contribution to economic growth. Empirical studies on economic growth of the state enterprise sector until around 2000 have largely been unfavourable. A host of empirical studies have found that total factor productivity – a source of economic growth – of these enterprises was reported to be zero or negative, and many reasons were attributed to their poor performance (Sachs & Woo, 2003). By comparing state enterprises' productivity with that of non-state and/or private enterprises, Sachs and Woo (2003) report higher and more rapidly rising profitability among non-state enterprises but declining profitability for enterprises with increasing share of state ownership (Sachs & Woo, 2003).

At the macroeconomic level, there were commentaries critical of state enterprises for inhibiting China's economic growth as the country's economic growth moderated considerably and state enterprise losses mounted at the onset of the Asian Financial Crisis (AFC) in 1997 (Dorn, 2000; Rawski, 2000). While these commentaries were mostly not supported by research, a few studies have attempted to make that link empirically. Chen and Feng (2000) analyse the cross-provincial data for the 1978-89 period and found evidence of growth-enhancing effect of "private and semi-private enterprises" and growth-diminishing impact of public enterprises (Chen & Feng, 2000). Similarly, Phillips and Shen (2005) discover that the size of the state enterprise sector (measured in terms of its share in total industrial output) is negatively related to provincial growth rates (Phillips & Shen, 2005).

In empirical studies conducted since the turn of the 21st century, an increasing number of positive analyses has replaced and eclipsed the mostly negative findings as state enterprise reform – which was initially aimed at stemming losses but gradually reoriented to nurture globally competitive enterprises – has produced an economic turnaround for the state sector. Recent literature surveys have indicated that there are signs of productivity growth in the state enterprise sector in the period leading up to 1993 and after, and that the existing gap between the state enterprise sector and the non-state and foreign enterprise sectors is narrowing (Jefferson, Rawski, & Zhang, 2008). The results were corroborated by the estimates made by Park (2010), who also documented the impressive rise in total factor productivity (Table 4.2) (Park, 2010).

An important reform that will likely have a major impact on growth is the consolidation of state enterprises into conglomerates under the supervision of the central government (SASAC). The objective of forming central enterprises is to help them achieve global competitiveness in both scale and technology. Adopting Korea's "picking winners" system, China chooses industries with cutting-edge and green technology, select manufacturing, and production of industrial materials of strategic importance like steel, cement, aluminium and rare earth elements as "pillar industries". Restructuring and mergers were supported by incentives such as tax credits and financing from state-owned banks and asset management companies (State-owned Assets Supervision and Administration Commission, 2010). These enterprises number fewer than 130 and efforts are being made to consolidate further.[27] These enterprises, together with selected state enterprise giants, will be key players in the government's strategy of "state-led" growth.

None of the studies discussed earlier dealt with data of an appropriate level of generality to offer a reasonable macroeconomic view. It does not seem possible to explicitly

[27] The number of central enterprises had to be reduced to fewer than 100 by 2010, but progress was slower than expected (Yang, 2011).

associate macroeconomic growth and productivity data with the role of the state enterprise sector. For instance, as Table 4.2 has shown, China's economic growth rate for various years bears little relation to changes in the state enterprise sector. It is therefore hard to refute Li and Putterman (2008)'s argument that "it is implausible that China's economic growth could have progressed so rapidly if the country has been dragging along its state sector like an albatross round its neck for all of these years (Li & Putterman, 2008)".

Table 4.2: Selected Macroeconomic Indicators of China's Economic Growth and Income Distribution (1980-2009)

Year	GDP Growth Rate (%)[1]	Period	TFP Growth Rate (%)[2]	Year	Gini Coefficient[1]	Income Share Held by Poorest 10 %[1]
1980	7.8			1981	0.291	
1984	15.2	1980-90	2.93	1984	0.277	
1988	11.3			1987	0.299	3.3
1990	3.8			1990	0.324	3.5
1992	14.2	1990-00	3.72	1993	0.355	3.2
1994	13.1			1996	0.357	3.1
1996	10.0			1999	0.392	2.1
1998	7.8					
2000	8.4			2002	0.426	2.3
2002	9.1	2000-07	6.04	2005	0.425	1.8
2004	10.1					
2006	12.7					
2008	9.6					
2010	10.4					

Source: [1] World Bank database at http://data.worldbank.org/indicator/
[2] From Park Jungsoo, "Projection of Long-term Total Factor Productivity for 12 Asian Countries", ADB Working Paper No. 227, October 2010, Table 3.

Finally, it should be noted that mainstream Western economics, which recognises the productive and redistributive role of state enterprises, cannot be criticised for the research focus and emphasis on efficiency. Responsibility lies in the dominance of neoliberal ideology towards the end of the 20th century, with the Washington Consensus holding sway with multilateral lending institutions. Consequently, the larger important role of state enterprises in general and China's in particular has been neglected (Chai, 2003). This missing role is examined in the next section.

4.5 State Enterprises and Social Protection: Missing in (Research) Action?

There is a plethora of research directed at measuring state enterprise performance in terms of efficiency, but there is little research linking state enterprises to their social security role. To be sure, there are however a few exceptions. Bai, Li and Wang (2003) stressed the importance of state enterprises playing both productive and distributive roles during the transition period as independent institutions get ready to become fully operational in the provision of a social safety net (Bai, Li, & Wang, 2003). Huang, Li and Lotspeich (2010) recognise that by preventing large-scale unemployment, state enterprises facilitated the growth and development of non-state enterprises through a positive externality – social stability – but at the cost of reduced productive efficiency (Huang, Li, & Lotspeich, 2010). Their estimates have shown that incorporating this externality has aligned state enterprises' contribution to economic growth with that of non-state enterprises. While relieving enterprises of their distributive role has strengthened their profitability, this has however left a void in the social safety net that has not been filled even today.

How did state enterprise reforms change the enterprises' original mandate? Before the start of China's economic transition in 1978, state enterprises accounted for three-quarters of China's industrial output, employed two-thirds of all industrial employees, and were responsible for employee welfare, including pension and housing. They also contributed to 90 per cent of the state's fiscal revenues (Dong & Putterman, 2003). Hence, the distributional role of state enterprises as provider of social protection and as income source to fund social provisions needs no further emphasis. During the first 15 years of transition, state enterprise reforms had improved financial discipline through restructuring incentives and increasing competition, but that had not given enterprise managers the autonomy to dismiss workers. By the mid-1990s, as the state enterprises' share in total output plunged, the share in total employment has decreased much more gradually. This implied that despite the serious losses suffered by state enterprises due to asset stripping by managers, inefficiencies arising from a long history of soft budget constraints and large labour redundancies (Hashiguchi, 2008; Mako & Zhang, 2003),[28] the social safety net had remained largely intact. However, the severe losses had attracted attention from the international community, which suggested privatisation as a solution. Little attention was given to alleviating the social burden of state enterprises though privatisation, as a remedy, was in place.[29]

The Chinese government reacted to the growing losses of state enterprises by making a shift in the reform strategy, retaining only the largest state enterprises while "releasing" the small ones (zhua qa, fang xiao) through sale, privatisation or closure (Zhou, 2000).[30] However, so long as the retained enterprises are not relieved of their social burdens, they would be forced and continue to rely increasingly on bank loans, which have become harder for state enterprises to obtain since then as a result of the reform. Hence, state enterprises' debt burden soared, while struggling even to fund their operations.

Despite the reluctance to shed labour, an estimated 3.6 million workers were laid off between 1995 and 1997, although some were rehired (Zhou, 2000). That it did not prove to be socially destabilising could be due to the fourfold increase in employment in the non-state sector during the period.

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[28] From May 1998, those who were retrenched were able to receive assistance through a re-employment service. The International Labour Organization (ILO) reported that by the end of 1998, about 85 per cent of those made redundant had registered (International Labour Organization, 2002). Dong and Putterman (2003) estimated that the ratio of state enterprise losses to before-tax profits rose from 5 per cent in 1980 to 22 per cent in 1995, reflecting a widening gap (Dong & Putterman, 2003).

[29] The World Bank did undertake a programme that aimed to reduce the social consequences of its enterprise reform programme. However, the fund allocated was modest, and the activities, which were later assessed to be partially successful, were limited to management and retraining of laid-off workers (Carlier, 2001).

[30] The strategy involved privatisation, liquidation and/or closure of numerous state enterprises at county and local levels, laying off about four million state enterprise employees, and restructuring of large enterprises through corporatisation, mergers and listing on international stock exchanges.

Corporatisation and shareholding reform, including the inclusion of foreign ownership and listing on international stock exchanges, did eventually erode the provision of social safety net, however (Moore & Wen, 2006).[31] This is the result of successful listing and foreign investor participation that required a clean set of accounts without any data on social costs, that solely displays the information about income of the listed enterprise (Walter, 2010).[32]

A by-product of the reforms was the creation of social security experiments to take over the role formerly played by state enterprises. These experiments ranged from the rehiring of laid-off workers and provision of compensation packages for laid-off workers to the establishment of the National Social Security Fund in 2001. They had helped relieve some of the hardships caused by the layoffs and restructuring under state enterprise reforms, but did not seem sufficiently comprehensive to form a national social security system. Discussions of forming the national social security system continued in the lead-up to China's 12th Five-Year Programme (Lim & Spence, 2010).[33] State enterprise reforms that are based partially on Western-style corporate restructuring had therefore obliterated the traditional distributive role of Chinese state enterprises, leaving a vacuum in the wake that had to be filled by piecemeal experimentations of social security.

Interestingly, in today's extensive discussion on social security, there are very few references made to the state enterprises' distributive role, which until slightly over a decade ago was a prominently significant function (Barnett & Chalk, 2010; Li & Piachaud, 2004; Organisation for Economic Co-operation and Development, 2010). While it is the case that the social security protection afforded by state enterprises at that time is no

[31] Moore and Wen (2006) were of the view that the direction taken of state enterprise reform was driven chiefly by the state's concept of privatisation and economic benefits derived rather than the need for a more balanced economic and social strategy (Moore & Wen, 2006).
[32] Walter (2010) called these reforms "a social disaster" (Walter, 2010).
[33] In the collection of papers that served as inputs to the FYP, two out of nine chapters and five out of 20 background papers were devoted to social security issues and an additional paper co-authored by Edwin Lim and Michael Spence on housing.

longer adequate today given the large number of rural-urban migrant workers to be covered, there is little from existing Western research that recognises state enterprises' distributive role.

Even after being relieved of their social responsibilities, state enterprises did make an impact on income distribution. In housing reform, the state has made a retreat in the provision of public housing, while promoting the development of the private housing market and construction industry. State enterprise employees were encouraged to and did purchase their housing units at subsidised prices. Financing for house purchase was made available through the Housing Provident Fund to which employees have to contribute, as well as through commercial mortgage financing. The latter had driven up the demand for housing, with housing prices rising sharply.[34] Regardless of their core business, state enterprises, whose original mission included building and providing housing for employees, began to undertake construction of residential (and commercial) units for profit on land that they owned or acquired from profit retention. The state enterprises' foray into real property had driven up land, and hence housing, prices, thus putting housing out of the reach of lower-income and rural-urban migrant households (Barboza, 2010; Li, 2011; Lim & Spence, 2010). Efforts by the central government to rein in these enterprises has had limited success. Thus, not only do state enterprises no longer provide social safety nets, they have contributed to increased inequality in access to housing.

Despite their focus on the market, due credit and justice should be given to state enterprises for continuing to support the government in such activities as disaster relief and diplomatic confidence-building. For instance, in the post-disaster reconstruction in Yushu, Sichuan province, four central enterprises – Sinohydro Group Ltd, China Railway Construction Corporation, China State Construction Engineering Corporation, and China

[34] As reflected from the data in the China Statistical Yearbook, the average residential housing prices increased two-and-a-half times from RMB 1790 per square metre in 1997 to RMB 4459 per square metre in 2009.

Railway Group Ltd – played a significant role (China State Enterprise News, 2011). Central enterprises are also involved in China's engagement with Africa, e.g., a unit of the China State Construction Company was responsible for the construction of the African Union Conference Centre (Ministry of Commerc of the People's Republic of China, 2012). Also, as China's largest state enterprises move towards international standards of governance, there is an increased focus on corporate social responsibility. This represents the state enterprises' formal return to the pursuit of social objectives that were once a part of their mission (China Knowledge@Wharton, 2010).[35]

As substantial resources are required to fund a comprehensive social safety net, state enterprise profits, estimated to be as much as 20 per cent of the national budget in 2010, are naturally regarded as the source of funding (Mattlin, 2009). Although the state as a shareholder is entitled to dividends, the largest state enterprise holding companies, empowered by the 1994 tax reform law, have been retaining the bulk of the profits.[36] At the same time, the successes of national champions and enterprises in strategic sectors have built powerful corporate interests that are able to resist pressures to distribute part of their earnings as dividends to the government, monies that could have been used to fund social security. The challenges faced by SASAC (established in 2003 to exercise the government's ownership rights), in fulfilling its mandate, serve as a cautionary tale (Lam, 2011; Mattlin, 2009; Naughton, 2008).

On a final note, the absence of micro-level research, coupled with the lack of macro-level data, implies that assessing the distributional impact of state enterprise reform at the macroeconomic level is impossible. Indeed, official data on income distribution at the national level were no longer published after 2005 (Table 4.2). Existing data show rising

[35] Corporate social responsibility was first introduced into China by multinationals to meet the demand of Western consumers, but its adoption was accelerated by labour protests within China.
[36] Listed subsidiaries of these holding companies are required to and do pay dividends to the holding companies, but these profits are retained at the holding company level.

income inequality, whether measured by the Gini coefficient or by the share of income accruing to the bottom decile of income earners. The extent to which state enterprise reform contributed to this deterioration cannot be determined; factors like growing urbanisation and unequal regional growth have been important factors.

4.6 Conclusion

The Chinese state today is the product of its political and cultural history, both the past and the recent, and is deeply embedded in the Chinese society. Complementing this rich history are numerous reform experiments undertaken by different levels of government during China's transition from a command economy to one based on market socialism. The result has been the emergence of state enterprises that do not fit a simple dichotomy of state and private.

Yet the dichotomy between state and private enterprises forms an essential part of the Western theories about public enterprises. In these theories, state enterprises are stereotyped to perform poorly in comparison with private enterprises. The standard solution being proposed is to privatise the state enterprises, which would also shrink the state sector. Save for the notable exceptions, existing research on China's state enterprises has relied heavily on these Western theories and paradigms.

Given the particularities of the Chinese state, benchmarking its enterprises using Western theories has several adverse consequences. First, the misinterpretation of state enterprises has resulted in the failure to recognise the emergence of a new type of enterprise – the state-private hybrid – that will play a growing global role. Second, while the pursuit of efficiency in enterprise operations is advocated in neo-liberalism rather than the Western theories per se, this is effected at the expense of the state enterprises' initial role in the provision of a social safety net. In its drive to create globally competitive corporations, China's own reforms have led to the demise of this pre-existing social safety net. With widening disparities, the implementation of a plethora of social security reform initiatives to date is strong evidence that the destruction of a system is far easier than rebuilding one.

This chapter, like other existing research, has not been able to establish the link between the performance of the state enterprise sector and macroeconomics. In addition, there is scant evidence of how losses incurred by state enterprises and the relief from social burdens could impact economic growth; neither is it simple to dissociate state enterprises' distributional impact from the impact of urbanisation and regional differences in growth. This will definitely warrant future research should more data become available.

Last but not least, whether the Chinese experience has relevance for other countries in transition, like Vietnam, or countries whose governments play a major role through government-linked corporations, like Malaysia, requires further research. Clearly, China's historical trajectory is unique and cannot be emulated; however, if the evolution of the Chinese state enterprise sector is but a phase of the country's experiment with market socialism, China's many experiments have much to offer by way of lessons of successes and failures.

CHAPTER 5 THE STATE'S ROLE IN A STRATEGIC INDUSTRY – CHINA'S BANKING SECTOR

5.1 Introduction

China's banking sector dominates its financial system. Efforts to improve the banks' efficiency have been made. China needs to prevent the banking sector from going into crisis in order to sustain stable economic growth (Allen, Qian, Zhang, & Zhao, 2012). Because the banking sector is crucial, the Chinese state's role is crucial as well. This is true because Europe and North America have private sector driven financial systems, China's financial system is dominated by the government. In China, commercial banking and investment banking are highly controlled (Genevieve & Wei, 2005).

The World Bank is considering proposing the privatization of one of China's state-holding commercial banks. Through this proposal, the entrance of foreign investment banks into China's market and with less control of the state and greater consideration for shareholder interest constitute its initial objectives (Davis & Orlik, 2013). The existing studies have suggested greater private ownership and less state involvement because banks have had relatively bad performance in terms of high NPLs, low efficiency, and other factors. In other words, they considered state ownership and governance as responsible for low profits and returns to shareholders.

Responding to weaknesses, China's banks undertook reforms as part of state enterprise reform since China began its marketization process in 1978. The state enterprise reform transformed China's state enterprises in terms of their governance mechanisms and ownership structures. So the first objective of this chapter is to review the changes of China's banking sector that were affected by state enterprises reform and what their ownership structure and governance mechanism look like today, more precisely, how the state-control mode evolved and what is the state-control mode today (how much state's control in both ownership and governance is today)?

However, to understand the changes in China's banking system, this chapter must refer to history. The importance of history has already been discussed in Chapter 4. It is argued here that the government's policies with respect to the financial sector have as much to do with the history of Chinese banking as with economic ideology. Hence, the objective of this chapter is to provide the historical context as an explanation of the state's role in the banking sector. This role is manifested in the fact that the banking sector has been designated a strategic sector. This objective needs to be matched with another objective. This is with respect to the functioning of the banking sector in the context of the Chinese state's efforts to improve efficiency. This functioning is manifested in indicators of financial robustness, the ability to remain profitable, and at the same time, as a major instrument of China's growth strategies, to support the state at critical times.

The next section analyzes the historical role of China's banking sector since the Qing Dynasty. Section 5.3 reviews how China's banking sector followed the state's policies towards reform. Also, it summarizes how China's banking sector looks today. And this section links state control to ownership structure and governance in state-holding commercial banks. Then, section 5.4 displays the overall performance of the main state-holding commercial banks during two specific circumstances. Section 5.5 offers a conclusion.

5.2 China's Banking Sector – A Historical Perspective

In the context of world history, the failure of the Paris Commune was partly attributed to its failure to take over the *Banque de France*, namely, to control the economic lifeline, i.e. the central bank as the center of the financial system in France. Marx and Engels (1959) pointed out in the Communist Manifesto (1848) that if the proletariat wants to become the ruling class, then the state has to control all finance through a central bank with state capital (Marx & Engels, 1959). Lenin (1927) pointed out that the banking sector is in the central position of an economic system (Lenin, 1917). After the establishment of the Soviet Union, the banking system under the state's control played a major role in its economic recovery. In 15 years, the Gross Industrial Production of the Soviet Union ranked second in the world (Wang, 2010). In reference to Chinese history, we also can see that the banking system is a crucial sector for the national economy.

5.2.1 *"Qianzhuang" (钱庄)* & *"Piaohao" (票号)* (the Qing Dynasty) Versus HSBC (British Power)

During the late Qing Dynasty, the Opium War destroyed China's currency stability. At that time, multiple currencies were used by different jurisdictions. The absence of a central bank did not permit the issue of a single currency in China. There was little credibility for the Qing Government's issued bank notes. In addition, several finance institutions were in existence. These were the "*Qianzhuang*" and "*Piaohao*" which focused on the currency exchange business and bank draft business, respectively. These institutions were the precursors of modern China's financial institutions. The Qing Government still had to repay loans from "*Qianzhuang*" and "*Piaohao*". "*Qianzhuang*" and "*Piaohao*" had to finance foreign trade.

The modern banking sector in China did not emerge until quite late into the Qing Dynasty because the Qing Government ignored the importance of creating a modern banking system. The history of modern banking in China started with the establishment of the Hong Kong and Shanghai Banking Corporation (HSBC) in 1865, which was founded for British power to control China's financial sector at that time. The capital foundation of HSBC stemmed from the opium trade and served to facilitate British Far East trade (Guo & Lu, 2013). Afterwards, HSBC swept away all financial institutions in Hong Kong and

Shanghai to become the new leader of Far East foreign banks, and controlled China's international exchange business. Relying on British power, HSBC refused the Qing government's request to reveal information about the bank's clients. Cheap deposits came to HSBC since it was the most safe wealth vault. It also acquired banknote issuing authority from the British Hong Kong government. Finally, it controlled the capital sources (monetary situation) of China's *"Qianzhuang"*, *"Piaohao"*, and the *"Chaipiao" (拆票)* business (Song, 2011). *"Chaipiao"* business referred to short-term loans among those banks. Backed by British naval might, HSBC quickly established itself as the dominant institution in the Chinese banking system. HSBC's other businesses were political loans for the Chinese government, loans for railways, and advanced payments for the opium trade. It gradually took over the central bank position, which further controlled the Qing Dynasty's monetary situation to eventually dominate China's financial network (capital and credit flows) (Song, 2011). HSBC's bank draft and packing credit were major channels for China's trade finance and international exchange (Wu, 2006). HSBC controlled China's money supply and acted as a central bank due to the business limitations of *"Qianzhuang"* and *"Piaohao"*. Foreign banks penetrated into Chinese financial networks and their agents monopolized financial markets.

5.2.2 The Establishment of the BOC

In 1905, *"Hubu"*[37] *(户部)* Bank was established by the Qing Government. It undertook a dual role of central bank and commercial bank. It also issued bank notes, acted as the national treasury, such as functioning as a central bank, in addition to basic commercial banking such as deposits and loans. In 1908, the Qing Government renamed the bank to "*Daqing*" *(大清)* Bank and entrusted it with the functions of a central bank. "*Daqing*" Bank was a joint-stock bank at that time in which the government owned half (5 Million

[37] "Hubu" was the Ministry of Finance of the Qing government.

"*Liang*" *(两)*) (the silver currency) and private entities could purchase the rest (5 Million "*Liang*"). The Qing Government officials assumed management responsibility.

The 1911 Revolution witnessed the collapse of both the Qing Dynasty and "*Daqing*" Bank. The revolutionary government (Beiyang Government) thought that all shares belonged to the Qing Government and enacted a crackdown policy. This caused private shareholders to gather and held a meeting to form strategies to protect their shares (Caijing Online, 2012).

In 1911, Chen Jintao, who was the Finance Chief for the Beiyang Government was going to establish a central bank for the Beiyang Government by restructuring the "*Daqing*" Bank to the BOC, which was to be a government private joint stock bank and to undertake the central bank's role (Wen Hui Bao, 2008). The new government firstly cleaned up businesses belonging to "*Daqing*" Bank and eliminated the shares (5 Million "*Liang*") belonging to the Qing Government. Private shareholders' shares were converted from "*Daqing*" Bank to the BOC with equal value. Then, the BOC attracted investments for 5 Million shares (Caijing Online, 2012). In 1923, Zhang Jiaao who was the Vice President of the BOC raised private sector share capital to replace government share capital by paying 5 Million "*Liang*". In this way, the BOC was no longer controlled by the Beiyang Government as the private sector held 99% of the shares (Qu & Luo, 2011).

5.2.3 The Change of Government after the Qing Dynasty

After the 1911 Revolution, there were several separatist warlord regimes on China's turbulent political scene. These warlords established several governments. In the north was the Beiyang Government, in the center was the Wuhan Government, and in the south was the Guangzhou Government. Chiang Kai-shek was the head of the Guangzhou Government.

Between 1923 and 1926, the Soviet Union provided financial support of 30 Million "Gold Rubles" to the Guangzhou Government to support the Northern Expedition by Chiang Kai-shek. Moreover, the Soviet Union provided 10 Million "Gold Rubles" for it to establish a central bank. In 1927, the Northern Expeditionary Army finally reached Shanghai, the financial sector that was controlled by Jiangsu and Zhejiang Financial Magnates (foreign banks, government banks, "*Qianzhuang*", and "*Piaohao*"), backed by British and American bankers. Agents for the foreign banks organized the Shanghai Chamber of Commerce, which included all important banks including "*Qianzhuang*", "*Piaohao*", and other commercial and industrial organizations to finance 60 Million Yuan for Chiang Kai-shek under the condition of cleaning up the members of Communist Party within the Wuhan Government (Song, 2011).[38]

In March 1927, the Wuhan Government sent Song Ziwen, the Minister of the Ministry of Finance, to Shanghai to unify fiscal responsibility and financing for the Wuhan and Guangzhou Governments. Nevertheless, Chiang Kai-shek requested the Shanghai Chamber of Commerce, which maintained good relations with Chiang Kai-shek, to ignore Song Ziwen. He also implemented an economic blockade on the Wuhan Government. He also reduced the financing channels for Jiangsu and Zhejiang Financial Magnates.

Feng Yuxiang, who was a powerful warlord independent of both the Kuomintang – and the Communist party, was courted by Jiang as a way to neutralize the Wuhan Government. Chiang Kai-shek was in a stronger position than the Wuhan government as he was able to offer Feng better financial benefits. In December 1928, the Nanjing Nationalist Government was established by Chiang Kai-shek to replace the Beiyang Government.

[38] Since the Communist Party cooperated with Kuomintang (*国民党*) to resist the warlord, in Wuhan Government, there were a group of members of the Communist Party joining as the officials.

We can see Chiang Kai-shek needed the money to the struggle against other warlords and the Communist Party, and then control a nationalist government.

5.2.4 The Establishment of the Central Bank of the Communist Party

The growing Communist Party calling itself the Soviet Republic of China (SRC), which could threaten Chiang Kai-shek, was located in central China. In 1932, SRC established its own central bank. Chiang Kai-shek responded by implementing a strict economic blockade on this area. As a result, commodities were in short of supply, the prices of commodities increased, and the SRC government's issued bank notes depreciated. Additionally, Chiang Kai-shek counterfeited currency to flow into those areas and exchanged gold and silver reserves from the central bank of SRC on a large scale (Culture China Online, 2010; Shandong University Party Committee Organization Department, 2010). The SRC government had to have enough gold and silver reserves to back the bank notes it issued. The government had to guarantee repayment in order to ensure its continued access to credit. It realized that as long as the currency issuing authority had the trust of the people, it did not need to have the full backing of silver and gold reserves. Therefore, the ability of the SRC government to resist the Kuomintang's siege and economic blockade largely depended on the credibility of this government's central bank.

5.2.5 The Evolution of Chiang Kai-shek's Financial Autocracy

The establishment of the Nanjing Nationalist Government in 1928 to oust the Beiyang Government to enable Jiang's group to become the central government needed to have an independent Central Bank. Song Ziwen, who had become the Minister of Finance under this government, wanted to restructure the BOC as a central bank. However, at the time, the Nanjing Nationalist Government was not powerful enough to control the BOC, and this proposal was rejected by the Vice President of the BOC (Bank of China, 2014c). The largest shareholder of the BOC was the Xi Family, who was also agent for HSBC. HSBC was backed by the British Empire. However, the Nanjing Nationalist Government was able to force the BOC and the Bank of Communications (BoCom)[39] to restructure and raise government shares to become the majority shareholder.

Song Ziwen indicated that there were three objectives to establishing a central bank: unify the monetary system, consolidate the national treasury, and adjust the financial system (Qu & Luo, 2011). The BOC was transformed into an international exchange bank. It was changed from a government bank into a commercial bank. The BoCom was transformed into an industrial development bank. Nevertheless, the BOC and the BoCom still undertook banknote issuance responsibility as a central bank. At that time, the BOC remained the number one financial institution in the sector. The BOC had a big advantage in total assets, total loans, total deposits, and total circulation over both the central bank and the BoCom until the end of 1934.

The Nanjing Nationalist Government implemented a financial monopoly policy and increased government shares of the BOC in order to control it (Wen Hui Bao, 2008). Since March 1935, it issued government bonds to raise capital for the central bank, the BOC, and the BoCom; it transferred out the Chairman of the Board and the Managing Director, and appointed Song Ziwen as Chairman of the Board. It tried to control the BOC totally through majority shareholding and restructuring at the management level. The capital of the BOC was 25 Million Yuan with 20% (5 Million) government shares. The Nanjing Nationalist Government raised government shares by 25 Million Yuan to ultimately own 30 Million Yuan out of 50 Million Yuan or 60%.

Shareholder objections were muted by the government's political pressure. Still they were able to force the government to accept two proposals to reduce the latter’s power. One

[39] BoCom was established in the capital of 2.5 Million “*Liang*” by Qing Government in 1908 with 2/5 “Youchuanbu” (*邮传部*) (Ministry of Postal Service and Transmission of Qing Government) shares and 3/5 private shares.

was to reduce government shares to 50% from 60%, and the other was to reduce government representatives to 9 (out of 21) among the Board of Directors, and managing directors were appointed by the Chairman instead of by election by the Board of Directors, and a "Chairman responsibility system" replaced the managing director responsibility system (Bank of China, 2014a).

At that time, the new Chinese financial system was known as the "Four Banks & Two Bureaus"[40] and was under the control of government officials. In 1935, currency reform unified different currencies and made the "*Fabi*" (*法币*) legal tender. The four banks controlled the financial system. In 1942, the Nationalist Government assigned different functions to each of the four banks. The BOC's commercial banking functions were limited to domestic savings and loans, supporting foreign trade and related investments and loans, and managing the government's foreign funds. Thus, the BOC became a specialized international trade bank. Most of its original businesses were gone and it no longer functioned as a central bank (Bank of China, 2014b).

5.2.6 The Collapse of Chiang Kai-shek's Financial Autocracy

After the currency reform, Japan launched its attack on China in 1937. As a result of the war and inflation, people sold "*Fabi*" for foreign currency. As a result, "*Fabi*" devalued and the value of loans to the Chinese government decreased. As a result, the Nationalist Government had to seek additional loans from Britain and America to support and stabilize the value of "*Fabi*". In 1939, the Sino-British Currency Stabilization fund was established with a value of 10 Million Pounds (the BOC – 3.25 Million; the BoCom – 1.75 Million; HSBC – 3 Million; and Standard Chartered Bank – 2 Million). In 1941, the Sino-British Currency Stabilization fund was incorporated into the Sino-American-British Currency Stabilization Fund (SABCSF) in the value of USD 110 Million.

[40] Four banks: the Central Bank, BOC, BoCom and Peasants Bank of China.

(America – 50 Million; British – 40 Million; and China – 20 Million). The Board of SABCSF managed this fund, whose duty was to stabilized the "*Fabi*", intervene in the foreign exchange market, and manipulate exchange rates. At that time, the "*Fabi*" was based on foreign currency reserves, the Board being the currency issuing authority. In addition, it had the authority to foreign currency policy. Thus, the Board of SABCSF took on the role of the central bank.

In 1942, America loaned USD 500 Million to support China's war with Japan. The Central Bank established the Foreign Currency Management Committee to manage those loans. The central bank replaced the Board of SABCSF to execute currency power because USD 500 Million was far greater than USD 110 Million.

However, a series of policies by the Nationalist Government, such as Quantitative Easing in 1945, Foreign Currency Liberalization in 1946, and "Gold Yuan Note" (*金圆券*) reform in 1948 led to inflation, currency system collapse, and the loss of loan resources, all of which brought financial paralysis and the collapse of the Kuomintang regime. The PBC[41] started to issue "*Renminbi*" (*人民币*), which was not based on foreign currencies, until December 1948. The currency in mainland China was unified in 1950. Additionally, foreign banks pulled their businesses from mainland China.

Table 5.1: The Evolution of Government and Central Banks in the Modern History of China

Period	Government	Central Bank
1865-1905	Qing Dynasty	HSBC acted as the central bank
1905-1912	Qing Dynasty	"*Daqing*" Bank
1912-1928	Beiyang Government	BOC and BoCom
1925.7-1926.12	Guangzhou Government	BOC and BoCom
1927.2-1927.8	Wuhan Government	BOC and BoCom
1927-1939	Nanjing Nationalist Government	Four Banks
1939-1942	Nationalist Government	The Board of SABCSF
1942-1948	Nationalist Government	The Central Bank

Source: Author

[41] The PBC was established in 1st December 1948, which is the central bank of PBC.

As the above historical account shows, the government's attempts to create a central bank has had limited success and the government was unable to exercise effective control of monetary policy such as the operation of a silver standard during the Great Depression. This was primarily because of the inability of the ruling Chinese government at that time to control its financial institutions due either to political weaknesses and infighting, or to the domestic strife after the establishment of the Chinese Republic. These weaknesses led to the need to bring in Western powers (especially the British but also increasingly the Americans) to ensure the functioning of China's fragile financial system. Both sets of factors have been detrimental to the creation of a strong financial structure regulated by a central bank.

Table 5.1 summarizes the evolution of the government and central banks in modern China. Controlling the banks allowed regimes to be in control. All regimes need money to run the state and to allocate resources. Therefore, the most effective way to control an economy is to control the currency and the banking system, which creates the currency.

We can see why state control is seen by the current leadership as vital for the banking sector and a strong banking system is needed to carry out government policies from the lessons of history learned by the Chinese state. We also can see the paternal role of the state and socialist ideology after 1949. It is not surprising that control of the banking sector is a prime directive for the Chinese government. Its effort to strengthen this sector through reform must be seen in this light.

5.3 Ensuring State Control and Reflecting the State's Role

During the period between 1949 and 1980, China remained closed, and there was no interference from outside. But inside China, the banking sector has been gone through many changes. Since 1949, the BOC has specialized in the foreign currency business, but it entrusted this task to the PBC to control foreign currencies. The BOC also engaged in other foreign currency related business (Bank of China, 2013). In 1951, the Agricultural Bank of China (ABC) was founded and merged into and separated from the PBC three times. It specialized in providing and managing agricultural funds for the state (Agricultural Bank of China, 2014). The initial establishment of the People's Construction Bank of China (PCBC) in 1954, which was affiliated to Ministry of Finance, was to act as an "appropriation" institution that controlled and allocated budgeted infrastructure project funds (China Construction Bank, 2014). Before opening-up in 1978, the big three banks: the Bank of China (BOC), the ABC, and the PCBC were not independent entities but subordinate to the state. They were specialized banks instead of commercial banks. The Chinese state in 1978 started its state enterprise reform. The development of China's state banks was in line with state enterprise reform.

5.3.1 China's Banking Sector Reform

According to existing studies about China's state enterprise reform (Zhou & Xia, 2008) and China's banking sector reform (Liu, 2009), China's banking sector corporatization process could be described as occurring in phases.

(a) Dissociation of the big-4 state-owned banks from the state and the emerging joint-stock system and the corporate governance structure (1979-1997)

The state initiated financial reform by the dissociation of the big-4 banks from the state. In 1979, ABC was reabsorbed by the government for the fourth time and officially opened to the public to receive savings deposit. The BOC became a branch of the PBC to operate the foreign currency business and the PCBC was separated from the Ministry of Finance by the State Council. In 1984, the Industrial and Commercial Bank of China (ICBC) was established to undertake the PBC's industrial and commercial credit and savings businesses (Industrial and Commercial Bank of China, 2013). In this stage, the specialized banks were transformed into commercial banks.

To an extent, the banking reforms tracked broader state enterprise reforms. From 1987 to 1988, a group of emerging joint-stock commercial banks was established to increase the competitiveness of China's banking system. The BoCom was the first joint-stock commercial bank in China. BoCom was also autonomous in its operations and a manager/contract responsibility system was adopted. As the pilot bank to implement joint-stock reforms, BoCom underwent ownership reform and governance reform by increasing managerial autonomy. Since 1992, another batch of banks such as the China Everbright Bank (CEB) emerged.

In 1994, there were key changes for three policy banks: the China Development Bank (CDB), the Agricultural Development Bank of China, and the Export-Import Bank of China were established for loan policy-based functions, agricultural policy-based functions, and export-import policy-based functions, respectively. The policy-based functions of the big-4 banks were formally removed and transferred to these policy banks. In 1995, the Commercial Banking Laws of People's Republic of China were promulgated, emphasizing a modern corporate governance structure in which commercial banks were to act in accordance with the Company Laws of the People's Republic of China (China Banking Regulatory Commission, 2008). These laws became the legal basis for the banking system and commercialization and corporatization were formally stressed. In 1996, PCBC was renamed the China Construction Bank (CCB). In 1997, CEB accomplished its joint-stock reforms and became the first state-holding commercial bank with foreign shares by the Asian Development Bank (Berger, et al., 2009). CEB initiated foreign ownership participation in China's banking sector.

(b) Further joint-stock reform by listing (1998-the present)

This stage was characterized by the state's preparations for public listings. Firstly, the big-4 state-owned commercial banks disposed of their NPLs and then were restructured into joint-stock enterprises with an aim to accelerate their corporatization and marketization processes (Kwan, 2009). In 1998, the Ministry of Finance issued RMB 270 Trillion of special state treasury bonds to complement the big-4 state-owned commercial banks' capital base. With the capital adequacy ratio of 8%, they fulfilled the requirements of the Basel Accords. The following year, the state established four Assets Management Companies (AMCs) to take over RMB 1500 Trillion of NPLs from the big-4. The state's strategies for the banking sector were to go international and import international competition because the Basel Accords rules represented international standards. In 2001, China's banking system qualified China to join the WTO as a member; and China's financial market was opened to foreign investors. Furthermore, the state encouraged foreign investors to become shareholders in joint-stock commercial banks as strategic investors[42]. Thus, both foreign ownership and foreign corporate governance mechanisms were introduced into China's banking sector (Matthews & Zhang, 2010).

Specific instructions from the state in 2002 indicated that the big-4 state-owned commercial banks were the only institutions able to deal in currencies. In 2003, the big-4 state-owned commercial banks and three policy banks started the process of preparing for public listing. The listing of this special sector had to overcome three thresholds, Company Laws and Commercial Banking Laws of the People's Republic of China, and the Basel Accords, with up to 8% capital adequacy ratio and no more than 10% NPL ratio required (Zhen, 2004). In 2003, the CBRC was established. China's banking sector has been supervised by the PBC, the CBRC, the CIRC, the CSRC, and the SAFE since 2003 (Zhong Guo Jin Rong Jie Wang, 2014).

[42] Strategic Investor refers to the legal person shareholder who subscribes newly issued shares from the issuer and has the long-term cooperation and investment relationships with the issuer. This legal person can be the domestic or foreign enterprises as long as it has capital, technology, management, market and talent advantage which can upgrade the industrial structure, expand the market share for the issuer, strengthen the core competition and innovative capacity for the issuer to acquire profit reward.

In December 2003, to enrich the required capital base of the BOC and the CCB for joint-stock reform, the State Council made the decision to use state foreign currency reserves of USD 45 Trillion. The Central Huijin Investment Limited (Central Huijin), a wholly state-owned enterprise, was established to supervising those funds. In June 2004, Central Huijin also injected RMB 3 Trillion to BoCom. Thus, Central Huijin owned 6.68% of BoCom. Central Huijin became the sole shareholder of BOC and the largest holding shareholder[43] of the CCB. In April 2005, with permission from the state, joint-stock reforms of the ICBC started. The ICBC was injected with USD 15 Trillion by Central Huijin and the Ministry of Finance and Central Huijin was given 50% in the equity of each.

In October 2005, the CCB listed through an IPO on the Hong Kong Stock Exchange (HKSE). Simultaneously, the ICBC issued A-shares through the Shanghai Stock Exchange (SSE) and H-shares through HKSE. In June and July 2006, BOC was listed on HKSE and SSE, respectively. In September 2007, the CCB listed on SSE. In October 2008, ABC's joint-stock reform scheme was passed by the State Council. In July 2010, ABC went on a public listing at both the SSE and HKSE. The banking sector welcomed internationalization of bank ownership through the banks' efforts toward globalization.

Following these reforms, most commercial banks were listed and began their split-share reforms (see Chapter 1) with the permission of the CBRC but the state had to maintain control. This meant that even when state shares became tradable on the stock markets, the state and state legal person shareholders could not sell their shares without the CBRC's approval. While other state enterprises were privatized and allowed to sell their tradable

[43] The holding shareholder refers to having greater than 50% ownership, and if less than 50% but more than other shareholders' ownership proportion in the same enterprise or if there are fewer shares than other shareholders had, but exercising control through other shareholders indirectly.

state shares, the banking sector remained under state ownership and followed state strategy.

Table 5.2: The Link between State Enterprise and Banking Sector Reforms

Year	State Enterprise Reform	Banking Sector Reform
Governance Reform		
1979	More autonomy in operations and employees for own benefits	None
1984	The dissociation of state enterprises from the government and the separation of ownership rights and control rights were encouraged	1. BoCom was given autonomy in operations and manager/contract responsibility systems were adopted. 2. The policy-based functions of the big-4 banks were formally stripped as the three policy banks was established. 3. No reaction for the separation of ownership rights and control rights policy. The state had the controlling power in terms of ownership and control.
1994	Corporate governance structure	1. The Commercial Banking Laws of the People's Republic of China emphasized corporate governance structures for commercial banks. 2. Commercial banks had to act in accordance with the Company Laws of the People's Republic of China.
2005	Share incentive plans	Few
Ownership Reform		
1986	Joint-ownership system	1. Two batches of joint-ownership commercial banks emerged (For example: BoCom was the first joint-ownership commercial bank; CEB accomplished its joint-ownership reform in 1997, and became the first state-holding commercial bank with foreign shares. 2. In December 2003, joint-ownership reform of BOC and CCB started. 3. In April 2005, with the permission from the state, joint-ownership reform of ICBC started. 4. In October 2008, ABC's joint-ownership reform scheme was passed by the State Council.
1993	Listing	1. The Ministry of Finance issued special state treasury bonds to complement the big-4 state-owned commercial banks' capital base. 2. The state established four AMCs to strip NPLs from the big-4. 3. The State Council enriches the required capital base for BOC and CCB. 4. Central Huijin also injected RMB 3 Trillion into BoCom. 5. ICBC was injected USD 15 Trillion by Central Huijin.
2005	Split-share reform	Under the permission of CBRC, most state-holding listed banks started the spilt-share reform.

Source: Author

Table 5.2 shows that the reform of the banking sector occurred in tandem with state enterprise reform except that the state's controlling position (through ownership and management) was maintained. This meant that the reform process in terms of diminishing state control lagged behind that of non-financial state enterprises. Control has been given priority over ownership for state enterprises, but not for the banking sector. After split-share reform, even though there is a potential trend to reduce majority shareholders' shares, the state made special policies to retain its controlling position in the banking sector in terms of ownership and control. Thus, it is not hard to understand the marketization and corporatization of China's banking sector has been at a slower pace than for other state sectors.

Table 5.3: Main Financial Indicators of the Big-5 Commercial Banks (2006-2012)

	2006	2007	2008	2009	2010	2011	2012
1. Credit Risk Indicator – NPLs to Total Gross Loans (%)							
ICBC	3.79	2.74	2.29	1.54	1.08	0.94	0.85
BOC	4.04	3.12	2.65	1.52	1.10	1.00	0.95
BoCom	2.01	2.05	1.92	1.36	1.12	0.86	0.92
CCB	3.29	2.60	2.21	1.50	1.14	1.09	0.99
ABC	23.43	23.50	4.32	2.91	2.03	1.55	1.66
Overall	7.1	6.2	2.4	1.6	1.1	1.0	1.0
2. Liquidity Indicator – Loan-Deposit Ratio (%)							
ICBC	51.4	56.3	56.4	59.5	62.00	63.50	64.10
BOC	57.60	64.78	63.71	70.30	70.20	68.77	91.19
BoCom	64.14	64.87	64.91	71.97	72.10	71.94	72.71
CCB	60.87	61.27	59.50	60.24	62.47	65.05	66.23
ABC	66.37	65.87	50.84	55.19	55.77	58.50	44.97
3. Performance Indicators							
3.1. Net Profit (Trillion Yuan)							
ICBC	48.72	81.26	110.77	128.60	165.16	208.27	238.53
BOC	41.89	56.23	63.54	80.82	104.42	124.18	139.43
BoCom	12.27	20.51	28.42	30.08	39.04	50.74	58.37
CCB	46.32	69.05	92.60	106.75	134.84	169.25	193.17
ABC	5.81	43.79	51.45	65.00	94.87	121.92	145.09
3.2. Return on Assets (%)							
ICBC	0.71	1.01	1.21	1.20	1.32	1.44	1.45
BOC	0.96	1.09	1.00	1.09	1.14	1.17	1.19
BoCom	0.80	1.07	1.19	1.01	1.08	1.19	1.18
CCB	0.92	1.15	1.31	1.24	1.32	1.47	1.47
ABC	0.88	0.84	0.82	1.24	0.77	1.04	1.05
3.3. Return on Equity (%)							
ICBC	15.18	16.15	19.39	20.14	22.79	23.44	23.02
BOC	13.86	14.22	13.72	16.42	18.86	18.27	18.10
BoCom	14.42	17.17	20.86	19.26	20.08	20.49	18.43

Table 5.3, continued: Main Financial Indicators of the Big-5 Commercial Banks (2006-2012)

CCB	15.00	19.50	20.68	20.87	22.61	22.51	21.98
ABC	N/A	-6.01	17.72	18.96	17.50	20.46	18.76
3.4. Earnings per Share (Yuan)							
ICBC	0.15	0.24	0.33	0.39	0.48	0.60	0.68
BOC	0.17	0.22	0.25	0.32	0.39	0.44	0.50
BoCom	0.26	0.43	0.58	0.61	0.73	0.82	0.88
CCB	0.21	0.30	0.40	0.46	0.56	0.68	0.77
ABC	N/A	N/A	N/A	0.25	0.33	0.38	0.45
3.5. Cost-Income Ratio (%)							
ICBC	35.68	34.84	29.54	32.87	30.61	29.38	28.56
BOC	38.96	35.59	33.55	37.15	33.62	32.58	31.81
BoCom	46.04	40.26	39.38	38.87	31.89	30.13	29.71
CCB	38.00	35.92	30.73	32.93	31.50	29.87	29.57
ABC	50.43	43.36	44.71	43.11	38.60	35.89	37.10
4. Capital Adequacy Indicator – Bank Capital to Assets Ratio (%)							
ICBC	14.05	13.09	13.06	12.36	12.27	13.17	13.66
BOC	13.59	13.34	13.43	11.14	12.58	12.97	13.63
BoCom	10.83	14.44	13.47	12.00	12.36	12.44	14.07
CCB	9.92	12.58	12.16	11.70	12.68	13.68	14.32
ABC	N/A	N/A	9.41	10.07	11.59	11.94	12.61
Overall	5.1	5.7	6.0	5.6	6.1	6.4	6.3

Source: Annual reports of big-5 commercial bank (2006–2012) and World Bank (2012)

Additionally, during reform, the state played an important role. In addition to efforts to boost their performance through preferences like low borrowing costs and shielding from competition, the Chinese state also paid attention to increasing efficiency within the confines of state policy. In addition, the state targeted the banking sector for public listing, joining WTO, and further opening to the international market to attract foreign equity and competition, i.e., going global (see later). The state also offered substantial assistance such as helping their recapitalization and the transfer of NPLs and the injection of reserve funds to fulfil Basel Accord requirements. Listings on stock exchanges mandated these banks to conform to international corporate governance benchmarks. Moreover, the GFC had propelled them higher in global rankings by asset size.

Table 5.3 shows the main indicators of the big-5 commercial banks that embarked on a substantial reform effort. Because of banking sector reforms, the NPLs to total gross loans ratio fell and indicators such as net profit, return on assets, return on equity, and earnings per share were gradually increasing. The cost-income ratio decreased overall and indicated the costs from deposits were reduced. The bank capital to assets ratio (%) was substantially greater than the average level of total banks that saw good capital adequacy. Loan-deposit ratios were increased overall and indicated that a leveraging strategy was adopted.

5.3.2 The Current Structure of China's Banking Sector and the Role of the State in the Main State-holding Commercial Banks

The above changes have produced a financial sector that continues to be dominated by government ownership and control. Today, the financial institutions of the banking sector includes policy banks, commercial banks, rural cooperative banks, urban credit cooperatives, rural credit cooperatives, finance companies affiliated to enterprise groups, trust and investment companies, financial leasing companies, auto financing companies, money brokers, and so on. Policy banks like the CDB, the Agricultural Development Bank of China, and the Export-Import Bank of China are joint-stock banks with 100% state ownership. Commercial banks consist of large commercial banks, joint-stock commercial banks, municipal commercial banks, rural commercial banks, and foreign investment banks. Major commercial banks include the big-4 commercial banks and BoCom, which are now known as the big-5 commercial banks. Joint-stock commercial banks consist of the China Citic Bank, the CEB, the Huaxia Bank, the China Guangfa Bank, the Ping An Bank, the China Merchants Bank, the Shanghai Pudong Development Bank, the Industrial Bank, the China Minsheng Banking, the Evergrowing Bank, the China Zheshang Bank, and the China Bohai Bank, for 12 in total (China Banking Regulatory Commission, 2013).

Table 5.4: Fourth-Quarter-End Balances for Major Commercial Banks and Joint-Stock Commercial Banks (2003-2012)

Year	Major Commercial Banks	Total Assets: % of in All Financial Institutions of Banking Sector	Total Liabilities: % in All Financial Institutions of Banking Sector	Joint-Stock Commercial Banks[44]	Total Assets: % of in All Financial Institutions of Banking Sector	Total Liabilities: % in All Financial Institutions of Banking Sector
2003	The Big-4[45]	54.9	54.8	13	13.8	13.9
2004	The Big-4	53.6	53.5	13	14.9	15.0
2005	The Big-4	52.5	52.4	13	15.5	15.7
2006	The Big4	51.3	51.0	13	16.2	16.5
2007	The Big-4	53.2	53.3	13	13.8	13.9
2008	The Big-5[46]	51.0	51.0	12	14.1	14.3
2009	The Big-5	50.9	51.0	12	15.0	15.1
2010	The Big-5	48.7	48.7	12	15.8	15.9
2011	The Big-5	47.3	47.4	12	16.2	16.3
2012	The Big-5	44.93	44.89	12	17.61	17.78

Source: Statistics of China Banking Regulatory Commission

Table 5.4 shows the proportions of China's major commercial banks in the total assets of all financial institutions of the banking sector, which had progressive reductions but remaining number remained considerable until 2012. Even though the total numbers of joint-stock commercial banks are much more than the major commercial banks, their total assets are not as significant as the major commercial banks'.

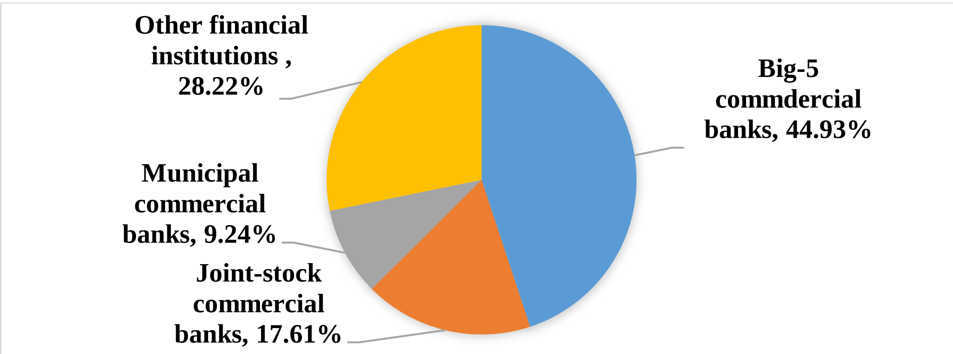

Figure 5.1: Percentage Share of Assets of the Banking Sector in All Financial Institutions[47]

Source: Statistics of China Banking Regulatory Commission

[44] 13 joint-stock commercial banks included BoCom while 12 joint-stock commercial banks did not.
[45] The big-4: ICBC, BOC, CCB, and ABC.
[46] The big-5: ICBC, BOC, CCB, ABC, and BoCom.
[47] Other financial institutions consist of policy banks, rural commercial banks, foreign investment banks, rural cooperative banks, urban credit cooperatives, rural credit cooperatives, finance companies affiliated to enterprise groups, trust and investment companies, financial leasing companies, auto financing companies, money brokers, and so on.

Figure 5.1 shows the ownership structure of the big-5 commercial banks and joint-stock commercial banks (17 in total), accounted for more than 60% of the assets of the banking sector. Thus, The Chinese state has tried to keep these institutions large and powerful. Foreign investment banks shares were not significant.

5.3.2.1 Ownership Analysis

Table 5.5 shows that among China's main banks, the state has a large proportion of ownership. By examining the ownership structure of the top-10 shareholders of those banks, the ownership concentration by the state and legal person shareholders is relatively high. Moreover, as one of the shareholders in most of those banks, the state or a state legal person is the controlling shareholder. This means the state exercises control over all major banks. Table 5.5 shows that foreign ownership is present among those banks, but compared to state ownership is not significant.

Table 5.5: Ownership Analysis of the Main Banks in China

Bank Name	Holding Shareholder	State Share And State Legal Person Share Portion[48] (%)	Foreign Investment Share Portion[49] (%)	Tradable Shares[50] (%)
BOC	Central Huijin	67.94	29.44	100
ABC	Central Huijin	82.70	9.36	17.3
CCB	Central Huijin	59.71	36.51	100
ICBC	Central Huijin	70.8	24.6	100
BoCom	Ministry of Finance	36.27	18.7	91.19
China Citic Bank	CITIC – Wholly Owned by Ministry of Finance (Actual controller[51])	63.29	30.93	95.43
CEB	Central Huijin	65.65	4.35	46.83
Huaxia Bank	Shougang Group	44.36	19.99	72.86

[48] State shares are shared owned by the state. A state legal person refers to state-owned, state-holding, and state joint-stock organizations. Then, state legal person shares could not be identified as 100% state shares. And the real number may be larger than showed here, since some shares may be hidden. And "N/A" represents "Not Applicable".
[49] The real number may be larger than showed here, since some shares may be hidden. And "N/A" represents "Not Applicable".
[50] "N/A" represents "Not Applicable".
[51] According to the Company Law of China, actual controllers referred to those who could acquire controlling power over a company without being the shareholder of this company through investing in the shareholder company, signing contracts, or through other channels.

Table 5.5, continued: Ownership Analysis of the Main Banks in China

China Guangfa Bank	Citigroup, China Life Insurance, Yingda International Holdings Group & CITIC Trust	72.15	23.67	N/A
Ping An Bank	Ping An Insurance	N/A	None	60.61
China Merchants Bank	China Merchants Group	30.57	17.87	100
Shanghai Pudong Development Bank	Shanghai International Group	62.99	N/A	80
Industrial Bank	Fujian Government	35.74	13.13	84.92
China Minsheng Banking	N/A	N/A	20.22	100
Evergrowing Bank	Yantai Blue Sky Investment Holding	20.55	14.26	N/A
China Zheshang Bank	Zhejiang Government	14.29	N/A	N/A
China Bohai Bank	Teda Investment Holding	62.01	19.99	N/A

Source: Authors' own calculation from latest annual reports of above listed banks, which are supervised by the CSRC through its Annual Report Standard.

Split-share reforms of those banks was adopted. Most uncirculated shares could not be traded for a fixed period. After this period, state and state legal person shares became freely circulated on the stock market. Nevertheless, the state also consolidates its controlling position by purchasing the tradable shares from the stock market. For example, the holding shareholder of the ABC, Central Huijin bought A-shares through SSE to increase its ownership proportion in 2012. The listing and split-share reform was completed and well received by those banks as most are listed domestically or in Hong Kong, and the numbers of tradable shares for listed banks are considerable.

5.3.2.2 Governance Criteria

Most of the Board of Directors and top management of China's five large state-holding commercial banks are hires of the financial and other fields from the government departments or other state enterprises. Key positions (Board of Directors, Board of Supervisors, and top management) in the big-5 commercial banks were filled by internal transfers among these banks as well as PBC, the three policy banks, CBRC, government departments (the Central Committee of the Communist Party of China, National People's Congress, the State Council, the Chinese People's Political Consultative Conference, etc.), and state enterprises, which were all government institutions. They were considered experienced in China's reforms and opening up as well as the transformation of financial institutions. In addition to strengthening internal collaborations and enacting strategies to boost performance, the control of management also ensures that government policies are followed by those banks.

The state's controlling power remains with the public officials. Among governments and government bodies, there are five general administrative levels for public officials: national level, provincial level, bureau level, county level, and district level.[52] Administrative systems for state enterprises were eroded and eventually abandoned during state enterprise reform, but were retained in major commercial, joint-stock, and municipal commercial banks through a hidden administrative level system.

China's system had a Party Committee established within an enterprise. For a private enterprise it is an option but for a state enterprise, it is compulsory. The role of the Party Committee is determined by the proportion of state shares. It functions to ensure that the Communist Party of China's policies and strategies are executed. It participates in decision-making, supervision, day-to-day operations, employment of key persons, coordination of internal relations, and other corporate governance details. The state's controlling power in the banking sector is through the Party Committee.

The ultimate power to decide policy, not day-to-day operations, is vested in the CBRC. The CBRC under the State Council regulates banks and ensures they follow the state's

[52] Peoples Republic of China's Law on Public Officials had been approved by the 15th Session of the Standing Committee of the Tenth National People's Congress (The Central People's Government of the People's Republic of China, 2005a).

policies and strategies (diplomatic policy, national defense policy, monetary policy, etc.) (China Banking Regulatory Commission, 2014).

For instance, directives given to the banks after the GFC included instructions to ensure real consumption contributed more to economic growth than gross fixed capital formation, and to ensure services are oriented toward the domestic middle classes than toward export-oriented manufacturing. Under the first directive, ICBC made more loans to individual consumption, small and medium-size enterprises, and middle-class consumers. ICBC bought government bonds, central bank bonds and policy bank bonds, but it was not compulsory; ICBC's purchases of government or other bonds were based on their returns on investment.

Partial after-tax profits of selected state enterprises had to be submitted to the state. The after-tax profit retention was for the state enterprise's own development, which took the place of the financial allocation from the state since state enterprises reform began. Again, this policy was not adopted by the banking sector financial institutions (Ministry of Finance of the People's Republic of China, 2013).

The state regulated pricing of commercial bank services, including charges for prices of basic service like bank bills of exchange, promissory notes, checks, credit transfers, and procuration services such as basic settlement prices. Pricing is the responsibility of the price administrative departments under the State Council, the banking regulatory authorities under the State Council, and the People's Bank of China (The Central People's Government of the People's Republic of China, 2012).

Major commercial banks' remuneration of and benefits for key personnel were decided by the respective supervision institutions according to their administrative level. However, their management is supposed to be in accordance with international standards, detailed in the Basel Accords III, and should include international audits and international financial statements.

At present, banks assume sole responsibility for their profits or losses. They do not submit their profits to the state. Four AMCs took over RMB 866340 Million of the NPLs big-4 commercial banks up to the end of March 2006 (China Banking Regulatory Commission, 2006a). The state ultimately bought the rest of the NPLs. After that, the four AMCs transited from policy institutions to commercialized companies. In addition, the proportion of NPLs in the big-4 remained low. Therefore, the four AMCs did not have to play a role in taking over their NPLs.

Overall, the Chinese banks have major state ownership, follow state policies and regulations, and enjoy state favor over non-state commercial banks. The Chinese state through the CRBC still maintains absolute control over the banking sector with the control channels being mainly through ownership and the Party Committees (China Banking Regulatory Commission, 2006b).

The need for state control, stemming from the unfortunate history of Chinese banking, has been stressed repeatedly by the leadership and top management of the banks. Zhou Xiaochuan, the president of the PBC, was reported to have said that the need to restructure the Central Huijin was to keep the absolute control of China's major banks (Zhang, 2007). Jiang Chaoliang, a director on the Board of BoCom, said that in order to ensure the absolute control position of the state in China's banking sector, China's banking sector should not relax the policy that foreign shares could not exceed a percentage[53] (Jiang, 2008). Cai Esheng, the Vice President of the CBRC, said the banking sector reform should be under the condition of the Chinese state's absolute control (Zhang, 2006).

[53] It shall not exceed 20% of the shares of Chinese financial institution when a single foreign financial institution invests in a Chinese financial institution, and it cannot exceed 25% for the joint shares of multiple foreign financial institutions (China Banking Regulatory Commission, 2003).

5.4 Answering the Government's Call

The commercial banks also have to assist other state enterprises. As initially specialized banks, China's banks were little more than fund disbursement institutions to fund state-owned enterprises' economic activities. In the 1980s, the state started to transfer funds to newly founded state enterprises in the form of loans instead of appropriations ("loan replacing appropriation"). Thus, the state-owned banks played a substantial role in providing these loans.

There were 6,599 large and medium state enterprises with losses in 1997, which prompted the 15th China Communist Party National Congress to put forward its "getting out of difficulties within three years" to bring them out of the red. The lending policy was framed such that bank lending would favor loss-making state enterprises. Moreover, technology innovation was rewarded with more loans and appropriations of special funds for selected state enterprises were encouraged. Preferential channels such as access to borrowed funds at favorable interest rates, debt forgiveness, or loans to boost creditworthiness were provided by the state. The Chinese state directed lending to favored state sectors through policy implemented by commercial banks (World Trade Organization, 2010).

State-holding commercial banks have to also answer the state's call under extraordinary circumstances as well as support state strategies overseas in addition to providing banking services to the Chinese people and financial support for the economy. Two such circumstances, China's entry into the WTO and the GFC, as well as an instance of supporting the state's "going global" strategy will be discussed next.

5.4.1 China's Entry into the WTO

As China globalizes, banks have an important role in facilitating trade with China's trading partners. To remove trade barriers, China wanted to be able to be fully competitive internationally. That was why it joined WTO in 2001. China's banks would engage with banks in WTO member countries under the WTO Financial Services Agreement, which is within the framework of the General Agreement on Trade in Services (GATS). GATS covered four modes of international service trade when applied to China's dealings with other members: cross-border supply referred to services delivered within the territory of China from the territory of another member; consumption abroad referred to service delivered outside the territory of China in the territory of another member to a service consumer of China; commercial presence referred to service delivered within the territory of China through the commercial presence of the foreign supplier; and the movement of natural persons referred to service delivered within the territory of China, with foreign supplier presenting as a natural person. China's banking sector also opened itself to foreign stock ownership. This forced banks to face fierce competition as foreign investment banks' join the Chinese banking market. China Unionpay was one product of China's entry into the WTO. China Unionpay is a Chinese bankcard association that provides an inter-bank, cross-region, and cross-border transaction settlement system among connected banks.

In compliance with the agreement under which China joined the WTO, the Chinese banking sector was opened to an international market in December 2006. Chinese banks also attracted foreign investment through international listings. Moreover, foreign financial institutions entered domestic markets as a stand-alone foreign bank or through acquiring shares of Chinese banks.

Foreign banks, however, did not operate on a level playing field when admitted and faced greater supervision from China's state supervision departments. In the early stages of foreign banking entering Chinese financial markets, the Chinese state worried that domestic financial institution would be disadvantaged if opened too quickly to foreign competition, so supervision departments issued accreditation to foreign bank businesses with a cautious attitude. In fact, however, foreign banks were not a threat to domestic banks at all. They were not allocated any of the RMB 4 Trillion stimulation during the Global Crisis and their local customer base and networks were small. However, the foreign banks' profitability came mainly from their investment in domestic banks. For instance, as at the end of 2012, HSBC Holdings owned 10.87% shares of the Industrial Bank[54] through Hang Seng Bank, which is the second largest shareholder. HSBC Holdings was also the third largest shareholder of BoCom, with 18.7% of ownership. It was the second largest shareholder of Shanghai Bank.

5.4.2 Penetrating Global Financial Markets

At the same time, the big-5 banks were important instruments of state policy to make acquisitions on global financial markets. Since the end of 2007, CCB acquired Bank of America (Asia) and BOC purchased Singapore Aircraft Leasing Enterprise. ICBC cooperated with the Kuwait Investment Authority to search for investment opportunities around the world. Since 1993, when the Singapore branch of ICBC was established, the globalization strategy was activated through purchased international banks to establish local branches. Since 2007, ICBC acquired Halim Bank in Indonesia and Seng Heng Bank (the biggest local bank of Macau), and purchased some stock equity from the largest local bank of South Africa (the Standard Bank of South Africa). In February 2013, China announced expansion of RMB exchange protocols with Singapore and the PBC appointed

[54] Industrial Bank is one of joint-stock commercial banks.

ICBC's Singapore branches to execute RMB clearing operations and to play an agency role between Singapore banks and the PBC (Yang, 2013). This protocol would build an easier trade bridge between Singapore and China and benefit the RMB's international progress. Of course, ICBC stands to profit from each transaction.

5.4.3 Global Financial Crisis

In 2008, the GFC rocked the whole world. As a consequence of this crisis, the foreign demand for China's goods plummeted; and to maintain economic growth, China was seeking to stimulate domestic demand. In November 2008, President Wen Jiabao required the banking sector to provide support for economic growth by participating in the RMB 4 Trillion stimulus plan. Enlarging credit was a major part of this plan. According to the Statistics and Analysis Department of PBC, credit was expanded by RMB 9.59 Trillion and the big-5 commercial banks accounted for approximately half of this expansion. Table 5.6 shows that loans by the big-5 commercial banks doubled from 2008 to 2012. This was mainly attributed to the state's policies to maintain economic growth.

Table 5.6: Total Value of Loans Extended by Big-5 Commercial Banks (2006-2012)

Iterm (Trillion Yuan)/Year	2006	2007	2008	2009	2010	2011	2012
ICBC	3534	3958	4436	5583	6623	7594	8583
BOC	2338	2754	3190	4797	5538	6203	6710
BoCom	910	1083	1299	1801	2190	2505	2880
CCB	2874	3183	3683	4692	5526	6325	7310
ABC	3124	3480	3100	4138	4788	5399	6153
Sum up	12780	14458	15708	21011	24665	28026	31636
Total Loans of Financial Institutions	22529	26169	30339	39968	47920	54795	62991
Growth Rate	N/A	16%	16%	32%	20%	14%	15%
% of Big-5 in Total	57%	55%	52%	53%	51%	51%	50%

Source: Annual reports from the big-5 commercial banks (2006-2012) and summary of sources and uses of credit funds of financial institutions from (2006-2012), from the Statistics and Analysis Department, the People's Bank of China.

The financial sector, strengthened through reforms and not having purchased much of America's toxic assets, remained resilient to the GFC shocks. China was also not overly dependent on foreign capital for its development. Indeed, the troubles facing Western banks have catapulted Chinese banks to the forefront in global rankings.[55] Another impact has been that banks, which have traditionally focused on large enterprises began to turn their attention to small and medium enterprises, especially after the government tightened credit in the aftermath of the stimulus package (Zhang & Cheong, 2011). In its assessment report, the IMF concluded that China's financial sector "entered the GFC from a position of relative strength" (International Monetary Fund, 2011). However, it also outlined several risks, including the growth of "off-balance sheet exposures and of lending outside of the formal banking sector" that can reduce banks' loan portfolio quality (International Monetary Fund, 2011).

The adverse impact of the GFC on export-oriented enterprises and construction firms was a major source of vulnerability for China. Another was the large credit expansion that accompanied China's RMB 4 Trillion stimulus package, which threatened to reverse the hard-won successes in containing a potential real estate bubble and cooling an overheated economy just prior to the onset of the GFC. In the housing sector, already low borrowing costs encouraged over-investment in housing,[56] while local municipal governments have directed state enterprises to invest in housing or channel funds to real estate developers (Xu, Yeh, & Wu, 2009). Even those worried about the banks' heightened vulnerability, however, were undoubtedly mindful of the considerable resources the Chinese government could deploy to support these institutions (International Monetary Fund, 2011).

[55] As of July 2011, Chinese banks – the ICBC and the CCB – occupied the top two spots in terms of market capitalization (Bloomberg).
[56] However, Huang (in Carnegie 2011) provided an interesting justification for this financial repression. He argued that to the extent that the wealthy lose more from this repression through an inflation tax, the government used this as a progressive form of taxation at a time when few Chinese citizens fell within the tax net.

One consequence of the GFC is that it may well have a greater lasting impact that is likely to slow down financial reforms of the kind advocated by the IMF. Whether this consequence is positive or otherwise remains to be seen. While the IMF and others lament this development (Lipsky, 2011), it should hardly be surprising if the GFC led the Chinese leadership to exercise greater caution moving this reform forward.[57] "Backwardness" in financial innovation and cross-border financial intermediation as well as underdeveloped capital markets was what allowed Asia to limit contagions from the GFC were views that Asian leaders shared (Khor & Tan, 2011). An important difference between the AFC and the GFC is that while during the AFC sizable NPLs signaled immediate danger to Chinese banks and, thus, spurred financial reforms, the weaknesses of banks during the GFC are nowhere as immediate. China's leadership clearly sees countering a continuing impact of the GFC having a higher priority than banking reforms. And, as the AFC clearly demonstrated, countering crisis impact is most effective under centralized decision-making followed by "unified action" (Yao & Wu, 2011).

Will financial reform continue, albeit with some delay or with greater caution? The answer will likely be yes. First, the lesson of the GFC is not so much that financial liberalization should be halted but that effective prudential regulation should have been enforced. The casualty is not financial liberalization but the neoliberal approach to liberalization. Second, the long-term costs to the Chinese economy of the weaknesses discussed above, in the form of distorting investment choices at the microeconomic level and of hampering the effective implementation of monetary policy at the macroeconomic level are persuasive arguments for continued liberalization (McCormick, 2008). These costs, not the accusation of Chinese culpability in the GFC in the form of adopting mercantilist policies (Wolf, 2008), will provide the impetus for continued reform.[58]

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[57] The need for caution in financial liberalization is shared by other Asian countries.
[58] Huang, Wang, Wang and Li (2010) found evidence that financial liberalization was helpful to China's economic growth while financial repression inhibited it (Huang, Wang, Wang, & Lin, 2010).

Indeed, China's 12th Five Year Plan speaks of reform to move towards market interest rates.[59] As history shows and given its abundant stock of foreign reserves, China will not be pressured by external voices but will manage this process at a pace it deems appropriate.

5.5 Conclusion

The reform of China's banking sector took place in conjunction with state enterprise reform but followed a somewhat different path. Instead of privatization, China's banking sector underwent corporatization and governance reform but the state did not reduce its ownership. To implement the governance reform, the big-4 banks acquired increasing autonomy and established a sound modern corporate governance structure. Through introducing the joint-stock system, the ownership structure was somewhat diversified with equity from private capital. They became joint-stock enterprises through listing, foreign investment joint, or the exchange of equity. However, the state still possesses a dominate position in much of the banking sector and regards banking as a strategic industry. Thanks to reform, however, this ownership is combined with an independent modern corporate governance structure. This structure means that while the state retained the controlling power it does not intervene in the banks' day-to-day operations. Thus, the reform of China's banking sector was in line with state enterprises reform-corporatization but without losing state control (both ownership and governance).

Why has the state maintained its dominance through ownership of the major banks? First, as has been shown in detail in this chapter, this dominance has historical origins, stemming from lessons learned from the Qing Dynasty and the post-revolutionary period before the outbreak of the Second World War, when successive governments tried but failed to control the financial sector and currency system to manage the economy. The

[59] Okazaki, Hattori, & Takahashi (2011)drew lessons from the Japanese experience in financial liberalization to urge financial reform to facilitate internationalization of China's banks, in line with that for the RMB (Okazaki, Hattori, & Takahashi, 2011).

result has been frequent changes and policy reversals in the quest to form a central bank, control of currency, and financially manage the economy, with policies held hostage to political rivalry and leadership struggles. The role of foreign interests, be they states or private enterprises, in furthering their own interests in China's financial system, and Chinese reliance on them to bolster the latter must have been another lesson not lost on later generations of the Chinese leadership.

Second, the central role of the state as a political philosophy, which is also rooted in China's culture and history as discussed in Chapter 4, calls for banks to be major instruments of Chinese policy under its state-led model. This means banks are called upon in extraordinary situations when the stability of the economy is threatened and when the state seeks to advance its interests beyond its borders. This role can clearly be seen when the GFC hit China in 2008-2009 and when the Chinese government sought membership in the WTO and to increase its international footprint.

At the same time, the government is aware of the inefficiencies associated with not privatizing these banking institutions. It has attempted modernizing their governance, strengthening efficiency, and distancing them from the central government in their day-to-day operations, which has resulted in their operating like and fulfilling the role of commercial banks in the country's financial system. It has however also accorded them preferential treatment.

With state protection, they are performing well, perhaps to the detriment of truly private banks. China is pursuing and its leadership is clearly aware of the transitional costs of the state role in banking for the development of a private banking sector, which is consonant with the state-led growth model. However, they must feel this cost is outweighed by what they believe to be the benefit from being able to use banks to support and implement state functions in ways that Western commercial banks have not or could not. China's enormous pool of external reserves undoubtedly gives the government comfort in managing whatever costs such a system may engender. Therefore, it is likely that the Chinese state will live with the costs until such time when the government feels sufficiently confident that the economic system is no longer vulnerable, especially from outside forces, to instability; be they financial, economic, or otherwise.

CHAPTER 6 CHINA'S "COMMERCIAL" STATE ENTERPRISES – A CASE STUDY OF ZTE CORPORATION

6.1 Introduction

The state has played a dominant role since the establishment of the People's Republic of China in 1949, with this role fulfilled by state enterprises since 1978. Reform of state enterprises was a central area of reform in the country's transformation towards a socialist market economy. One product of this reform is that it is very hard to characterize a state enterprise in China today. Some enterprises are 100% owned by the state, while others are partially owned with varying degrees of state control. Some are held by a state enterprise which is a subsidiary of another state enterprise. In addition, there are enterprises over which the state has control despite having less than a controlling ownership share. Because of the complicated ownership of those enterprises, as well as an unclear link between ownership and control, characterizing state enterprises is not a simple matter.

This situation raises questions that have implications for both the applicability of theory as well as the meaning of state enterprise as currently understood. The western concept of public enterprise is defined by ownership, whether in whole or in part, by the state. Through ownership, control is exercised. To the extent it is the latter which really matters for the state, two related questions are, first, how control is exercised, and second, how does this control affect enterprise performance. Existing theories answer the latter question by pointing to the inferior performance of state enterprises compared to their private counterparts.

Gaining insights into the above issues are the research objectives. Specifically, the objectives are to: (1) clarify the meaning of state and state enterprise in the Chinese context, (2) assess the applicability of extant Western theories of public enterprise in light of (1) above, (3) link the complexity of Chinese state enterprises ownership and control and performance to the reforms that brought the situation about, and (4) view all the above through analysing the case of ZTE Corporation, a large enterprise officially classified as a "state-holding enterprise". Since objective 1, 2, 3 has been stated in previous chapters, this chapter will focus on objective 4.

Using a case study approach, we profile in section 6.2, 6.3 ZTE Corporation, relating its development to the reforms mentioned earlier. The discussion is centred on the evolution of the magnitude and nature of state ownership and control. How these links with the state impact enterprise performance is the subject of section 6.4, 6.5, 6.6. The concluding section draws together the main findings and highlights several implications, including for the application of existing theories.

6.2 Rationales for Choosing ZTE Corporation

The case study method cannot allow conclusions to be generalized. However, one way to ensure the significance of case study-based research is to select a case that is important to, in our case, a particular industry or the economy, this importance deriving from its scale of operations, or its contribution to national strategy. These criteria led us to select ZTE Corporation, a major manufacturer of electronic communications equipment. To understand ZTE Corporation requires an appreciation of its holding company, ZTE Holdings. Since ZTE Holdings is not listed, the information in this chapter is gleaned from interviews/conversations with its management.

This study is also embedded and longitudinal. Embedded in this case are key players in the enterprise – top managers and officials with knowledge of state enterprises – with whom interviews were conducted. The period covered is from the enterprise's inception to the present. Secondary data was from existing online databases and also annual reports of ZTE Corporation and selected other state enterprises were used to provide supporting data including the shareholder structure, assets, profits, and so on.

In terms of size, ZTE Corporation is the largest firm in the integrated communications manufacturing industry, with 2012 revenues of 84,219,400,000 Yuan. From the government's perspective, it, together with firms like Huawei Technology Co. Ltd., spearheads the country's drive to upgrade national technological capability under the Medium and Long-term Plan for Science and Technology Development 2006-2020.

ZTE Corporation provides global communications network solutions. Its businesses focus on design, development, distribution, installation of various advanced telecommunications systems and equipment including wireless, access & bearer, VAS, operators' networks, terminals etc.. It was listed in the Shenzhen Stock Exchange domestically and the Hong Kong Stock Exchange internationally. The Corporation not only cooperates with China's leading telecommunications services operators like China Mobile to provide telecommunications products but also delivers its innovative products and business solutions across 140 countries through building operators' networks (ZTE Corporation, 2013a).

6.3 A State Enterprise in Transition – ZTE Corporation

ZTE Corporation is officially classified as a state-holding company by two of the criteria stated above – the state, though a minority shareholder, is the largest shareholder among all shareholders, and it also exercises control through its holding company – ZTE Holdings. Its corporate history, divisible into phases, is an eloquent documentary of the progress of state enterprise reform. The period from its formation in 1985 as the Shenzhen Zhongxing Semiconductor Co. Ltd. to about 1992 marked its first phase.

As the workshop director and the chief technology officer of the state military industry enterprise Aerospace System 691 Factory, Hong Weigui was selected as the enterprise's representative to go to the Shenzhen Special Economic Zone to look for cooperation partners to form a new technology enterprise. In May 1985, with the approval of the Shenzhen government, Shenzhen Zhongxing Semiconductor Co. Ltd was founded with Hong Kong's Yunxing Electronics Trading Company as the foreign partner, and two state enterprises China Great Wall Industry Corporation Shenzhen Branch (now merged into Shenzhen Aerospace Guangyu Industry (Group) Corporation) and Aerospace System 691 Factory as equity owners. With registered capital of 2,800,000 Yuan and 66% of ownership from Aerospace System 691 Factory, the new company appointed Hong Weigui president. The contract responsibility system was adopted when the Board chose one of the three main shareholders to take the operating responsibility through a contract against which its share capital and dividends were pledged. In December 1992, a group of technicians and managers from Shenzhen Zhongxing Semiconductor Co. Ltd incorporated a private enterprise Shenzhen Zhongxing Weixiantong Equipment Co. Ltd. with registered capital of 3,000,000 Yuan. This company would have a significant role to play in ZTE Corporation's development. It should also be noted that while Shenzhen Zhongxing Weixiantong Equipment Co. Ltd. was legally a private enterprise, its owners were employees of a state enterprise. As will be demonstrated later, this ownership pattern has major implications for ownership and control.

The second phase began with the enterprise's transformation into the Shenzhen ZTE Holdings and lasted just 3 years until 1996. In March 1993, Zhongxing Weixiantong Equipment Co. Ltd. merged with two state enterprises – Shenzhen Aerospace Guangyu Industry (Group) Corporation and Aerospace System 691 Factory to form a joint venture company "Shenzhen ZTE Holdings" with the state owning 51% of shares. It was run by Zhongxing Weixiantong Equipment Co. Ltd. and owned by both state and private parties. Thus Shenzhen ZTE Holdings is an example of the "state holding and private operating" system referred to earlier in which the state as owner delegated management to a private shareholder but the private shareholder had to pledge its share rights. State ownership with private management occurred with state enterprise reform to loosen ownership but retain control. In 1995, Shenzhen ZTE Holdings began its internationalization strategy.

Phase 3 (1997-2003) saw the enterprise listing on the Shenzhen Stock Exchange. In November 18 1997, Shenzhen ZTE Holdings incorporated Shenzhen ZTE that issued 65,000,000 shares with the price of 6.81 Yuan per share as its initial public offering at Shenzhen Stock Exchange. It was the first listed Chinese enterprise manufacturing large scale telecommunications equipment. Shenzhen ZTE is thus also an example of a state enterprise listing to tap outside capital and at the same time subjecting itself to the discipline of the market.

It was in this period that Shenzhen ZTE's technological potential was recognized by the government. In 1998, the State Economic and Trade Commission identified Shenzhen ZTE as one of the national technology centres, rendering it eligible to enjoy preferential treatment in the form of duty-free import of new technologies, instruments, and materials for R&D (Lian, 2012). Tax exemptions and relief were also accorded to expenditures for pilot projects and fixed assets investment for science and technology facilities. But the last two were terminated since 2000.[60] As evidence of its growing capability, Shenzhen ZTE cooperated with the Guangzhou Railway Corporation to construct the first home-engineered railway telecommunications system, thus breaking the monopoly held by foreign enterprises in this area.

The last stage focusing on shareholding reform was from June 2003, when Shenzhen ZTE Co. Ltd. was renamed ZTE Corporation to enter the international market, which is also a part of the government strategy of state enterprise reform to build internationally competitive firms. In December 9 2004, ZTE Corporation was the first A-share listed

[60] The last two preferences were terminated in 2000.

enterprise (A-shares refer to Yuan-denominated shares which can only be traded in the SSE) which listed in Hong Kong Stock Exchange and issued H-shares (Hong Kong dollar 3.1 Billion denominated shares listed in Hong Kong).

In accordance with the shareholding reform mentioned earlier, "Directions for ZTE Corporation's split share reform" was announced by the Board on November 23, 2005 and adopted by ZTE Corporation on December 25, 2005. Because 7 state-holding enterprises were state legal person shareholders, SASAC's review and approval of this proposal was required (Shenzhen Stock Exchange, 2005).

The non-tradable shares could not be traded or transferred in the first 12 months of their issue, no more than 5% of the general share capital from ZTE Holdings could be circulated after 12 months, 10% after 24 months and 37.41% after 36 months. Further ownership protection was accorded holders of non-tradable shares through the setting of a higher price than tradable shares when the former became tradable.

In 2006, in order to support its expansion in the international market, ZTE Corporation transferred competent management staff overseas to support its international expansion (ZTE Corporation, 2014).

Finally, according to the annual report of ZTE Corporation, with the approval of the CSRC, the first phase of equity incentive plans for employees was implemented on March 13 2007, and 85,050,238 shares were allotted to 4,022 qualified employees. This step could be seen as using incentives to boost employees' performance.

6.4 Ownership, Control and Governance

Changes in the ownership structure have major implications for the degree of state ownership, while the institution of split shares has a major bearing on control. How this control is exercised has to do with governance of the enterprise. And all these factors affect ZTE Corporation's performance.

6.4.1 Ownership Changes

Table 6.1 tracks ZTE Corporation's state ownership changes based on milestones in its corporate history. At the end of 1998, state ownership in the form of legal person shares numbered 223,600,000, amounting to 68.80% of the general capital. There was no foreign owned share. The state legal person shares were owned by 7 state enterprises, and ZTE Holdings was the holding company with 62.80% of the general capital. Since ZTE Corporation listed in Hong Kong in 2004, Hong Kong Securities Clearing Company Nominees Limited (HKSCCNL), the foreign shareholder, was the second largest shareholder. Individual owners included top management and other qualified employees who were beneficiaries of the equity incentive scheme. ZTE Holdings held the most shares among state legal person shares; the remaining state legal person shares accounted for only a small proportion (6%) of the total.

With each corporate milestone, state ownership, reflected by the percentage of shares held by state legal persons, diminished. By 2004, state ownership had fallen to below 50%, making it no longer a majority shareholder, and, by conventional definition, no longer a state enterprise. Under the Chinese classification, however, ZTE Corporation remains a state-holding enterprise. By 2011, state ownership has fallen to a third, of which 30% is held by ZTE Holdings. Much of the state ownership decline is attributable to the fall in the share ownership of ZTE Holdings.

Table 6.1: Change in State Ownership of ZTE Corporation (1998-2012)

Year	% Shares Held by State Legal Persons	Reason(s) for Change in % of State Ownership	% Shares Held by ZTE Holdings	% Shares Held by HKSCCNL
1998	68.80	Share structure at formation of Shenzhen ZTE Corporation.	62.80	
1999	64.90	Share placing was adopted to all shareholders with total 19,500,000shares. But state legal person shareholders gave up the placement. As a result, the general capital was increased without the state legal person shares' increases.	59.24	
2001	57.90	Since 13 March 2001, 50,000,000 shares were issued to the public.	52.85	
2004	48.18	ZTE Corporation issued 160,151,040 H-shares which were circulated in at Hong Kong Stock Exchange on December 9. It regulated that the state corporation shareholders had to reduce to hold some shares as the amount as 0.9% of those H-shares.	44.10	14.8
2005	40.86	Since ZTE Corporation adopted the split share structure reform, holders of non-tradable shares paid 2.5 shares for every 10 shares to holders of tradable shares as a sort of compensation.	37.41	16.62
2008	39.07	Through share placement, 58,294,800 H-shares were issued.	35.52	16.66
2009	37.25	85,050,238 shares were granted to 4,022 qualified employees.	33.87	15.89
2010	35.73	58,294,800 H-shares were issued and a warrant call "ZTE ZXC1" exercised the option at the price 42.394 Yuan per share and 21,523,441 A-shares was subscribed successfully.	32.45	18.27
2011	34.04	In June 13, ZTE Holdings reduced the holding shares 48,495,000 of ZTE Corporation through Shenzhen Stock Exchange.	30.76	18.27

Source: Annual reports of ZTE Corporation (1999-2012).

Throughout this transformation, ZTE Holdings remains the key entity for ZTE Corporation. It is therefore important to understand the ownership structure of ZTE Holdings itself. As shown in Figure 6.1, "*Yangqi*" China Aerospace Science and Technology Corporation was the second largest shareholder that owned 34% proportion of ZTE Holdings in 2012. Another "*Yangqi*" China Aerospace Science & Industry Corporation owned 17% of ZTE Holdings. In total, these two state-owned enterprises owned 51% of ZTE Holdings. Since state enterprises had over 50% ownership, the conventional definition of a state enterprise applies to ZTE Holdings. More importantly, that state enterprises have 51% ownership translates into effective control of ZTE Holdings by the state. The largest single shareholder (49% of shares) was Zhongxing Weixiantong Equipment Co. Ltd. which was a pure private enterprise owned by individuals.

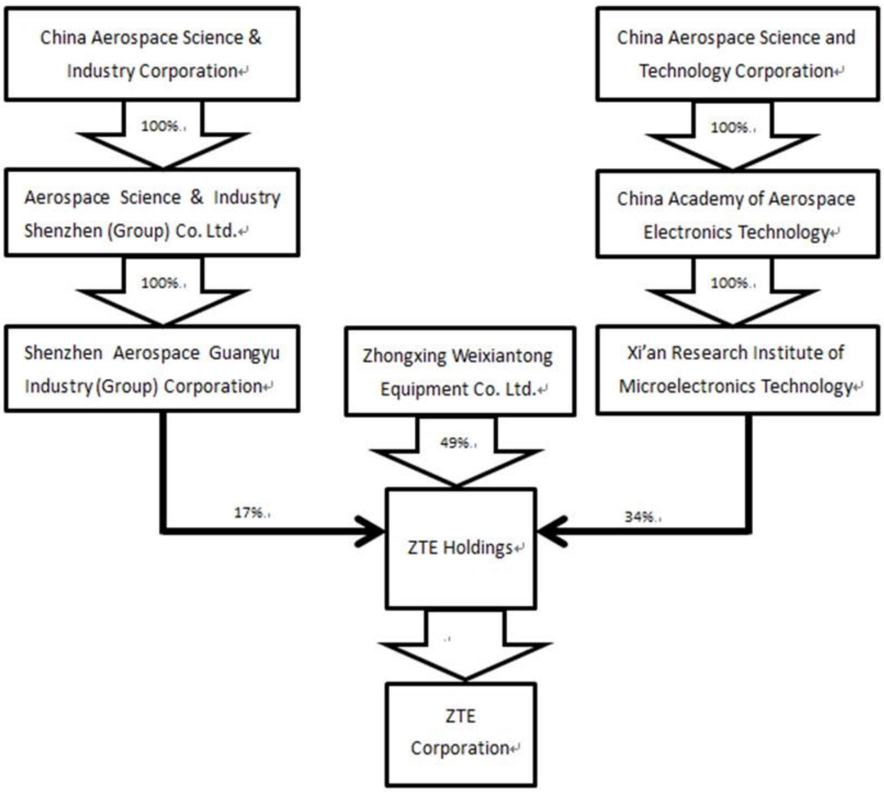

Figure 6.1: Ownership Structure of ZTE Holdings, as of 2012

Source: China Aerospace Science and Industry Corporation. (2014). Corporation structure. Restrived from http://www.casic.com.cn/n101/n127/index.html, and annual reports of ZTE Corporation (1999-2012).

With ZTE Holdings owning just 30.76% of ZTE Corporation in 2012 (Table 6.1), the 51% state ownership of ZTE Holdings translates into just 15.69% of state ownership of ZTE Corporation. However, because ZTE Holdings is the holding company of ZTE Corporation, as stated in both companies' annual reports, and the largest of the shareholders (HKSCCNL owns 17% and all other shareholders less than 1% each), it retains full control of the latter. Thus, while state ownership had fallen to the point that it was only a minority shareholder, the state retained control through its majority ownership of the holding company.

There is more to this ownership than these numbers suggest. Although the state through ZTE Holdings has an equity stake of only 15.69% in ZTE Corporation, the other shareholders of ZTE Holdings are former employees of the original state enterprise. Together with the state, these shareholders can be considered "insiders" in the Corporation. There would also be other "insider" minority shareholders would are beneficiaries of the Corporation's incentive program. To the extent that these "insiders" grew up with the Corporation, their "ownership" counts for much more than ownership as legally defined. They, together with HKSCCNL the nominee company voting with ZTE Holdings which appointed them, would ensure that there would be *de facto* state ownership and little contest in board decisions.

The nature of private sector ownership in ZTE Corporation – the private sector participation coming from employees of state enterprises – is not uncommon in China. While new private enterprises have undoubtedly emerged as a result of the gradual liberalization of the economy, many of today's private enterprises began life as collectives[61] and TVEs (Gregory, Tenev, & Wagle, 2000). Others were small SOEs that were privatized, especially under the "grasp the large and let go the small" state enterprise

[61] Some collectives had been leased out to private entrepreneurs to run, with the option of taking the enterprise private eventually (Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006).

reform policy beginning in 1995. Thus, the public-private enterprise distinction, already less well-defined given the embedded nature of the state in civil society described earlier, is made even more opaque by China's state enterprise reform experience.

6.4.2 Corporate Governance

How is this control exercised? It can be exercised through governance of the enterprise on the one hand and its relations with the state on the other. The state's control over ZTE Holdings is reflected in the composition of its Board of Directors. The Board of Directors having 9 directors from the three shareholders: Zhongxing Weixiantong Equipment Co. Ltd. (4), Xi'an Research Institute of Microelectronics Technology (3) and Shenzhen Aerospace Guangyu Industry (Group) Corporation (2) State-appointed directors outnumber others 5 to 4.[62]

ZTE Holdings is represented on ZTE Corporation's Board by 5 directors, a third of the total number of directors, while the remaining directors have been selected for their expertise rather than to represent any single or group of shareholders.

Board directors and senior managers had worked in management in various capacities within the related entities of ZTE Corporation and its parent companies.[63] There are no bureaucrats among them. As already indicated, this close connection to the holding company also bolsters ZTE Holdings' *de facto* control of ZTE Corporation. That all members of the Board are "insiders", those who grew up in or had been part of the component entities of ZTE Corporation and were knowledgeable about both the operations and the technology of the business, is likely to be more material to the success of the Corporation, given the technology intensity of the business, than the much touted

[62] Question answered by Top Management H of ZTE Holdings on 15th August 2012, but due to confidentiality, this information was not disclosed.
[63] For example, Hou Weigui is the President of ZTE Corporation and Zhongxing Weixiantong Equipment Co. Ltd.; Xie Weiliang, is the vice-resident of ZTE Corporation, the president of ZTE Holdings, the general manager of Shenzhen Aerospace Guangyu Industry (Group) Corporation and the president & general manager of Aerospace Science & Industry Shenzhen (Group) Co. Ltd.

autonomy from state control (Li, Xia, Long, & Tan, 2012).

The Board of Directors of ZTE Corporation held office for three-year-terms. In the 5 terms since its incorporation, Board members made all the major strategic decisions about the Corporation. They also oversaw top management's appointments and dismissals. The top management took charge of day-to-day operations like recruiting management personnel, supervising enterprise operations, and setting market strategies.[64]

ZTE Corporation was totally independent of the holding shareholder ZTE Holding in respect of employees, assets, finance and accounting, businesses and internal organization managements. Thus, for major decisions, ZTE Corporation did not rely on the state but took decisions deemed to be in the best interest of the corporation. For instance, the technology policies were set by the Chief Technology Officer and his team, who had the final say. And the state through ZTE Holdings did not exercise control over ZTE Corporation through finance. Employees of ZTE Corporation were paid by the Corporation and not by ZTE Holdings.[65]

Whether a *de facto* role is played by government officials in ZTE Corporation is unclear however. Although state enterprise reform had officially ended the role of government officials in these enterprises' administrative hierarchies, interviews with officials revealed that it was not uncommon for state enterprises to be supervised by central and local government officials under overt administrative systems.[66] ZTE Corporation is not under this category of major state enterprises, and there is the possibility that such an overt system did not exist.

[64] Questions answered by Human Resource Manager S of ZTE Corporation on 2nd September 2012, but due to confidentiality, this information was not disclosed.
[65] Questions answered by Top Management S of ZTE Corporation on 18th October 2012, but due to confidentiality, this information was not disclosed.
[66] Peoples Republic of China's Law on Public Officials had been approved by the 15th Session of the Standing Committee of the 10th National People's Congress (The Central People's Government of the People's Republic of China, 2005a). There are 5 general administrative levels for public officials – national, provincial, bureau, county, and rural.

In common with other state enterprises, ZTE Corporation has a (mandatory) Party Committee. Traditionally, this Committee functioned to ensure the policies of Communist Party were followed and implemented, participating in decision making, supervision, employment of key persons, and even day-to-day operations. However, interviews with bureaucrats suggest that the Committee in ZTE Corporation functioned far less intrusively than those in major state enterprises. There could be some truth to ZTE Corporation President Hou Weigui's testimony in a Congressional hearing in Washington DC on September 14, 2012 that the Party Committee had no say in major decision-making and the day-to-day operations of the Corporation. He added that he was not a Communist Party member or a member of ZTE Corporation's Party Committee.[67]

Finally, two indicators point to ZTE Corporation's autonomy from state control. First, while it is customary for part of the after-tax profits of state enterprises to be surrendered to the state (Ministry of Finance of the People's Republic of China, 2013), ZTE Corporation made no such repatriation. Second, prices of major state enterprises products that are closely associated with people's life had to comply with state pricing guidelines (The Central People's Government of the People's Republic of China, 2005b). But again for ZTE Corporation, it is free to set prices based on market determined.[68]

Since ZTE Corporation's listing in Hong Kong, financial reports were prepared according to Hong Kong accounting standards which conformed to international accounting standards (International Financial Reporting Standards) and Chinese accounting standards (Generally Accepted Accounting Principles) and were audited by professional accounting firms. Generally speaking, employees were hired and fired by the human resource department according their capacities and performance. Additionally, employees

[67] The hearing was held because ZTE was suspected by members of the US Congress that it would do the bidding of the Chinese government and would pose a threat to American national security if allowed to do business (supply equipment to American companies) there (ICEO Online, 2013).
[68] Question answered by Top Management S of ZTE Corporation on 18th October 2012, but due to confidentiality, this information was not disclosed.

were paid and rewarded according to industry benchmarks, with bonuses set based on profitability.[69]

6.5 Relations with the State

ZTE Corporation's relationship with the state took several forms. First, the state ensured that its policy were followed when President Jiang Zemin visited ZTE Corporation in 2000 and issued important instructions in regard to major issues like technology trade combination policy and stock options issue.

Second, the government leadership also motivated ZTE Corporation to embrace innovation and go global. In 2010, President Hu Jintao visited the ZTE Corporation booth at the Expo on “Emerging Industries of Strategic Importance" in Shenzhen, giving his endorsement to TD-LTE deployment. In 2011, a member of the Standing Committee of the Political Bureau of the Communist Party of China Central Committee, Li Changchun, visited China Content Broadcasting Network and motivated ZTE Corporation to persist in innovation to revitalize China.

Third, in 2003, Chinese President Hu Jintao came to the ZTE Corporation headquarters to encourage ZTE Corporation to accelerate the "going global" pace. Also when ZTE Corporation signed strategic cooperation plans with other countries' companies such as India's Sistema and Hi3G Sweden, the signing ceremony was attended by the presidents of both countries.

Not unexpectedly ZTE Corporation has a good relationship with the central and local (Beijing and Shenzhen) governments.[70] This relationship is built on compliance with the country's technology strategy. This compliance saw ZTE Corporation investing heavily

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[69] Questions answered by Human Resource Manager S of ZTE Corporation on 2nd September 2012, but due to confidentiality, this information was not disclosed.
[70] Question answered by Top Management S of ZTE Corporation on 18th October 2012, but due to confidentiality, this information was not disclosed.

in R&D and hiring many R&D staff (Table 6.2), including for "TD-CDMA", "TD-LTE" and "Gota" – related technologies and products. Also, consistent with the policy of collaboration with research institutes and universities – "*Ke jiao xing guo*" (Development through Promoting Science Technology and Education), ZTE Corporation founded a corporate training centre ZTE University to deliver corporate training in 2013. Also, in order to acquire technological support for its products, ZTE Corporation established Industry-University-Research Institute Collaboration Forum to seek for long-term development. This forum makes full use of the advantages in R&D of the other members (universities). Publications by ZTE Corporation, such as the journal "ZTE Communications", "ZTE Technologies" and "Mobile World", update to track its technological development.

ZTE Corporation's support of the state has been rewarded. ZTE Corporation was able to bid successfully for businesses with major state enterprise clients such as China Unicom, China Telecom, China Mobile, and Guangzhou Railway. When the central government promoted Chinese telecommunication industries and products overseas, ZTE Corporation would have the opportunity to follow through with bids for projects. An example is during celebrations for the 60th anniversary of the establishment of Australia – China relations in 2012, when the door was open to ZTE Corporation as part of China's proposed cooperation with Australia. ZTE Corporation also plays a role when the Chinese government provides assistance to third world countries. Sometimes, the state offered telecommunication projects which enjoyed preferential treatments, ZTE Corporation was asked to submit the tender. And when China offered preferential loans to Papua New Guinea for infrastructure development including the installation of a telecommunication system, ZTE Corporation is one of the companies selected.

Another dimension of this recognition is the state's favoured treatment of the enterprise in recognition of its achievements in technology. In the early years of ZTE Corporation's establishment, its products were recognized by the Ministries of Posts and Telecommunications and of Information Industry and the State Science and Technology Commission. And this Corporation itself also received the central and local governments' recognition. In 1996, ZTE Corporation was recognized by the State Science and Technology Commission as one of key high-tech enterprises under National Torch Program and by the State Council as one of the 300 key state enterprises. This recognition arises from the state's drive for indigenous innovation under the Medium and Long-term Plan 2006-2020 referred to above. As early as 1998, the State Economic and Trade Commission identified ZTE Corporation as one of the national technology centres which rendered it eligible to enjoy preferential treatment in the form of duty-free imports of materials, income tax exemption on the sale of technology products, and incentives for investment. In 1999, ZTE Corporation was also involved in the State Council's National High Technology Research and Development Program. State recognition of ZTE Corporation's contribution also came in the form of the presence of state dignitaries in major ZTE Corporation events. For instance, ZTE Corporation's Pakistan branch was opened in 1999 with Premier Li Peng present, while in 2000, President Jiang Zemin and Vice Premier Wu Bangguo's visited ZTE Corporation.

It is relatively easy for ZTE Corporation to secure special state funds like science and technology innovation supporting funds and awards. For exports, the state provided export tax rebates for ZTE Corporation. Other export incentives were also offered to ZTE Corporation. For instance, the CDB contracted with ZTE Corporation to buy some of the latter's accounts receivable if it was able to meet its export quota. ZTE Corporation also could also get loans at lower than market rates from CDB.[71] And for specific projects in developing countries, ZTE Corporation could secure preferential loans. In 2012, CDB

[71] Questions answered by Managing Director Z of ZTE Corporation on 22nd November 2012, but due to confidentiality, this information was not disclosed.

announced it would increase its strategic cooperation with ZTE Corporation in the next five years in the amount of USD 20 Billion (ZTE Corporation, 2014). According to its financial statement, ZTE Corporation had government subsidies and tax preference in previous years till 2013.

Beyond financial incentives, the state was prepared to allow a change in “Hu Kou”[72] to attract talented workers to ZTE Corporation and retain productive employees. Cheap land was offered by local governments to ZTE Corporation to construct research centres, factories, and affordable housing. For normal commercial loans, ZTE Corporation had better access to credit than private enterprises.

The above suggests that state control of the enterprise is exercised through ensuring compliance of and support for state strategies rather than through the placement of bureaucrats on the board or intervention in the management of the Corporation. Indeed, the last function is “outsourced” to professional managers who make all the key decisions for the Corporation. Financial support comes not from direct payment of employee wages but from preferential financial arrangements available to the Corporation. These arrangements represent just one dimension, albeit the most important, of the state’s support of the Corporation.

6.6 Corporate Performance

How has this enterprise model of minority state ownership, state control over policy but enterprise autonomy in day-to-day operations performed over the years? Table 6.2 shows performance indicators based on sales and profits for the period 2001 to 2012. These show growing sales yielding a healthy rate of return of 3.94 percent or more during the decade.

[72] The “Hu Kou” system refers to the country’s household registration system, which specifies for each household a particular residential location. Residents have full rights and enjoy education and social welfare benefits offered by the state as long as they remain in their specified location, but lose these rights and benefits if they move away without official permission.

In 2011, total sales reached 86254.50 million Yuan, a 23.39% increase over the previous year, the highest within this industry. International sales made up 54.21% of total sales, having grown 24%, elevating it to become the world's fourth largest mobile phone manufacturer.

What might account for the Corporation's success? One explanation may lie in the model of light state control only in the form of ensuring national strategy compliance combined with autonomous management. However, the many areas of state support would also have given ZTE Corporation an edge over private sector competitors.

Table 6.2: Financial Performance of ZTE Corporation (2001-2012)

Year	Total Sales (Million Yuan)	Expenditure on R&D as % of Sales	Net Profits (Million Yuan)	Rate of Return (%)	R&D Staff/Total Staff
2001	9,440.90	11.10	414.00	4.39	45.5%
2002	10,795.90	10.45	703.60	6.52	42.0%
2003	17,036.10	9.01	1,028.30	6.04	37.6%
2004	21,220.10	10.67	1,272.50	6.00	32.5%
2005	21,740.70	9.01	1,287.70	5.92	31.2%
2006	23,214.60	12.20	767.00	3.30	34.6%
2007	34,777.20	9.23	1,252.20	3.60	35.1%
2008	44,293.40	9.02	1,660.20	3.75	33.8%
2009	60,272.60	9.59	2,458.10	4.08	33.5%
2010	69,906.70	10.14	3,250.20	4.65	32.8%
2011	86,254.50	9.85	2,060.20	2.39	33.6%
2012	84,219.40	10.48	(2,840.90)	(3.37)	38.0%

Source: Annual reports of ZTE Corporation (1999-2012).

A better measure of ZTE Corporation's performance is its achievements in technology. As a technology company, ZTE Corporation's success must necessarily be built around technology. The innovation theme of ZTE Corporation was from "Made in China" to "Created in China". Pursuing this objective, the company had indeed progressed from basic material processing to the forefront of the Chinese technology sector. It made efforts in indigenous innovation while also introducing foreign advanced technologies to reach international standards. For these efforts it was rewarded and recognized by both Chinese government and other countries' governments. As early as 1986, an R&D team created the first generation of 68-lines stored program control exchange ZX-60. Sequential improvements led to the licensing and adoption of ZTE Corporation's equipment for use in China. In August 1995, it became the first within the industry to receive ISO9001 Quality Certificate, and in 2000, it also received the 2000 edition 9001 standard authentication. With a total 3,906 PCT applications in 2012, ZTE Corporation was ranked No. 1 globally by WIPO (World Intellectual Property Organization, 2012), surpassing Huawei, the perennial No. 1 for China (Table 6.3). In terms of authorizations and applications of the domestic patent for invention, ZTE Corporation was No. 1 in China (ZTE Corporation, 2013b).

Table 6.3: The Global Top Five PCT Applicants and the Number of International Applications (2008-2012)

Rank	2008	2009	2010	2011	2012
1	Huawei Technologies Co., Ltd (CN) 1,737	Panasonic Corporation (JP) 1,891	Panasonic Corporatio n (JP) 2,154	ZTE Corporation (CN) 2,826	ZTE Corporation (CN) 3,906
2	Panasonic Corporation (JP) 1,729	Huawei Technologi es Co., Ltd (CN) 1,847	ZTE Corporatio n (CN) 1,863	Panasonic Corporation (JP) 2,463	Panasonic Corporation (JP) 2,951
3	Koninklijke Philips Electronics N.V. (NL) 1,551	Robert Bosch GmbH (DE) 1,586	Qualcomm Incorporate d (US) 1,677	Huawei Technologies (CN) 1,831	Sharp Kabushiki Kaisha (JP) 2,001
4	Toyota Jidosha Kabushiki Kaisha (JP) 1,364	Koninklijke Philips Electronics N.V. (NL) 1,295	Huawei Technologi es Co., Ltd (CN) 1,528	Sharp Kabushiki Kaisha (JP) 1,755	Huawei Technologies Co. Ltd (CN) 1,801
5	Robert Bosch GmbH (DE) 1,273	Qualcomm Incorporate d (US) 1,280	Koninklijke Philips Electronics N.V. (NL) 1,435	Robert Bosch Corporation (DE) 1,518	Robert Bosch Corporation (DE) 1,775

Source: PCT Newsletter by WIPO (2008-2012) from http://www.wipo.int/pct/en/newslett/year.jsp.

These technology indicators point to an enterprise that is competitive in its core area of competence. This competence is less a reflection of state support, although it helped to attract talent, than of management capability. In this sense, it provide a degree of vindication for the state enterprise model exemplified by ZTE Corporation, a model that is at variance with the stereotype implicit in existing conceptualization of state enterprises and more akin to the so-called government-linked companies that exist in many countries.

Since ZTE Corporation initialled its internationalization strategy, its share of revenue from outside China has soared. 2007 saw international revenues accounted 60% of the total revenue – the first time it exceeded domestic revenues (ZTE Corporation, 2014). It also cooperated with international high technology companies like IBM. In all, its equipment are used by more than 500 telecommunications companies in more than 140 countries and regions. For some of these countries like Malaysia, it had a significant market share.

6.7 Conclusion

Although the role of the Chinese state and its enterprises has been viewed through the lens of Western theories as generally negative, a systematic reading of China's history suggests that this view should be contested. Add to this history China's unique state enterprise reform experiments and an assessment of Chinese state enterprises that is far from clear cut emerges. Thus, while numerous studies have espoused a negative view of Chinese state enterprises, research endorsing the opposite view, both theoretical and empirical, is growing.

This chapter has not attempted this assessment but instead focuses on one enterprise, ZTE Corporation, tracing its origins and linking its growth and transformation to China's stepwise state enterprise reform. Because of these changes, it has come to embody the state's strategy of reducing ownership but maintaining control. Yet the term "control" may be a misnomer – ZTE Corporation retains almost complete management autonomy although complying with national strategies of technology development. Even board members, who are instruments of state control, are chosen from within the corporation and its affiliates.

At the same time, state support in the form of tax preferences has undoubtedly helped ZTE Corporation's performance. Such support weakens arguments that attribute state enterprise competitiveness principally to autonomy and/or the absence of state control. However, since, as shown by the many loss-making state enterprises with state support, preferential treatment by the state does not necessarily translate into better performance, arguments that autonomy begets better performance remain intact (Li, et al., 2012). Still, ZTE Corporation does not easily fit the mode posited of state controlled, dispersedly controlled and privately controlled in that it embodies elements of both state and private control. What appears to be critical to ZTE Corporation's success, apart from managerial autonomy, is the presence of "insiders" both in the state and private entities owning ZTE Corporation who are well versed with the company's operations at the helm. Since these insiders were there from the beginning, it is also not very meaningful to refer to ZTE Corporation's management as being "outsourced".

As a "state-holding company", ZTE Corporation embodies much less "state" than what is normally understood in a state enterprise. Its management is also not in the hands of bureaucrats. Although no generalization is warranted, ZTE Corporation's performance attests to the relative success of the state strategy to stress control over ownership. And this control is limited to providing a strategic direction. In moving from state-owned to state-controlled, more appropriately state-led, China's state enterprises can be said to be at the forefront of the model of state capitalism.

The ZTE Corporation experience speaks also to how not only agency costs have been reduced but also public choice issues have been resolved. It also shows that the importance of property rights can be exaggerated. What has emerged from the interviews is that ZTE Corporation's personnel, from the management down, take pride in what they have created, despite owning very little of the enterprise. This sense of collective pride, attributable to Confucian concepts of collective identity and increasingly recognized as an East Asian trait, this trait – of collective pride and shame – has most recently been discussed in the context of a South Korean jetliner crash in San Francisco (Klug & Lee, 2013), can contribute materially to performance.

Finally the relevance of neo-liberal theories has been muted by the complexity of ownership in the specific case of state enterprises like ZTE Corporation and in general by the embeddedness of government in Chinese society. China's state enterprise reform experience has blurred further the lines between state and private enterprises which are central to Western public enterprise theories. Many of China's private enterprises today began life as state enterprises or as collectives. Some, like the private enterprise which is an equity partner of ZTE Corporation, have been formed by state enterprise employees.

With these enterprises, a calculus of ownership and control that is different from that predicated on existing theories has emerged. We believe it is this calculus, as much as the management autonomy to which much research is directed, that helps to explain good state enterprise performance.

CHAPTER 7 CONCLUSION

7.1 Summary and Findings

The prevailing discourse on the Chinese state and its state enterprises is dominated by the application of Western political and economic concepts. These concepts ignore China's cultural and political history where the state has played a major role and is "embedded", to use Polanyi's term, in Chinese society. However, China has both absorbed and adapted foreign ideas to fit its circumstances. Thus, its role in numerous innovative reform experiments during China's economic transition from a command to a socialist market economy is indicative of the application of Western ideas. Relying mainly on these ideas, most assessments of Chinese state enterprises are unbalanced. The preoccupation with a state-private dichotomy has led to the failure to recognize the emergence of a distinct corporate entity. In fact, Chinese state enterprises are distinguished from those defined by stereotypical Western public economics theories by the manner in which they are owned and controlled. There is a need to reframe the analysis of China's state enterprises to recognize how its particular cultural and political history has shaped these institutions. Central to this analysis are the reforms that have been put in place by the government to consolidate and strengthen this sector, and not, as many believe, to diminish their role.

Within the above framework, this study seeks to answer three specific research questions. First, after state enterprise reform, what is the dynamic role of the Chinese state in relation to its state enterprises in terms of ownership structure and control mechanisms, and how different is it from what Western public enterprise theory argues? Second, what is the role of state enterprises for the Chinese state in the economy? Third, do different ownership-control combinations affect performance outcomes?

Four qualitative research methods supported with descriptive secondary data analysis are the main methods to explore these three research questions. They are historical narrative, case study, ethnography, and phenomenology. Of these, historical narrative and case study are the primary methodologies utilized while the other two are supporting methodologies. These methods are more appropriate than the quantitative methods used in most studies because of the need to gain deep insights into the construction of the state enterprise sector and its relationship with government.

The answers to these three questions are summarized below. From the findings, implications for theory, policy, and research are drawn.

7.1.1 Ownership and Control (Objective 1)

The state enterprise sector has been officially classified as consisting of three types of enterprises. The first type consists of enterprises wholly owned by the state, i.e., state-owned enterprises, state-owned corporations, and state legal person joint ownership enterprises. The second type, referred to as state-holding enterprises, are those in which the state has majority ownership (capital or shares greater more than 50%), or have the highest ownership among other shareholders with the same enterprise even if it is a minority shareholder (less than 50%), or where the state exercises control through other state-controlled shareholders. The third type, referred to as state joint-ownership enterprises, consists of those in which the state has minority ownership and exercises no control.

The issue of state ownership has been complicated by state enterprise reform that produced various corporate structures and types. State ownership ranges from 100% through majority ownership to minority ownership, the last of which does not appear in government statistics. Apart from national-level enterprises, the sub-national enterprises belonging to provincial and local governments also exist in large numbers and function alongside, often compete with, national enterprises. There are also enterprises for which ownership is ambiguous, including quasi-state entities, non-state enterprises, urban collectives, and local government-owned township and village enterprises.

The government's role may well be larger than what the official statistics suggest because parts of government (minority) ownership are undocumented and/or under multiple layers of indirect ownership that may indicate the government has an important say if not exercising strong control. However, there is no way of knowing what role the government plays in these enterprises that do not come under the banner of state enterprises.

State control is exercised through the administrative body, SASAC, which functions at various levels of government. Control channels are through governance, such as top management appointments. Furthermore, some state enterprises are managed and run as private firms in terms of rewards for performance, such as executive compensation linked to corporate performance, talent attracted through listings internationally, foreign investors represented by multinational representation on the Board, and private sector top managers and executives hired with high compensation in the open labor market. Efforts had been made to use attractive employment terms to target better corporate governance to achieve competitively domestically and internationally.

For strategic state enterprises in what the state considers sectors vital to the economy or national security, the state retains a controlling position in terms of ownership and control even after innovative reform. In addition, the state exercises control through governance by Party Committees as a part of management. Such control is needed to ensure the government's strategies are followed. Thus, state strategies can be executed through state enterprises. In return for compliance with state strategies which this control mandates, state enterprises are favored by explicit state support including preferential credit access.

For "commercial" state enterprises, such control has been made on commercial rather than political grounds. Reform experiments have produced progressive reductions in state ownership without commensurate diminution of state control. There is *de facto* separation between ownership and control, with the former declining and the latter in the hands of professionalism management. Thus, this control is only lightly exercised through ensuring compliance with state strategies rather than through day-to-day management. ZTE Corporation has good relations with the state and in the presence of state support receives preferential treatment from it with state funding.

7.1.2 Meeting State Objectives (Objective 2)

Since state enterprises are key players in China's economy, they should have a material impact on growth and distribution. Since this century started, negative findings between state enterprises and economic growth were replaced by increasing positive analysis. However, little empirical research existed that could make the direct link associating loss-making state enterprises with damaging state enterprise performance and China's economic growth. The emergence of globally competitive state enterprises like China Petrochemical Corporation (Sinopec Group) is one of the major manifestations of their economic revival. Productivity growth in the state sector has also been reported.

The central state enterprises from "pillar industries" were selected as national champions and have been driven to achieve global competitiveness in terms of scale and technology. They were consolidated into conglomerates supported by incentives to act as key players in China's economy. China's state enterprises are viewed by the state as engines of growth to promote innovation that facilitates the technological catch-up to the West.

On the negative side, reforms have led to worker lay-offs and have freed state enterprises from social responsibility, even to the workforce that was retained. Despite its many shortcomings, the end of original social role these enterprises played has left a void in the social safety net that has not been filled even today. Social security experiments to take over this redistributive role, from the rehiring of some laid-off workers and compensation packages for those laid off to the establishment of the National Social Security Fund have helped relieve some of the hardships caused by the lay-offs but have yet to come near anything resembling a national social security system.

Reform has also changed the role of enterprises in income distribution. Spatial income distribution has also been affected by a shift in industrial production to coastal regions. State enterprises, whose original mandate included construction and provision of housing for their employees, began to undertake the construction of residential (and commercial) units for profit on land owned or acquired from profits amassed through profit retention. To be fair, state enterprises have continued to support the government in such activities as disaster relief and diplomatic confidence building. Also, national champions and enterprises in strategic sectors' with powerful corporate interests distributing part of their earnings as dividends to the government.

For strategic state enterprises, they exercised government functions on the government's behalf. Historically, the Chinese banking sector's role was transformed from being a government department to supporting other state enterprises as government entities. However, after China's financial liberalization, this role has diminished. Instead, under China's opening up policy, the banking sector is considered to be the key institution executing state strategies. This is evidenced during China's entry to WTO. Even after China's entry to the WTO, this sector continued to assist the government's "go global" strategy. This role notwithstanding, the government has made efforts to liberalize the banking sector. However, the GFC was a wake-up call to Chinese leaders of the excesses of financial liberalization. Hence, a major impact of the Crisis may be to slow down the pace of China's financial liberalization.

Even "commercial" state enterprises may be designated as part of "pillar industries" as long as they actively support government strategies. An example is ZTE Corporation, the largest firm in the integrated communications manufacturing industry. From the government's perspective, ZTE Corporation spearheads the country's drive to upgrade national technological capability. It cooperates with China's leading state-holding telecommunications services operators such as China Telecom to provide telecommunications products and assists other state enterprises in other industries such as Railway ICT construction. ZTE Corporation has put forth effort in support of the state's global strategy and delivered products and services internationally on a large scale. Moreover, as a state instrument, it has provided assistance to third-world countries.

7.1.3 State Enterprise Performance (Objective 3)

During the early stages of state enterprise reform, state enterprises were criticized for their economic inefficiency and poor profitability, the result of bureaucratic management, monopoly positions, and fulfilling state objectives at any cost. However, as reforms progressed, this performance was progressively reversed. Recent studies have reported positive economic performance. Nevertheless, state favor plays an important role in making this happen. In addition, some Chinese state enterprises have made great efforts in technology catch-up with the West in line with the state policies and national strategies in the presence of R&D funding from the state. As a result, some were even in the forefront of innovation and comparable to firms in developed countries. At the same time, non-strategic state enterprises were facing intense competition created as much by other state enterprises as by non-state sectors and foreign firms. The competitive conditions between these different enterprises were converging. Thus, government preferential treatment comes with intense competition. These companies have also gone international and have faced even more fierce competition.

In the reform process, different routines have resulted in different corporate entities. As a result, some were successful while some were not. Successful entities might be criticized due to state favoritism. The number of successful entities is not known and may be a small proportion of the total, but in terms of size and share of industrial output, they are likely to be significant. The reason for this is that they are typically listed companies and national champions. The results may not permit categorization of the Chinese state enterprise sector as profitable, innovative, and competitive, but the argument that the state sector is inefficient can be decisively rejected. The notion that there is a clear distinction between private and state enterprise also cannot be applied.

For strategic state enterprises, the overall performance was considered good. Nevertheless, it had to be linked to the government policies such as for the banking sector which is to a great extent attributable to transfers of bad assets to Assets Management Companies, loan growth, recapitalization, write-offs, and China's strong economy. Listings on stock exchanges and international competition have mandated these banks to conform to international corporate governance benchmarks. Moreover, the GFC had propelled them up the global rankings. While unfavorable comparisons of these institutions with fully private financial institutions continue to be made and have some merit, the sub-optimal performance of these Chinese banks could be a matter of conscious choice made by Chinese state, which is prepared to bear the costs to maintain its prime objectives. Efforts to strengthen efficiency of banks represent the state's efforts to minimize these costs. These statements are likely to be true of state enterprises in general, given they are vital instruments of the model of state capitalism that China has embraced.

ZTE Corporation, as a representative of the group of "commercial" state-holding enterprises, has sustained profitability thanks to its ability to take advantage of the government's drive for indigenous innovation. Its record of accomplishment for innovation is reflected by the number of patent applications as well as by its leading role in various products and services technology innovations. By innovating domestically and introducing international technologies, it was recognized and rewarded by the Chinese government and other countries. Facing a domestic competitive environment, the enterprise has used a combination of “insiders” who are familiar with the enterprise and the employment of professional management that has ensured acceptable governance standards. In addition to professionalism in management, links with the state have brought the Corporation a range of benefits from preferential access to business opportunities that have also played an important role in improving its efficiency.

7.2 Implications

7.2.1 The Applicability of Extant Theories

The specific context of China means that even if partially valid, Western theories of public enterprise must be modified to consider the unique nature of the Chinese state and society. This means many arguments based on prevailing theories must be revisited and judgments revised. For instance, the assumption is that state enterprises are run by bureaucrats is invalid because many Chinese state enterprises, especially those listed on stock exchanges are not run differently from private enterprises, and actually pay better and attract the best talent.

The assumption that state enterprises are monopolies is also invalid. In China, many state enterprises compete fiercely among themselves and with the non-state sector. The result has been management professionalism and innovation capabilities for an increasing number of state enterprises, which contradicts the stereotype perception of uncompetitive state enterprises.

Even more fundamental has been the assumption that the state and private sectors are distinct. For China, the boundaries are not distinct. The non-state sector is not all private, and includes Town and Village Enterprises and collectives. The state sector has ownership interests in enterprises to different degrees, and also been given large doses of private sector management. To make things even more opaque is the *de facto* separation between ownership and control, with the former declining and the latter in the hands of professional management for the most important enterprises. This is producing, in effect, a system, many characteristics of which are not that different from Western models.

This lack of a clear partition between public and private enterprises has produced apparent paradoxes that Western economic theories, such as agency, public choice, property rights, have been unable to explain. However, while alternative theories, such as economic embeddedness, market socialism, and developmental state, have relevance, they are also not wholly applicable. This is likely because these alternative theories have also been developed to explain situations at variance with what exists in China. The most obvious example is that of the developmental state. Applied initially to Japan and then to Korea, it envisages extensive state intervention to shape the competitiveness of the private sector, which is envisaged to be the driver of economic growth. In China's case, despite expectations by many for a greater private sector role, it remains the state that is in the driver's seat. More fundamentally, none of these theories has accommodated a situation in which the state is at the apex of an orderly hierarchy in which layers of society make up the rest of the pyramid. Nor do any of these models envisage a role of the state as expansive as that of the Chinese state throughout its history.

However, what is indisputable is that with its millennia of history providing lessons for the state's decision-making processes in general and state enterprises in particular, total reliance on economic arguments can provide only partial explanations of the behavior of the Chinese state and its enterprises. For instance, decisions made to keep the banks under state control have as many historical antecedents and strategic priorities as any economic considerations of rationality and efficiency. It may well be that with this complexity, with a wide span of ownership and control, developing a theoretical framework for all Chinese state enterprises is a herculean task. It is even unclear if such an endeavor is a meaningful pursuit, given the limited applicability of such a framework outside China. A more meaningful academic pursuit may be to seek greater in-depth understanding of key enterprises like telecommunications or key areas like innovation that are likely to impact economies well beyond China's shores.

7.2.2 Policy Implications

Even if China's historical trajectory cannot be emulated, China's experience has implications for other countries. The Chinese state is still the key agent that cares for the macro economy and its institutions and has a vital role to play in this regard. This is also the case in developing countries where information and other asymmetries create all manner of negative externalities that the state must overcome. However, the China experience shows that the emphasis on ownership may be misplaced. The essence of the state's role is control. In this sense, the importance attached to privatization may be exaggerated on the one hand while resistance to its implementation may likewise be overdone on the other.

Second, a number of ways exist to improve performance of state enterprises of all shapes and sizes. One way adopted by China is listing on foreign stock markets. This imposes market discipline on the listed enterprises, while the fact that listing is done overseas removes the ability of the state to interfere in the enterprises' governance. Another is to emulate the Korean example of setting mandatory performance benchmarks as conditions for state favor.

Third, the Chinese experience offers lessons on how state enterprises can share if not take the lead in technological innovation. Chinese enterprises that innovate are rewarded by various benefits. Although outside the scope of this study, that ability rests on the growing depth of China's human resource pool. Emulating China would require considerable effort towards augmenting human resources.

7.2.3 Research Implications – Limitations of this Study

This study, by abandoning any effort to achieve representativeness, clearly suffers from lack of it as an obvious disadvantage. Few case studies and focus on one strategic sector cannot fully describe the entire state enterprise sector. In addition to national-level state enterprises, there are sub-national enterprises which belong to provincial and local governments as well as urban collectives and township and village enterprises. However, it is argued here that achieving representativeness is impossible for a variety of reasons. Including definitional boundaries that are ill-defined. Further, the current situation is rapidly evolving and any snapshot at any one time will soon be outdated.

At the same time, this study has not covered major areas of state enterprise roles and impact. These include the shedding of social obligations that state enterprises used to shoulder, and their role in the housing market, in which they have the advantage of land banks that they can use to readily develop. Yet another area is the relationship between central and local state enterprises, and the impact of their collaboration, competition, or even conflict on the economy and stakeholders. A third area for study relates to the role of relationship ("*Guanxi*") governance. In short, there is no shortage of topics for further study. Studying China's state enterprises is a dynamic never-ending endeavor and rightly has engaged many scholars. Future studies will open up even more areas for research. If there one area future research can improve on today's work, it is to integrate multiple relevant disciplines to arrive at more holistic analyses than the mono-disciplinary (mainly economics) and value-based (mainly Western) research that is in vogue today.

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LIST OF PUBLICATIONS AND PAPERS PRESENTED

PUBLICATIONS

1. “The impact of China on the emerging world: new growth patterns in Chinese import-export activities” has been published in “Engineering Economics”.

2. “China’s State Enterprises, Economic Growth and Distribution: A Revisionist View” has been published in “China: An International Journal”.

PAPERS PRESENTED

1. “China's State Enterprises, Economic Growth and Distribution: A Revisionist View” at “China in the World, the World in China "Growth, Governance and Equity: Exploring the Social Implications of China's Economic Transformation"” in Kuala Lumpur, Malaysia in 1-2 June 2011.

2. “Must China's State Enterprises Follow the Path of Western Governance to Thrive?” at “3rd International Conference on Information and Financial Engineering” in Shanghai, China in 19-21 August, 2011.

3. “The Chinese State, State Enterprises and The Global Crisis” at “The State's Return to Business: Government-linked Companies in the Post-crisis Global Economy” in Siem Reap, Cambodia in 9-10 February 2012.

4. “Towards More Balanced Growth: Land Consolidation as a Rural Development Strategy in China at “From Hu-Wen to Xi-Li Administration: China’s Leadership Transition and its Domestic and International Implications in Kuala Lumpur, Malaysia in 12-13 September 2013.

5. “How Much “State” is in China’s State Enterprises? A Case Study of ZTE Corporation” at “The 23rd International Business Research Conference” in Melbourne, Australia in 18-20 November 2013.

China's State Enterprises, Economic Growth and Distribution: A Revisionist View

CHEONG Kee Cheok, LI Ran, TAN Eu Chye and ZHANG Miao

The prevailing discourse on the Chinese state and its state enterprises is dominated by the application of Western political and economic concepts to China. These concepts ignore China's cultural and political history in which the state plays a major role and is embedded in Chinese society, as well as the role of numerous reform experiments during China's economic transition from a command to a socialist market economy. As a result, most assessments of Chinese state enterprises are unbalanced. The preoccupation with a state-private dichotomy has also led to the failure of recognising the emergence of a distinct corporate entity.

INTRODUCTION

China's arrival at centre stage has made it the focus of attention among Western and Western-trained commentators in general and economists in particular. As China's impressive economic advance has been achieved under a political system and via strategies that are both antithetical to dominant Western thinking, this attention has at times been hostile.[1]

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[1] Two examples from credible sources suffice to prove the claim. "Taming Leviathan", *The Economist*, 17 Mar. 2011, p. 1; John Micklethwait opined that "[t]he country's rulers are acutely aware that their government does not serve ordinary Chinese well". This judgement was based on a single person's view, and the article was not even entirely about China. See "Bear in a China Shop", *Foreign Policy*, 22 May 2012; Arthur Kroebar, in explaining China's continued resilience to the global finance crisis, ended his article with the account of China's "second-rate society" being built upon inequality, and this is ironic considering the revelations about what unfettered capitalism had produced in 21st-century United States.