

AN INSTITUTIONAL ANALYSIS OF MANAGEMENT PROBLEMS

IN CHINESE STATE-OWNED ENTERPRISES

A THESIS

SUBMITTED TO THE

STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES

AT THE STANFORD LAW SCHOOL,

STANFORD UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS

FOR THE DEGREE OF

JURIDICAL SCIENCES MASTER

by

Akira Matsunaga

May 1999

ABSTRACT

This thesis analyzes the corporate governance of Chinese State-Owned Enterprises (SOEs), with a particular focus on the institutional arrangements by which SOEs discipline their managers. I ask: Which types of institutional arrangements explain the inadequate discipline of SOE managers? This article reveals that Chinese asset diversion is caused not only by transitional features such as expansion of managerial autonomy, but also by more inherent features rooted in Chinese socialism, localism, and Confucianism.

Although a number of studies, including some by the World Bank, have been made on Chinese corporate governance, only a few attempts have thus far been made at mapping the inherent institutional arrangements of Chinese SOEs. Despite the concentrated state ownership in large SOEs, why can the state not prevent rampant managerial wrongdoing including asset stripping? To answer this question, the article employs a comparative institutional analysis to shed light on Chinese distinctiveness, thereby contextualizing the problems of Chinese SOEs.

The argument begins with a brief overview of asset diversion in SOEs, and then explores Chinese SOE reform efforts to examine how the ownership structure of SOEs has been changed or not changed, and how reforms have provided managers with new opportunities to steal assets. In addition to such historical analysis, this article explores in great depth whether there is a causal mechanism that links state ownership and asset diversion from an institutional perspective. Comparison of SOEs in developed and transitional countries with those in China reveals that Chinese management problems

have been caused mainly by its fundamental institutional features, including a legacy of socialism, localism, and culture, many of which also exist in Russia. The thesis also examines the inability of Chinese large creditors to monitor SOEs, in comparison with creditors in developed countries.

Finally, a comparative institutional analysis points to the difficulties that Chinese corporate governance will continue to face. One cannot expect a quantum leap in SOE management problems in the short-term; Chinese corporate governance evolves gradually, and is largely shaped by a strong path dependency reflecting its historical legacy.

TABLE OF CONTENTS

INTRODUCTION	1
I. ASSET DIVERSION.....	7
II. OVERVIEW OF SOE REFORM	9
A. The Reform of Incentive Mechanism	10
1. Contract Responsibility System.....	10
2. The Regulations for Converting the Status of the Enterprises.....	12
B. Corporatization.....	14
1. Company Law in China	14
2. Government as Majority Shareholder.....	16
C. Partial Privatization.....	19
1. Enterprise Groups of Large SOEs	19
2. Release of Small SOEs	24
D. Conclusion	27

III. DISCIPLINE BY STATE OWNERSHIP.....	28
A. Principal-Agent Relationship.....	28
B. Comparative Study of SOEs between Developed Countries and China.....	30
1. Objectives of Principals.....	30
2. Behavior of Principals	43
3. Behavior of Management	57
4. Information Asymmetry.....	73
5. Exit and Voice.....	77
C. Conclusion	83
IV. MONITORING BY CREDITORS.....	84
A. Banking Sector and State-owned Specialized Banks.....	85
1. Banking Sector in China.....	85
2. State-Owned Specialized Banks (SSBs).....	86
B. Monitoring Function in Credit Allocation	87
1. Monitoring Functions of Creditors in Developed Countries	87
2. The Direct Intervention of the Local Government in China.....	88
3. Commercialization of SSBs.....	89
4. Back- and Forth Reform	91
C. Supervision of Credit	93
1. Supervision of Credit in Developed Economies.....	93
2. Inadequate Accounting Information in Chinese SOEs	94
D. Threat of Bankruptcy	95
1. Threat of Bankruptcy in Developed Countries.....	95
2. Bankruptcy of SOEs in the Chinese Context.....	96
3. Experiment of Bankruptcy and Bankruptcy Law	97
4. Can SOCBs Claim Their Rights?	99
E. Conclusion.....	101

V. THE IMPLICATIONS OF COMPARATIVE INSTITUTIONAL ANALYSIS	102
A. Findings in Chinese Institutional Arrangement	103
B. The Myth of Full Privatization.....	104
1. Insider Control.....	105
2. Capital Market	109
C.Path Dependency.....	112
CONCLUSION	115
BIBLIOGRAPHY	