The Restructuring of Ownership and Governance in China: An Empirical Study of the Shareholding Reform

Yi-min Lin and Tian Zhu [1]

Using a firm-level survey data set, we examine the factors that have shaped the restructuring of ownership and governance among China's state-owned enterprises (SOEs) in its recent shareholding reform. We find that the pace and form of the restructuring are influenced by path-dependent variations in the transaction cost of finding the "right price" for re-arranging property rights. While the shareholding reform has brought about some substantive changes, we also find significant government involvement in the ownership and governance of restructured enterprises, which we view as a transitional phenomenon rather than as a failure of the reform. We argue that the gradual pace and the halfway separation of the government from enterprises may be inevitable in the initial stage when institutional environments and socialist legacies impose serious constraints on the restructuring.

Keywords: State-owned enterprise, Ownership restructuring, Corporate governance, Transaction cost, China

JEL Classification: P21, P31, D23

*Assistant Professor, Division of Social Science, Hong Kong University of Science and Technology, Clear Water Bay, Hong Kong, (E-mail) y.lin@ust.hk; Assistant Professor, Division of Social Science, Hong Kong University of Science and Technology, Clear Water Bay, Hong Kong, (Tel) +852-2358-7834, (Fax) +852-2335-0014, (E-mail) sotimzhu@ust.hk, respectively. We wish to thank the participants at the 8th SJE International Symposium on Corporate Governance and Restructuring in East Asia and, particularly, Young Lee for their very helpful comments on an early draft of the paper. All errors are ours. Financial support from the Research Grants Council of Hong Kong (grant # RGC.HKUST.6053/98H) is gratefully acknowledged.
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I. Introduction

A unique feature of China's economic transition is its gradualist, dual-track nature. While encouraging the non-state sector to develop, China has until recently avoided privatizing state-owned enterprises (SOEs) and instead sought to reform them through piecemeal measures, such as increasing decision-making autonomy and financial incentives (Naughton 1995). In the second half of the 1980s the reform measures were accompanied by robust and improving performance of SOEs. This is shown by a number of studies using both aggregate statistics and enterprise survey data (Groves *et al.* 1994; Jefferson and Rawski 1994; and Li 1997). As the plan steadily declined and SOEs' activities changed course toward markets, however, SOEs faced an increasingly competitive environment. Since the early 1990s, the performance of SOEs has steadily deteriorated despite greater autonomy granted to them (Lardy 1998; and Zhu 1999).

The decline in performance among SOEs prompted the Chinese government to embark on a major effort to shift the focus of SOE reform to ownership and corporate governance restructuring in the mid-1990s. The strategy is two-pronged: to turn small SOEs into private enterprises or employee shareholding cooperatives,[1] and to reorganize large and medium SOEs as limited liability companies or limited liability stock companies.[2]

[1]Employee shareholding cooperatives are limited liability entities owned wholly or predominantly by the majority or all of their employees, either individually (through shares issued to individuals) or collectively (through "collective shares"). There is no minimum equity capital requirement. The shares for individual holding can only be issued to enterprise employees, who may receive dividends in addition to their regular wages. Unlike the other two types of companies where shareholder voting is based on the "one share one vote" principle, shareholder voting in employee shareholding cooperatives is based on a "one person one vote" principle. See *RMRB*, August 7 1997, September 2 1998.

[2]According to the *Company Law*, the main differences between limited liability companies and limited liability stock companies lie in the following: (i) the threshold of equity capital (0.5 million vs. 10 million yuan), (ii) the level of approving authority (sub-provincial vs. provincial government or an authority designated by the State Council), (iii) the number of shareholders (2-49 vs. 5 or above), and (iv) the liquidity of shares—only the shares of the latter can be traded on stock exchanges, where only those with equity capital of over 50 million yuan are eligible for listing. The shares of both

The central goal of the shareholding reform, as the reform is called in China, is to establish a "modern enterprise system" featuring corporate governance structures that separate the government from enterprises. The separation is deemed necessary both for enterprises to achieve full autonomy in structural and operational decisions and for the government to limit its liabilities to the enterprises, hence hardening the budget constraint. It is also hoped that, by quantifying equity ownership, ownership restructuring will help facilitate efficient reallocation of capital resources through mergers and acquisitions. Another objective is to alleviate the debt burden of SOEs, a result of over-reliance on state banks for external finance, by increasing direct finance through selling ownership stakes to equity investors as well as employees. Finally, it is assumed that ownership restructuring will improve managerial incentives by installing a more clearly defined structure of rights and responsibilities and by introducing stakeholders that have incentives to monitor the managers.

In this paper, we explore how efforts to achieve these objectives has been conditioned by factors rooted in China's existing economic institutions. Our analysis is based on the premise that the process of institutional change is not free of transaction cost (North 1990). We use a firm-level survey data set to examine the factors that have shaped the restructuring of SOEs. We find that the pace and form of the restructuring are influenced by path-dependent variations in the transaction cost of finding the "right price" for re-arranging property rights. While the shareholding reform brought about some substantive change,[3] such as increase in decision-making autonomy, diversification of state ownership, and adoption of managerial and employee shareholding, we also find significant government involvement in the ownership and governance of restructured enterprises, which we view as a transitional phenomenon rather than as a failure of the reform. We argue that the halfway separation of the government from enterprises may be inevitable in the initial stage

types of organization are classified into five categories: state-owned, institution-owned, individual-owned, collective-owned, and foreign-owned. The first two categories of shares have not been allowed to be traded on stock exchanges, and their transfer requires special approval from the government. See *RMRB*, August 3 1998, February 1 1999.

[3]Lee (1999) finds that corporatization lowered wages by 11 to 15% and improved productivity by 6%.

of reforms when institutional environments and socialist legacies impose serious constraints on the restructuring process.

The rest of the paper is organized as follows. Section II examines the constraints and costs facing ownership restructuring in the institutional context of China's SOEs. In particular, we focus on the personnel and financial liabilities of different enterprises and explore how they affect the efforts to find the "right price" for rearranging property rights. We also discuss where and why it is possible or difficult to bypass the initial transaction cost hurdle. Section III describes the data and the econometric method we use. Section IV presents the main findings and then contrasts the analysis in Section II with these findings. Section V concludes the paper.

II. Transaction Costs and Institutional Constraints on Restructuring

China's shareholding reform is apparently modelled on the Western-style organization of public corporations that are characterized by the separation of ownership and control. However, the emergence of public corporations in the West was a result of an endogenous, evolutionary process based on voluntary exchanges of private property rights in pursuit of gains from specialization (Fama and Jensen 1983). In the process, various corporate governance mechanisms were developed to deal with the agency problem arising from the separation of ownership and control. They are legal and economic institutions for owner-investors to have effective control over managers and to assure themselves of a return from their investment (Hart 1995; and Shleifer and Vishny 1997). Fundamentally, effective corporate governance under a private property rights regime hinges upon a well-functioning financial market and a sound legal system. The existence of large non-state shareholders may also be crucial for effective governance because those who hold significant ownership stakes have the abilities and incentives to exercise effective control rights and monitor management.

An obvious difference between the development of corporate governance structures in Western contexts and what the latest SOE reform in China is intended to achieve is that China's SOEs face an institutional setting based on state ownership. Market-oriented economic and legal institutions that are conducive to effective corporate governance take time to establish in a transitional economy like China's. Social institutions such as a social security system that are necessary for the complete separation of the government from enterprises have just begun to develop in China. Moreover, socialist legacies also make it unlikely for wealth-constrained private entrepreneurs to take on major stakes in many large SOEs. Under these circumstances, even in the absence of ideological constraints on private ownership of enterprises, some degree of government ownership and government control in corporate governance in privatized or corporatized enterprises is to be expected (Qian 2000).[4] This also implies that corporate governance in restructured enterprises may deviate from what is stipulated in the law.

Furthermore, SOEs do not start their restructuring on an equal footing. Since the late 1950s, SOEs have been organized as public sole proprietorships controlled by various industry-specific agencies of the government (Granick 1990). But they have not been treated equally in terms of resource allocation and regulation. Despite the increase of competition in the reform era, such disparity still persists. Centrally controlled enterprises, for example, are still better endowed and given more preferential regulatory favors than enterprises controlled by city or county authorities. Those that are situated in more advantageous allocative and regulatory niches (*e.g.* more resourceful or protected sectors) tend to perceive drastic organizational change as risky. As a result, they are less willing to make bold moves to enter the "market" to rearrange property rights.

Relatedly, an important feature of the SOE system is that not all enterprises are regarded by the leadership as having the same degree of importance and, consequently, the flexibility of organizational change varies. "Upstream" sectors such as extraction of natural resources, energy, and utilities, for example, have long been deemed as crucial for economic stability. Reform in these sectors has proceeded in a much more controlled manner than "downstream" sectors producing manufactured products (Naughton 1995).

[4]Also see Anderson, Lee and Murrel (forthcoming) for a similar argument in the case of Mongolian privatization.

There is no sign that such a long-standing stance toward different sectors has changed in the recent reform. An implication of this is that even if the pertinent officials and managers in upstream sectors want to speed up the process of change, the binding rules and restrictions imposed from above based on strategic planning calculations tend to pose formidable obstacles for bargaining their way out of the old mode of organization.

For enterprises that do face relatively strong push-and-pull effects of marketization, there are other constraints that they have to face. With the deterioration of performance under growing competition during the past two decades, many SOEs have accumulated considerable amounts of financial liabilities (Lardy 1998) and redundant personnel (Lin *et al.* 1998). Rearranging the property rights of SOEs involves efforts to define and divide these liabilities among the parties concerned. Finding the "right price" for this transaction, however, faces obstacles posed by the lack of resolute and universalistic policies regarding SOEs' financial and personnel liabilities.

As Shirk (1993) points out, China's industrial reform policies feature a high degree of particularism and incremental adjustment. In debt payment and restructuring, some enterprises have been treated more leniently in debt payment and restructuring, and the number of enterprises selected for such special treatment has varied due to inconsistencies in the criteria used and ad hoc bargaining.[5] The uncertainties fostered in this policy environment are likely to lead the parties involved—enterprises, existing supervising authorities of enterprises, creditors, and prospective owners, among others—to have diverse expectations about how their interests may be accommodated or affected in the restructuring process, posing a major hurdle to consensus building in multilateral negotiations.

As to personnel liability, because of the slow pace in the development of a social security system, the government has restricted outright layoffs, and SOEs have to find ways to find placement for

[5]In 1998 a total of 40 billion yuan's "bad loan" was written off, mainly to help "key enterprises" and those in "key sectors" (*RMRB*, December 1, 1998). In 1996, 300 "key enterprises" were identified by the central leadership for preferential treatment; in 1997 the number increased to 512; and by the end of 1998 the cumulative amount of write-offs was 90 billion yuan, and the SOEs receiving such treatment totaled 5,800. See *RMRB*, January 5 1999.

their redundant workforce, known as off-duty employees. In the organizational restructuring of SOEs, the new owners are in principle required by the government to inherit the entire labor force and their social welfare provisions (including contributions to various social security funds).[6] There exist uncertainties about the future changes in policies regarding the compensation and placement of employees removed from active duty. Moreover, the process of restructuring involves multiple government agencies that often have different priorities in decision making.[7] Supervising agencies of SOEs may be more inclined to transfer at a discount subordinate enterprises with heavy personnel liabilities, but the state asset management authority tends to focus on preserving the value of state assets. The labor department emphasizes adequate provision of basic support for off-duty workers, whereas the fiscal authority often seeks to minimize its obligation in providing subsidies for the accommodation of employees removed from active duty. Finding the "right price" for an enterprise with a large number of surplus workers, therefore, is often not a straightforward matter. As a result, variations in personnel liabilities may have an important impact on the pace and the form of restructuring among different SOEs.

Since embracing outright privatization is still politically risky, the agencies and officials supervising SOEs tend not only to limit privatization mainly to poorly performing enterprises that have heavy financial and personnel liabilities, but to demand from the private owner higher price as a "risk premium," so as to justify their choice of this organizational form. On the other hand, however, unilateral imposition of problem-ridden enterprises on private owners would not be accepted unless the private owner sees an opportunity to turn the situation around after restructuring. Given the difficulty of finding a way to address the concerns on both sides, it is unlikely for private enterprise to emerge as a major organizational form in ownership restructuring.

Of all the other three organizational forms, the limited liability stock company poses the highest threshold. It requires higher levels

[6]*RMRB*, December 23, 1998.

[7]For discussions of the conflicting agenda and interests of various government agencies involved in the restructuring process, see *RMRB*, August 8, 1998 and July 24, 1999.

of capitalization and higher levels (and hence a longer process) of regulatory approval, and has greater likelihood of being more directly and fully exposed to market discipline because it is the only organizational form through which an enterprise can seek public listing on the stock exchanges. This precludes entry by many SOEs, especially small ones and those with mediocre performance.

Therefore, for enterprises with adequate motivation, less regulatory restrictions, and relatively light financial and personnel liabilities, paths of less resistance may be more likely found in limited liability company and, to a lesser degree, employee shareholding cooperative. But there is a catch here. The lower initial threshold posed by these organizational forms also makes it possible for divergent agendas to be accommodated in the process of restructuring. A key group of influence in the process are government officials in charge of SOEs. Their motives to proceed with the restructuring may be more diverse than solving the governance problems of the enterprises. Speedy action in restructuring, for example, can earn political credit for career advancement within the state bureaucracy. This may lead some officials to focus on nominal change in organizational form rather than finding optimal alternative arrangements for the enterprises, which entails more extensive negotiation and bargaining among the parties involved. But the enterprises where nominal restructuring is pushed through for other-regarding agendas will have to cope with the postponed problems as well as the cost for readjustment in organizational form. Restructured enterprises, therefore, often have to face "postponed" cost for dealing with the organizational legacies carried over from their predecessors. The significance of such cost varies among different corporate forms adopted by restructured enterprises. Where there is more initial room for postponing the cost of restructuring, the pertinent corporate forms tend to face continued pressure for organizational readjustment.

In short, the foregoing discussion can be summarized into the following general observations, which we will examine against survey data in the following sections.

- Enterprises that receive ad hoc favorable allocative and regulatory treatment under the existing system tend to demonstrate great lethargy in the reform.
- Enterprises located in strategic sectors are likely to be slow

movers in restructuring.

- Enterprises with heavy financial and personnel liabilities and weak abilities to compete and make profit are likely to be slow movers in ownership restructuring.
- State ownership is likely to be quite significant in restructured enterprises, particularly in the larger ones that are mostly converted into either limited liability or limited stock companies.
- Among restructured enterprises limited liability stock company and private enterprise tend to be less widely adopted than other corporate forms, especially limited liability company.
- Signs of halfway organizational change are likely to be found in a sizeable number of restructured enterprises. Particularly, corporate governance is likely to deviate substantially from what is stipulated in the law, and the government would continue to play a significant role in corporate governance in many restructured firms.
- Compared to other restructured enterprises, those that have been turned into private enterprises tend to have poorer profitability and assume greater financial and personnel liabilities.
- Those turned into private enterprises are least likely to switch to alternative organizational forms after restructuring, and those turned into limited liability stock companies are more likely to maintain their existing organizational form than those turned into limited liability companies and employee shareholding cooperatives.

III. Data and Method

The data that we analyze are from a questionnaire survey on the restructuring of industrial SOEs conducted by the State Statistical Bureau in the summer of 1998.[8] It took the form of a two-part questionnaire. The first part contained questions about (1) the basic profile of the enterprise (*i.e.* enterprise code, sector, location, and size); (2) the process of enterprise restructuring (*e.g.* whether steps had been taken for ownership restructuring, what new organi-

[8]A more detailed discussion of the data is provided in Lin and Zhu (forthcoming), which uses the same data but has different focus and objectives.

zational form was adopted, *etc.*); and (3) the personal profile of the top managers. These questions were posed to all the enterprises surveyed. The second part of the questionnaire contained a set of questions about enterprise finance (*i.e.* assets, liabilities, equity, sales, interest payment, profits, taxes, and number of employees) at the time of the survey, and 53 questions about various aspects of restructuring, such as governance structure, insider stake holding, assessment of the initial outcome of restructuring, *etc.* These questions were posed to the top managers of the SOEs that had undertaken restructuring.

A total of 40,246 industrial SOEs responded to the survey, which was equivalent to 62% of the total number of industrial SOEs that were in operation in that year.[9] All the industrial sectors and, with the exception of Tibet, all the provinces and centrally administered municipalities were represented in the responses. 6,872 of these enterprises (*i.e.* 17% of the SOEs surveyed) indicated they had completed restructuring at the time of the survey.

From the responses in the survey we separate three sets of data. The first set, referred to below as "data set I," contains responses provided by 40,246 enterprises with regard to part one of the questionnaire. The second set, which we call "data set II," contains responses from the 6,872 restructured enterprises. The scope of the questions answered includes those in data set I, as well as the questions concerning enterprise finance in part two of the questionnaire.[10] The third set, referred to as "data set III" in the following discussion, contains responses from 2,632 of the 6,872 restructured enterprises. It includes the responses to questions in data sets I and II, and the responses to the 53 questions in part two of the questionnaire.

Our analysis of the data focuses on three major issues: the process of restructuring, the organizational features of restructured enterprises, and variations among restructured enterprises adopting different corporate forms.[11] We use a logistic regression to examine

[9]State Statistical Bureau (1999, p. 7)

[10]Some of the enterprises that had not started or completed restructuring also provided information on enterprise finance—either voluntarily or by mistake. We treat such information as "windfall" data and leave it in data set II.

[11]Because most of the enterprises in data set II had just completed their restructuring at the time of the survey and the only accounting data

the factors that shape the process of restructuring.[12] Based on the information provided by the enterprises with regard to their stages of restructuring, we construct a dependent variable on an ordinal scale (coded as "1" for "no plan to reform," "2" for "inclined to restructure but no concrete plan yet," "3" for "restructuring plan under design," "4" for "restructuring plan pending approval," "5" for "restructuring plan approved and ready to be implemented," and "6" for "restructuring completed"). We then regress this on several independent variables. They include: (1) perceived importance of reform (coded as "1" for "badly needed," "2" for "necessary," and "3" for "nonessential"); (2) enterprise size (coded as "1" for "extra large," "2" for "large," "3" for "medium," and "4" for "small");[13] (3) industrial sector (coded as "1" for "mining and extraction," "2" for "utilities," "3" for "capital goods," "4" for "consumer goods"); (4) percentage of off-duty employees (in total workforce); (4) debt-equity ratio; (5) ratio of pre-tax profit to total assets; and (6) location in coastal province (coded as "1" for coastal province and "0" for inland province). Results of the regression are reported in Table 1.

To profile the restructured SOEs, we compute descriptive statistics on their basic organizational features, the pattern of controlling share distribution, and some relevant aspects of corporate governance, which are reported in Tables 2, 3, and 4, respectively.

A multinomial logit regression is used to examine the variations among the five different types of corporate forms adopted by restructured SOEs in relation to a common set of independent variables. We use private enterprise as the reference category. We include all the independent variables used in the logistic regression

reported were those for 1997 and the first quarter of 1998, there is not sufficient evidence for assessing the impact of restructuring on performance. In the data analysis, we assume financial performances were unaffected by restructuring itself during 1997-8. Moreover, accounting data for non-restructured enterprises are not available, and hence comparisons between restructured and nonrestructured firms cannot be performed based on accounting data.

[12]This logistic regression and the multinomial logit regression to be discussed below follow the standard model specifications discussed in Agresti (1990). We do not duplicate them here due to the limitation of space.

[13]This four-level classification of enterprise size is determined by the government on the basis of a number of criteria, such as capital, workforce, and production capacity.

TABLE 1

MAXIMUM LIKELIHOOD ESTIMATES FOR LOGISTIC REGRESSION OF VARIATIONS IN THE PACE OF RESTRUCTURING

Independent variables	Parameter estimate	Standard error	Odds ratio
Perceived need for reform	0.300***	0.062	1.350
Enterprise size	0.0533	0.045	1.055
Industrial sector	0.317***	0.046	1.373
Ratio of pre-tax profit to assets	2.244***	0.574	9.433
Percentage of off-duty employees	-0.336**	0.133	0.715
Debt-equity ratio	-0.030**	0.016	0.970
Location in coastal province	-0.607***	0.072	0.545
-2 log-likelihood (df=7)	154.15		
Number of cases	4,103		

Note: **: $p<0.05$, ***: $p<0.01$

Source: 1998 survey data set I.

and redefine one of them, *i.e.* enterprise size with "enterprise size being small" (coded as "1" for "yes" and "0" for "no").[14] And we add several other variables in the regression. They are (1) recency of restructuring (coded as "1" for "before 1997," "2" for "1997," and "3" for "1998"); (2) approving authority (coded as "1" for "central," "2" for "provincial," and "3" for "subprovincial"); (3) perceived significance of debt (after restructuring) (coded as "1" for "being the top concern" and "0" for "not being the top concern"); (4) imposed restructuring (coded as "1" for "the greatest achievement of restructuring is completing a task assigned by the government" and "0" for "otherwise"); (5) assessment of (the outcome of) restructuring (coded as "1" for "excellent," "2" for "good," "3" for "fair," "4" for "yet to be effective," and "5" for "not effective"); and (6) (enterprises' expecting) to keep current organizational form (in the near future) (coded as "1" for "yes" and "2" for "no"). Results of the regression are reported in Table 5.

[14]The reason for this is that some categories such as private enterprises and employee shareholding cooperatives, do not contain any observation that can be classified as "extra-large" or "large" enterprise.

TABLE 2

PROFILE OF RESTRUCTURED SOEs

Indicator	%	Indicator	%
Enterprise size		Restructuring perceived as	
extra large	0.7	badly needed	30.0
large	12.2	necessary	61.9
medium	20.0	nonessential	8.1
small	67.1		
		Relative size of off-duty	
Industrial sector		employees in labor	
mining & extraction	3.0	force (mean)	13.6
utilities	2.1		
capital goods	55.8	Ratio of debt to equity	
consumer goods	39.1	(median)	83.0
Location in coastal province	38.3	Ratio of gross profit to total	
		assets (median)	-0.2
Year of restructuring			
before 1997	8.8	Top-ranking concern after	
1997	75.6	restructuring	
1998	15.7	heavy financial debt	33.1
		shortage of capital	23.2
Approving authority		difficulty in sales	17.0
central	1.8		
province	8.9	Completing a task assigned	
sub-provincial	89.3	by the government deemed	
		as greatest achievement of	
Organizational form		restructuring	19.3
limited liability stock company	11.4		
limited liability company	53.0	Managerial assessment of the	
employee shareholding coop	17.9	outcome of restructuring	
private enterprise	4.2	excellent	7.2
other	13.4	good	47.2
		fair	29.1
After restructuring old enter-		yet to be effective	13.0
prise was		not effective	3.6
abolished	59.2		
kept as function auxiliary	18.9	Enterprises expecting to re-	
no longer functional but	21.9	main in the current organi-	
kept as depository for		zational form in the near	
social service responsi-		future	27.1
bilities & financial debt			

Source: 1998 survey data set III (n=2,632).

TABLE 3

DISTRIBUTION PATTERN OF CONTROLLING SHARES AFTER RESTRUCTURING

Organizational form	Percentage of enterprises with more than 50% of equity capital held by		
	The state	Institutional owners	Private owners
(1) Limited liability stock companies (n=498)	57.6	12.4	22.7
(2) Limited liability companies (n=1,931)	53.2	12.6	27.4
(3) Employee shareholding cooperatives (n=710)	23.9	3.7	48.7
(4) Private enterprises (n=216)	7.4	3.8	83.9
(5) Other (n=686)	85	7.1	4.5
(6) All (n=4,041)	53.5	9.7	27.6

Note: Only those that provided full and consistent information on ownership structure (*i.e.* the sum of the equity shares from all five categories equals the total amount of equity shares of the enterprise) are included in this table. For more detailed patterns, see Lin and Zhu (forthcoming).

Source: 1998 survey data set II.

IV. Findings

By and large, the results reported in Tables 1-5 are consistent with our general observations summarized at the end of Section II, though they also pose some questions for further investigation. We discuss the findings in the order of the three focal issues mentioned above.

A. Variations in the Pace of Reform

Although data set I contains only a rather limited amount of information, the logistic regression results in Table 1 do reveal some interesting features of the process of ownership restructuring among industrial SOEs. First, fast movers perceived greater urgency for reform than slow movers. An important reason for this may be that slow movers were rather content with their existing organiza-

TABLE 4

SELECTED FINDINGS ON GOVERNANCE STRUCTURE AFTER RESTRUCTURING

	All	Limited liability stock companies	Limited liability companies	Employee share-holding companies	Private entities	Other
(1) % of enterprises that instituted shareholder meetings						
	62	87	67	90	6	7
(2) % of enterprises that formed board of directors						
	75	92	87	89	7	16
(3) % of enterprises where the board of directors was selected by						
shareholder meeting	70.2	75.9	63.0	90.7	100	58.8
government	8.8	4.1	11.8	1.0	0.0	26.5
CEO	0.9	0.0	0.8	0.0	0.0	5.9
enterprise nomination & government approval	12.4	11.0	15.6	4.1	0.0	8.8
other	7.7	9.0	8.9	4.1	0.0	0.0
(4) % of enterprises where company by-laws were authorized by						
government	23.5	14.5	25.1	17.6	14.6	44.4
board of directors	17.8	18.5	22.0	9.4	8.3	9.5
CEO	5.9	2.9	2.7	2.1	62.5	29.0
shareholder meeting	50.4	62.5	48.7	70.3	6.3	4.1
other	2.4	1.5	1.4	0.7	8.3	13.0
(5) % of enterprises where the CEO was						
enterprise-nominated & government-approved	15	15	14	9	14	29
government-appointed	17	12	17	4	11	44
board-nominated & government-approved	49	63	56	61	6	5
shareholder-appointed	9	7	8	21	3	2
employee-appointed	3	3	2	4	6	3
other	7	2	3	2	62	16
(6) % of enterprises where the voting method used at shareholder meetings was						
one share one vote	52	64	54	40	43	54
one person one vote	13	12	13	15		17
the above combined	35	24	33	45	57	29

Source: 1998 survey data set III (n=2,632).

tional arrangements and the pertinent regulatory and allocative treatment that they received from the government.[15]

Second, enterprise size did not seem to make much difference with regard to the pace of reform. Fast movers and slow movers

[15]This is confirmed by a further examination of the data, which shows that 22% of those indicating that they had no plan to reform (n=9,867) claimed that the existing system was adequate and hence there was no need for reform.

TABLE 5

MAXIMUM LIKELIHOOD ESTIMATES FOR MULTINOMIAL LOGIT REGRESSION OF ORGANIZATIONAL FORMS OF RESTRUCTURED SOEs

Covariate	Limited liability stock company			Limited liability company		
	Parameter estimate	Standard error	Odds ratio	Parameter estimate	Standard error	Odds ratio
Enterprise size being "small"	-2.328***	0.467	0.098	-2.103***	0.450	0.122
Industrial sector	0.215	0.196	1.240	0.324*	0.177	1.383
Location in coastal province	-1.285***	0.279	0.277	-1.243***	0.251	0.289
Recency of restructuring	-0.981***	0.239	0.375	-0.891***	0.232	0.410
Approving authority	-1.128***	0.425	0.324	-0.263	0.408	0.4769
Perceived need for reform	-0.003	0.236	0.997	0.171	0.210	1.186
Off-duty employee/workforce	-0.714	0.542	0.490	-0.878*	0.449	0.416
Debt/equity	-0.897	0.260	0.408	-0.562***	0.203	0.570
Gross profit/assets	4.068***	1.021	58.428	3.335***	0.781	28.09
Perceived significance of debt	0.558*	0.316	1.748	0.546*	0.287	1.727
Imposed restructuring	-0.626*	0.350	0.535	-0.304	0.302	0.738
Assessment of restructuring	-0.339**	0.152	0.713	-0.167	0.133	0.846
To keep current organizational form	-0.211	0.283	0.810	-0.575**	0.254	0.563
Covariate	**Employee shareholding coop**			**Other**		
	Parameter estimate	Standard error	Odds ratio	Parameter estimate	Standard error	Odds ratio
Enterprise size being "small"	-0.862*	0.471	0.422	-1.566***	0.467	0.209
Industrial sector	0.454**	0.187	1.574	0.338*	0.196	1.402
Location in coastal province	-1.255***	0.265	0.285	-0.310	0.271	0.733
Recency of restructuring	-0.660**	0.241	0.517	-0.860***	0.239	0.423
Approving authority	0.606	0.455	1.833	-0.348	429	0.706
Perceived need for reform	-0.079	0.221	0.924	0.160	0.228	1.174
Off-duty employee/workforce	-1.203**	0.487	0.300	-0.080	0.484	0.923
Debt/equity	-0.389*	0.218	0.678	-0.467**	0.227	0.627
Gross profit/assets	3.303***	0.861	27.208	1.545*	0.851	4.688
Perceived significance of debt	0.685**	0.298	1.983	0.777**	0.306	2.175
Imposed restructuring	-0.435	0.318	0.647	0.331	0.320	1.392
Assessment of restructuring	0.176	0.138	1.192	-0.235	0.146	0.791
To keep current organizational form	-0.411	0.268	0.663	-0.369	0.277	0.692
Likelihood ratio (df=8,696)		5,029				
Number of cases		2,189				

Notes: (1) *: p<0.10, **: p<0.05, ***: p<0.01.
(2) The reference category is private enterprise.
Source: 1998 survey data set III.

were likely to have similar patterns of size distribution. On the other hand, fast movers were more likely to be concentrated in downstream industries, whereas slow movers tended to concentrate in upstream industries where regulatory hurdles are relatively high.[16]

Third, faster movers had both higher rates of return and lighter financial and personnel liabilities than slow movers. This suggests that strong or proven profit-making ability may reduce uncertainties in restructuring negotiations and thus help overcome the hurdle posed by financial and personnel liabilities. A further implication is that those claiming that they were content with the existing system and perceived no need for reform might be under soft budget constraint rather than being highly competitive.

Fourth, fast movers were more likely to be located in inland provinces, whereas slow movers tended to concentrate in coastal provinces. Given that coastal provinces have been the forerunners of reform (Shirk 1993; and Naughton 1995), this finding is a bit puzzling. One possible explanation is that overall SOEs in inland provinces are more disadvantaged in terms of infrastructure and resource allocation, and to contain the growing gap with coastal provinces in face of marketization they may have sought to speed up the process of the latest round of reform so as to avoid being left further behind.

B. Organizational Features, Ownership, and Governance

Table 2 profiles the basic organizational features of restructured enterprises. The pattern of size distribution is similar to that in the industrial sector as a whole, whereas the sectoral and spatial patterns are consistent with the results of the logistic regression discussed above. Most restructured enterprises carried out the reform after 1997, when the Chinese Communist Part convened its 15th Congress and called for a deepening of economic reforms. That political event obviously had an important boost to the restructuring of SOEs. Meanwhile, local authorities appeared to have played an important role as well, as most approving authorities of reform were subprovincial governments, reflecting the decentralized locus of decision making in the reform era (Shirk

[16]A cross tabulation of the data shows that 19% of those without any plan to reform were situated in sectors deemed as "not suitable for reform."

1993). As expected, private enterprise and limited liability stock company were not widely adopted, whereas limited liability company constituted the most widely adopted organizational form.

While the reform was generally viewed by the restructured enterprises as being necessary and positive, there are limitations as well as signs of halfway organizational change. A little over half of the restructured enterprises had below break-even financial results, though the logistic regression results reported above indicate an even poorer overall pattern of performance among slower movers. Restructured enterprises continued to carry sizeable personnel and financial liabilities. Heavy financial debt and shortage of capital were regarded by over 50% of them as their top concern.

Other than the four organizational forms prescribed by the government, a fifth and unclearly defined category ("other") was adopted by a number of enterprises that claimed to have completed restructuring. A further examination of the data reveals that the restructuring of many of those in this category involved measures that might not have fully resulted in any of the four prescribed forms such as leasing, managerial contract with collateral, and merger (Lin and Zhu forthcoming). Nearly 20% of the enterprises ranked "completing a task assigned by the government" (over "increasing efficiency" and "improving management effectiveness," among other choices) as the greatest achievement of reform, suggesting that other-regarding bureaucratic agendas might have led to efforts to push through nominal restructuring. The organizational forms adopted by most restructured enterprises appeared to be transient, as 73% of them indicated that they would not expect to stay in the existing organizational form in the near future.

As to ownership structure, the reform led to a diversification of stake holders, as can be seen from the figures reported in Table 3. On the other hand, the state continued to hold significant stakes in large numbers of restructured enterprises, especially those organized as limited liability stock companies, limited liability companies, and entities in the "other" category. It is not clear why the state continued to hold over 50% of the equity capital in a number of those turned into private enterprises. A possible reason is that the land use rights and factory estate ownership had yet to be transferred in part or fully to the private owners at the time when restructuring was declared to have been completed.

The picture of governance in restructured enterprises is also mixed (see Table 4). Quite a number of them instituted such arrangements as shareholder meetings, board of directors, company by-laws, and shareholder voting mechanisms. Yet, the government continued to hold considerable sway over the formation of the board of directors and the appointment of CEOs. In a significant number of cases, the voting methods used by limited liability stock companies and limited liability companies deviated from the principle of "one share one vote" stipulated in the *Company Law*, whereas only 40% of the employee shareholding cooperatives stuck to the regulatorily prescribed principle of "one person one vote."

C. Variations among Different Corporate Forms

Table 5 reports findings on variations among different organizational forms, with those turned into private enterprises as the reference group for multilateral comparison. Several results are noteworthy. First, those turned into private enterprises were smaller than other types of restructured enterprises, yet they were less skewed toward downstream industries. Spatially, they were more concentrated in inland provinces than other types of restructured enterprises. In terms of the time of restructuring, they were more recently structured, suggesting a possible softening of restrictions on private ownership toward the end of the decade and implying that a continuation of this trend could broaden the way for outright privatization. Except for employee shareholding cooperatives, private enterprises were approved by lower level authorities than the other three types of restructured enterprises, whereas limited liability stock companies had the highest level of approving authority. There was no significant difference among the restructured enterprises with regard to the perceived urgency of reform.

Second, private enterprises absorbed relatively more redundant workers and assumed comparatively heavier financial debt than enterprises turned into other organizational forms. They were also the least profitable compared to restructured firms in the other categories at the time of restructuring, whereas limited liability stock companies were the most profitable. Moreover, private enterprises were more likely to face imposed restructuring than limited liability stock companies (where nominal reform was least likely to be pushed through), limited liability companies, and employee shareholding cooperatives. These pieces of evidence suggest that private enterprises were treated as a "dumping ground" for problem-ridden enterprises. It is not surprising, therefore, that those turned into private enterprises had less favorable assessment of the outcome of reform (whereas limited liability stock companies had the most favorable assessment).

Third, despite the seemingly unfavorable condition on which privatization occurred, those turned into private enterprises tended to face less difficulty in servicing their debt than other enterprises. This suggests that the negative impact of personnel and financial liabilities and initially poor profitability had probably already being factored into the "price" of restructuring. This can be further inferred from the finding that private enterprises were least likely to resort to further changes in organizational form after restructuring. Relatedly, limited liability stock companies were likely to be more stable than the other three forms, whereas limited liability companies were most likely to seek alternative arrangements after restructuring. An implication of this finding is that over time organizational forms with initially high threshold, *i.e.* private and limited stock companies, may be the ones towards which post-restructuring readjustment is geared.

V. Concluding Remarks

The experience of China's recent SOE reform demonstrates a high degree of path dependence in the transition from central planning to markets: the pace, form, and outcome of institutional change are all subject to considerable transaction costs and constraints rooted in the pre-existing political and economic institutions. Unlike corporatization in the West where private ownership preceded and formed the foundation for the rise of the modern corporation and its variants, the process in China involves the dual task of limitedly divesting state ownership to non-state parties and creating new institutions that redefine the form and boundaries of both public and private property rights. Such different initial condition poses some important constraints on the reform.

In the short run, continued government involvement in ownership and governance is inevitable due to institutional constraints. However, the long run success of the reform will hinge upon the development of a large body of legal and market institutions, many of which have yet to be introduced. According to one official report (*RMRB*, January 10, 1998), the *Company Law* alone requires at least over 30 other related laws and regulations in order to be fully functional. Undoubtedly, China's recent restructuring of ownership and corporate governance may provide a major impetus for the development of these institutions, and for the acceleration and deepening of reforms in other areas such as banking and social security. How the interplay between enterprise restructuring and institution building shapes the future of the Chinese economy will be an issue of great interest for future research.

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