Steering and Rowing in Chinese SOEs: the Modern Enterprise System in China

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Abstract
The paper provides an overview of the reforms in the state owned sector in China, with particular attention to the iron and steel industry. It examines whether the government has really distanced itself from the management of this sector under the so-called Modern Enterprise System. Although some of the problems of conflict and diffused responsibility appeared to have been solved by the new system, and the sector is apparently quite successful, there are still some unintended consequences.

Keywords: Modern Enterprise System (MES), State-Owned Enterprises (SOEs), Party-State

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Introduction

In response to economic, institutional and ideological changes, as well as criticisms of inefficient and costly public sectors, public sector reform has become an international phenomenon (Bennington and Cummane, 2000; Hughes, 1998). Consistent with the philosophy that market oriented systems are more efficient and effective, and that the role of government is to steer, not row (Osborne and Gaebler, 1993), a tidal wave of corporatisation and privatisation of government businesses has been engulfing public sectors throughout the western world for over two decades now. A paradigm of New Public Management, characterised by a preference for minimal government interference and an espousal of market philosophy beliefs (Beckett, 2000; Jaconelli and Sheffield, 2000), has emerged. The purpose of this paper is to identify where China is on this road to reform based both on the extant literature and on case examples from the state-owned iron and steel industry in China.

China’s Success To Date

According to many pundits, China has made huge economic progress over the last two decades and some argue that there is no doubt that China will become a world economic superpower (e.g. Lewis, 2003). Child and Lu (1996) state that this has resulted from the reform of the centrally planned economy (to a more market-oriented system) and from the so-called Open Door Policy. In contrast to other economies such as Russia, China has taken a slow and gradual path to reform and, while the development of a private sector is now encouraged, corporatisation rather than privatisation of large and medium-sized state-owned enterprises has been the norm (Forrester and Porter, 1999).

The progress of reform in this sector is significant. From 1978 to 1996, the average output of the state sector was officially recorded as having sustained a growth rate at 6 per cent (Putterman and Dong, 2000); and the state-owned sector has remained the dominant employer over the last two decades, accounting for about 78 per cent (7.451 million) of the industrial workforce in 1978 and nearly 74 per cent (10.94 million) in 1996 (Ding, Goodall, and Warner, 2002). In addition, state dominance exists in those industrial sectors considered to be vital to the national interest; they account for an average exceeding 70 per cent of the gross value of the industrial output in the relevant industrial sectors, such as metallurgy, petroleum, transportation and mining, despite the fact that their total share of the gross value
of industrial output decreased from 54.6 per cent in 1990 to 28.2 per cent in 1998 (Chen, 2002). However, Choe and Yin (2000) have argued that this sector has performed relatively poorly compared to other forms of Chinese enterprises, albeit that the performance on a percentage improvement basis would have been very acceptable in a western economy during the same period. Just the same, there are a number of threats to ongoing improvement. For example, Lewis (2003) states that more effective HRM practices in these enterprises will be necessary for the continued growth of China; amongst other issues, motivation is low, resources are used “irrationally”, absenteeism is rife, productivity is low, turnover is high, and labor disputes are increasing (Sun, 2000), so these factors are likely to hinder further development.

What else then might be needed to improve SOE performance? In a study of twelve developing countries, not including China, Shirley (1999) found that most improvements in state owned enterprise performance arose from comprehensive reforms that included corporatisation and privatisation, with ownership reforms and private management apparently having had the most effect. To work though, these reform strategies needed political desirability, feasibility and credibility; in other words, each country had to be ready for such change, and the Chinese government does not appear ready since the Chinese Communist Party (the Party) is still reluctant to surrender much power, possibly fearing the collapse that occurred in the Soviet Union (Anonymous, 2002).

In China, even though there has been a move to separate the Party from government functions and enterprises from government functions; and government officials have been instructed to allow market-oriented reforms to occur (Straussman and Zhang, 2001), Tan (1999), based on the state-owned electronics industry, has pointed out some of the differences between the Chinese approach and the western approach, suggesting that many of the idiosyncrasies come from the Chinese traditional way of managing. For example, the SOEs are part of the bureaucratic command system, subject to rigid civil service rules; requirements to report to government controllers and objectives are only partially related to market requirements (Tan, 1999). Leung (2002), too, states that the powerful party apparatus provides rigid control and that party cadres safeguard the Party views and decisions, with all promotions obviously being under party apparatus control.
Background to recent reforms

Attempts by the Chinese government to transform SOEs have been guided by two major national reform campaigns: the Contract Management Responsibility System (CMRS) in early 1980s and the Modern Enterprise System (MES) from 1993. Both systems were characterized by the granting so-called autonomy to SOEs without changing the ownership of the state (Forrester and Porter, 1999; Scot, 2002). These transformations have significantly impacted upon the power structure relationships in SOEs, leading to the apparent weakened role of the Party and relaxed intervention of the state at the micro-level, particularly under the Contract Management Responsibility System (CMRS) (Child, 1994; Harvie, 1999; Warner, 2001; Warner and Zhu, 2000) - see Figure 1.

But, despite the success of enterprise reforms in Chinese SOEs’ in the early stage (Chen, 1995; Child, 1994; Fan and Nolan, 1994; Harvie, 1999; Warner and Zhu, 2000), studies show that there were concomitant issues including the conflicting interests between the government, the Party and the management (Jin, 1997; Forrester, 1999; Putterman and Dong; 2000). The influence of the government on SOEs was seen to be rapidly decreasing and this became one of the major concerns of the Chinese government (Hu, 2000; Jin, 1997). As a result, the new modern enterprise system (MES) was introduced to SOEs in expect to solve the above-mentioned problems (Choe and Yin, 2000; Sheenhan, 2000). MES is the latest effort of the Chinese government attempting to clarify the position on property rights of SOEs, providing a clearer definition of rights and responsibilities between the state and the management. It has been characterized with reconstruction and restructuring of SOEs into corporations similar to their Western counterparts and introduction of the new management mechanism or so called ‘scientific enterprise management’ into SOEs (Forrester and Porter, 1999).
There are conflicting views on the results of MES on Chinese SOEs, with many scholars (e.g. Forrester and Porter, 1999; Harvie, 1999; Li and Wu, 2002; Putterman and Dong, 2000; Ross, 1999; Selmer, Erdemer, Tung, Worm, and Simon, 1999) hailing the present success in some large SOEs as being related to the adoption of the MES, while many other observers contending that MES does not help to solve the conflicting principles between the Party-State, management and workers in SOEs (Hutzler, 2002; Pei, 2002). The optimists argue that under the structure of MES, the separate responsibilities of different actors have been clarified, thus providing a clearer definition of rights and responsibilities between enterprises and state (Li and Wu, 2002; Pu, 2001; Selmer et al, 1999). However, the pessimists indicate that without the much-needed political reform, the present MES reform in the SOEs is doomed (Anonymous, 2002; Hutzler, 2002; Pei, 2002).

Therefore this study will examine the role that the Party-State plays in SOEs and whether the MES has solved the issue of conflict that arose from the dual leadership system (under CMRS). The specific industry that will be used as the focus will be iron and steel industry. The background to this industry is that it began to adopt a policy of enhancing productivity through technological development and managerial reform from as early as 1981 (Pu, 2001). The systematic enterprise reforms have significantly enhanced productivity (Hogan, 1999). More remarkably, China has come to and maintained its position as the largest steel producer in the world from 1996 (Hogan, 1999; Zhang, 2001). Until very recently large and middle-
sized SOEs in the industry continued to be directly owned by the state or the provincial
governments and dominate in the Chinese economy (Forrester and Porter, 1999). During the
period 1994-95, the iron and steel industry began to be corporatized with the MES being
implemented in large and medium-sized SOEs (Hassard, Sheehan, and Morris, 1999; Pu,
2001).

Method
This study involved six major SOEs that controlled 251 businesses in the iron and steel
industry, employed over 580,000 people, and accounted for nearly 28% annual steel output
in China (Liu, 2001). Although the study was broad ranging, the findings presented here
arose from interviews with 52 key players in the industry, analysis of policy documents, and
was supported by survey responses from a sample of 393 respondents who were randomly
selected in each of the SOEs. The fieldwork was carried out by the first author as part of his
doctoral research and was facilitated by the Ministry of the Labour and Social Protection.
The focus was to examine the role of the Party-State in these SOEs and, to a more limited
extent, to examine any effects of the existing power/leadership structures.

Table 1: Profile of the Iron & Steel Enterprises Investigated (Liu, 2001)

<table>
<thead>
<tr>
<th>Name</th>
<th>Location</th>
<th>Ownership</th>
<th>History (Year)</th>
<th>Sub-companies</th>
<th>No. employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise A</td>
<td>Liaolin</td>
<td>Central</td>
<td>1916</td>
<td>30</td>
<td>153,016</td>
</tr>
<tr>
<td>Enterprise B</td>
<td>Shanghai</td>
<td>Central</td>
<td>1982</td>
<td>72</td>
<td>154,441</td>
</tr>
<tr>
<td>Enterprise C</td>
<td>Beijing</td>
<td>Central</td>
<td>1920</td>
<td>79</td>
<td>183,355</td>
</tr>
<tr>
<td>Enterprise D</td>
<td>Hebei</td>
<td>Provincial</td>
<td>1958</td>
<td>20</td>
<td>10,910</td>
</tr>
<tr>
<td>Enterprise E</td>
<td>Anhui</td>
<td>Provincial</td>
<td>1956</td>
<td>29</td>
<td>69,464</td>
</tr>
<tr>
<td>Enterprise F</td>
<td>Jiangsu</td>
<td>City</td>
<td>1958</td>
<td>21</td>
<td>9,013</td>
</tr>
</tbody>
</table>
Findings

The Role of the Party-State in Iron and Steel SOEs

Just as the Chinese government has insisted that the interests of the Party and the state must come before SOEs, the changes have reflected this priority. Through the process of establishing MES in SOEs, the role of state and various governments has been strengthened in many respects. However, both the parent corporations and their subsidiaries do enjoy greater autonomy, to some degree, at the micro-management level. In the six SOEs studied the power of the Party-State has clearly re-emerged. The Party secretaries have been legally appointed by the government to represent the State, following an “election” in either a shareholders’ conference or workers’ congress. Moreover, the important positions are occupied by the Party secretaries in all six SOEs investigated. To illustrate, in two SOEs that do not have a board of directors, the Party secretaries occupy the general manager positions, becoming the absolute power in these enterprises. In the other four SOEs, the Party secretaries occupy either the chair or deputy chair of the boards, and the deputy Party secretaries hold the general manager positions. In other words, all six SOEs have adopted the so-called ‘one-man responsibility system’, under which the Party secretaries have become part of the management. Over 80 per cent of survey respondents also perceived a strengthening of the Party in their enterprises following the introduction of MES.

Furthermore, a number of other measures have been implemented in recent years to safeguard the role of the Party in the process of system transformation, e.g. the Party’s Regulation Supervisory Office has the power in the Supervising Committee, one of the three committees in the new enterprise system, which is purported to check the behaviours of the board of directors and the management committee. Furthermore, a new department, the Department of Organisation and Personnel (DOP), comprising the old Party Organisation Department and the Personnel Department, has strengthened the role of the Party in SOEs. The DOP, under the direct leadership of the Party, is responsible for HRM issues of both cadres and workers. Thus, it is not surprising that nearly all interviewees believe that it is the Party that controls the SOEs rather than the chairs of board or the general managers under the new system. See Figure 2 for the structure of Iron and Steel Enterprise A.
Streamlined Bureaucratic Bodies and Improved Efficiency

During the MES implementation large numbers of once protected white-collar staff have been reallocated to lesser positions, and the size of bureaucracies reduced. In all but one SOE, the ‘one-man responsibility system’ has been implemented in the subsidiaries. Most of the deputy positions in the operational sections have been abolished. In addition, since the Party has become part of the management, it no longer needs its subordinate organisations functioning as forces to provide checks and balances to the management as did in the previous years. As a result, the staff number in the Party’s subordinate organisations including trade unions, youth leagues, women unions and so on, have been radically decreased with halving of the number of white-collar staff not uncommon. However, in Enterprise B, staff numbers in the Party organisations have been reduced even further to one third of the previous size.

The structural changes made as a result of implementing MES have led to more simplified and efficient decision making procedures in SOEs, at the same time the administrative cost has also been significantly reduced. Power struggles and responsibility diffusion in all levels of management has decreased, significantly improving administrative efficiency.
Unintended Consequences

However, the structural changes brought about by establishing MES has led to unchecked absolute power of managers at various levels in the SOEs. Including the one SOE that is still practising CMRS, the previous collective responsibility system of leadership based on the ‘dual system’ (including the Party and the management) has been replaced by the ‘one-person responsibility system’ at all levels. This system has become the source of the widespread corruption – confirmation of this also came from the questionnaire responses, with nearly 90 per cent of respondents believing that the present political and organisational system is the source of widespread corruption.

With the increasing power of management at all levels in the six SOEs investigated, trade unions have been sidelined and generally have not been able to protect interests of workers, in the same way as their counterparts can in the Western economies. As subordinate to the Party, trade unions in SOEs find that in practice they can play only a limited role in protecting the interests of workers. Investigations show that the official pronouncement and legislation on the power of the trade unions as protectors of the workers has little substance. As some union leaders privately point out that if they try to be independent from the Party, they will be labelled as being unfaithful and dismissed from their positions. (This tends to be summary dismissal rather than non-reappointment upon completion of contracts.) For workers in SOEs, they too have little protection with limited grievance mechanisms in the present system. No longer treated as ‘masters of SOEs’, workers are becoming increasingly discontent with the present reform and this does not augur well for SOEs.

Discussion

The present MES and corporation transformation in Chinese large SOEs in the iron and steel industry since 1994 has had a significant impact on the bureaucratic structure and the role of leadership in the SOEs. In comparison with the previous power structure in SOEs (Child, 1994), the present one has given priority to the role of the Party. In contrast to previous studies (Harvie, 1999; Pu, 2001; Putterman and Dong, 2000) that assume that the Chinese government is providing full autonomy to SOEs, this study found that the Chinese state and
provincial governments have been able to bring SOEs under tighter control in the process of implementing MES.

On a positive note, though, after implementing MES, particularly after establishing the so-called ‘one-person responsibility system’, the previous conflicts between the Party (representing for the state) and the management have disappeared as the Party has virtually become the management. As a result, the rights and responsibilities between the state and SOEs remain ambiguous and perhaps not as suggested by Pu (2001). Moreover, in contrast to Scot (2002), who attributed the centralised control and the dominating enterprise paternalism in SOEs to the cultural and institutional heritages, the evidence suggests that rather it has been a political necessity to centralise control.

Conclusion
In conclusion, contrary to the political and economic changes in countries of the former Soviet Union and East Europe that embraced pluralism in the society and in the economy (Melich, 2000; Pavlinek, 2002), the present MES reform in China has strengthened a centralized power structure and paternalist management in Chinese SOEs. The government in China is certainly both "steering and rowing", to use Osborne and Gaebler's (1993) term. However, so far the MES campaigns seem successful in the industry, as the evidence shows the industry has gained a rapid growth in the recent years and maintained its position as the largest steel producer in the world from 1996 (Hogan, 1999; Zhang, 2001). However, the power of managers in SOEs at all levels has been increased at the expense of the trade union and workers, which has further intensified the relationship between the management and workers. Under the present power structure in SOEs, the lack of independent forces to provide a check on the absolute power of the Party-Management has given rise to widespread corruption.

To overcome the inadequacies of MES, it may be necessary to develop an independent mechanism that is able to oversee the activities of the Party-Management in SOEs. In addition, the functions of trade unions need to be enhanced and legalized to protect the rights and interests of workers. Further enterprise reform implies that political system reforms may be needed so as to overcome the present inadequacies of the centralized structure that
generates problems such as labour unrest and widespread corruptions. Nevertheless, the China’s One-Party political system seems to be unable to initiate such a transition. Whether the present MES campaigns can help Chinese SOEs survive in the future, or the government and the Party will everlastingly maintain their dominant role in SOEs, remain largely uncertain.
References


