**Private Capital and Reform of State-Owned Enterprises**

Zhang Siping

In the new year, the whole society hopes for greater progress in reforms, especially in the reform of state-owned enterprises, which lies at the heart of China’s economic reform. In September last year, the Central Committee of the Chinese Communist Party and the State Council issued *Guidelines on Deepening the Reform of State-Owned Enterprises* (hereafter referred to as the “Guidelines”). As the master plan for the reform of SOEs in the new era, this document sets out the direction of the reform. Although interpretations of this document may vary, the Guidelines lay down a host of reform targets and measures, which provides the basis for deepening SOE reform.

In my opinion, two points in the Guidelines deserve our recognition.

First, it continues to take the development of mixed economy as the goal of China’s economic system. It upholds the dominance of public ownership, give full play to the leading role of the state-owned sector, and encourages state-owned enterprises, collective enterprises and private enterprises to develop together through cross holding and mutual fusion. I think this is a point well made, as it highlights two basic directions – shareholding reform and market economy.

Strictly speaking, the idea of mixed economy is not new. In the 1980s when the reform of SOEs was just launched, we put forward the notion of transforming state-owned enterprises into share-holding companies. At that time, the Chinese people understood very little about the shareholding system. Some Western academics equal shareholding reform with privatization. As a result, for a time the goal of the reform was also expressed as ownership diversification. Later on, as state-owned enterprises were reorganized and went public and as the securities market developed, the goal was defined as diversification of social investment and securitization. Now the Guidelines provide a new expression, that is, the development of mixed ownership. Although these expressions differ in their wordings, the idea is the same.

In practice, the development of mixed economy varies from place to place. In some localities, transforming state-owned enterprises into ones with mixed ownership was completed ten years ago. On a national scale, however, pressing ahead with such reforms still makes sense, especially for centrally administered enterprises and state-owned monopolies. The central government’s statement of developing mixed ownership suggests that the goal of ownership diversification remains unchanged. This provides an important basis for further reforming the SOEs.

Second, it advocates improving the state-owned assets management system so that it can be transformed from asset management to capital management. This represents a huge leap in both theory and practice for the reform of SOEs. If the role of SASAC can be changed from managing enterprises, their staffing, operations and assets into managing capital, it will truly be a major breakthrough in the reform of the state-asset management system.

The above-mentioned two goals not only provide the direction and basis for the reform of SOEs, they also create tremendous opportunities for the development of private businesses. Private capital will play an increasingly important role in China’s economic development and SOE reform.

First, private capital is a binding force for the mixed ownership reform. The participation of private capital and social capital will open up the channels for the integration of capital from different economic sectors. As a result, the public sector and non-public sector will be intermingled and provide financial support for the mixed ownership reform.

Second, private capital is a bridge for state-asset management to transition from managing assets to managing capital. Private capital can exploit their advantages in the capital market and the investment chain to help state-owned capital in terms of equity operation, value management and capital flow. This can be achieved through various methods, especially through equity investment funds. It will contribute to the free flow of state-owned capital, better preserve and increase its value, and facilitate the transformation from managing assets to managing capital. Without equity investment from private and social capital, it would be impossible for the state-owned assets to be turned into capital and securities for market trading; and it would also be impossible for state-asset management to be transformed into managing capital.

When we talk about the tremendous opportunities for private enterprises, it is only a theoretical hypothesis. In practice, however, over the past few months since the release of the Guidelines, private businesses were not as enthusiastic about taking part in the SOE reform as we had expected. Some well-known entrepreneurs even publicly talk about their refusal. So far, the private and social equity investment funds have been lukewarm to the opportunities of investing in state-owned enterprises and developing the mixed economy. Why is this the case? As I see it, the problem does not lie in the private or social capital themselves. Nor should it be attributed to the lack of funds. Instead, it is the inadequate understanding as well as poor theoretical and policy preparation for the SOE reform that is to blame. Therefore, to give full play the role of private capital in the SOE reform, we need to straighten out the issues in our thinking and create an enabling environment for private and social capital to participate in the SOE reform. Only in so doing can we facilitate the development of mixed ownership and achieve the transition from asset management to capital management.

What are the issues that need to be addressed? From Shenzhen’s experience, I think there are ten issues that deserve further reflection.

1. We need to give private businesses and social capital political assurance about participating in the SOE reform.

In recent years, more and more rich Chinese are moving to the United States, Canada, Australia and other developed countries and regions. According to some reports, entrepreneurs with more than 100 million *yuan* of wealth make up a large proportion of the people who emigrate or transfer their wealth overseas. There are a number of reasons for such movements, including better education, medical services, environment, food safety and pension abroad. A few of them do it for more complex reasons. But on the whole, I think the most important reason is the lack of political assurance and legal safeguards in China for private businesses and social capital.

To be frank, since the reform and opening up, the Party and the government have made great improvement in their treatment of private businesses both in theory and in practice. The role of the private sector has changed from being a complement to socialist economy to being an integral part of the socialist market economy and an important foundation for socialist economic development. In recent years, the central government announced to “unswervingly strengthen and develop the public sector” and “unswervingly encourage and support the sound development of the non-public sector”. However, for private businesses, their role in the political life of the Party and the government is still unclear. For instance, according to the Guidelines, state-owned enterprises provide an important material and political foundation for the cause of the Party and the State. This is undoubtedly right. However, this document does not provide for the political status of private businesses and social capital. Are they also the material and political foundation for the cause of the Party and the State? If not, whose cause do they lay the foundation for?

I believe, after over three decades of reform and opening up, the private sector has become the de facto material and political foundation for the cause of the Party and the State. For instance, as a window of opening up to the outside world, Shenzhen witnessed tremendous development of its private sector. Private businesses outweigh others in terms of their contribution to tax revenue, number of enterprises, number of staff, and GDP. Shenzhen is home to many well-known private conglomerates, such as Tencent (with over 10, 000 employees), Huawei (with 170, 000 employees), BYD (with 180, 000 employees) and SF Express (with over 350, 000 employees). These companies are the pillars of economic development for Shenzhen and for China at large. Currently there are over 200, 000 Communist Party members working in the private sector in Shenzhen. Party cells can be found in almost all the private companies. Some entrepreneurs themselves are Party members. Under the leadership of the Municipal Party Committee, Shenzhen Non-Public Economic Organizations and Social Organizations Working Committee expanded the governance foundation of the Party by strengthening community-level Party cells and highlighting the exemplary role of the Party members. In Shenzhen, over 150 entrepreneurs are deputies of the Municipal People’s Congress and members of the Municipal People’s Political Consultative Conference, and several dozens of them are deputies of the National People’s Congress and members of the Chinese People’s Political Consultative Conference. They have made great contributions to the political and legal progress in Shenzhen for their political participation and congress supervision. Judging from Shenzhen’s experience, private businesses actually provide the material and political foundation for the development of the cause of the Party and the State. Otherwise one cannot explain Shenzhen’s remarkable achievements since the reform and opening up; nor can one explain their contribution to the Party and the State, and Deng Xiaoping’s conclusion that “Shenzhen belongs to Socialism rather than Capitalism”

Notably, the market economy in Shenzhen is mature. The entrepreneurs include workers from humble backgrounds, scientists and engineers, salespersons and executives of SOEs and civil servants. They fought hard in fierce market competitions and overcame many unimaginable difficulties before finally succeeded. They grew up with the Communist teaching and uphold the reform and opening up policy. In fact, they themselves are the beneficiaries of this policy. Most of them support the leadership of the Communist Party and love the country. Therefore these entrepreneurs should be seen as the allies of the Party and the government rather than their opponents.

2. We need to formulate impartial policies to give a level playing field for private and state-owned businesses.

When the government develops polices, it always assume that SOEs will abide by the industrial policies, the laws and regulations, but it is inherently skeptical about the private companies. As a result, the government always sets higher threshold for private companies to enter industries closely related to national welfare, major infrastructure projects, or strategic industries like resource development, or even excludes private companies altogether from these sectors. As a result, these sectors are monopolized by SOEs, enterprises that are regarded as the most trustworthy. Different market players often play by different rules, and the opportunities they get are not equal. Although the State Council released come recommendations and regulations on supporting the development of private businesses, these documents are not fully implemented. Invisible barriers are still commonplace.

In fact, according to Shenzhen’s experience, private companies can match SOEs in carrying out government policies and regulations. With the development of new and hi-tech industries, some private technology companies in Shenzhen have entered sectors such as military industry, aerospace, development of important resources and construction of large-scale urban infrastructure. They observe the laws and regulations, accept the supervision of relevant departments, and have good records in defending national security and protecting the rights and interests of consumers. They are welcomed by relevant departments and consumers. According to Shenzhen’s experience, whether a company is good for a country’s economic security and overall interests depends on government supervision, rather than its ownership status. Without proper supervision, even wholly state-owned enterprises might do wrong. There are numerous such examples.

3. We need to have more faith in private businesses and social capital when they participate in the SOE reform.

In some Party and government departments, there is a mentality that one can only count on SOEs in time of need, whereas private businesses are regarded as less trustworthy. To be fair, SOEs did help when the country was at critical junctures. Does it mean that private businesses cannot play such a role? For Shenzhen, the answer is negative. Both state-owned and private enterprises are important forces for defending national security and keeping social stability. Many private companies in Shenzhen can match SOEs in terms of protecting national security and interests. For instance, Huawei has made great contributions to safeguarding national interests; the same is true for Tencent to keeping social stability, and SF Express to protecting national security. This has been repeatedly recognized by the Party and the State. In Shenzhen, most private companies can fulfill their corporate social responsibilities while maintaining good business performance. They always give generous donations in the municipal disaster relief and poverty alleviation campaigns. A number of them donate over 10 million *yuan* or even 100 million *yuan* a year. Some entrepreneurs were awarded the title of ‘philanthropist’ by the State or provincial governments and enjoy good reputation. By contrast, SOEs tend to be less generous due to various restrictions.

On the other hand, are SOEs always reliable in time of need? Not necessarily. When the stock market crashed not long ago, what did the state-owned financial institutions do? Did they fulfill their social responsibilities? Did they become the safeguards for social stability? I rather doubt it.

4. We need to protect to lawful rights of private businesses and social capital to hold shares in SOEs and give them a greater say.

When developing mixed economy, we invite private businesses and social capital to hold shares in SOEs. Some may hold more shares, others may hold less. In this process, private businesses, no matter how much shares they have, need to abide by market rules. Private and state-owned businesses should enjoy equal rights for equal shares. However, this is not the case in reality. For instance, private shareholders should be fairly represented based on the number of shares they have. Qualified shareholders should also be able to appoint board members and top executives. This is a lawful right that needs to be protected. However, many private shareholders of SOEs are not given such rights. There are many such examples. A private company acquired in the secondary market a large amount of shares for a public company based in Shenzhen. It was supposed to have two seats in the board. However, as the State was the largest shareholder of this public company, it did not give single seat to the private shareholder. SOEs can have countless excuses to hurt the rights of private and social shareholders. If this is the case, how can one expect private businesses and social capital to be enthusiastic about participating in the SOE reform? How can we develop the mixed economy?

5. We need to abide by the laws and regulations and safeguard the decision-making rights of private shareholders

Currently, the most important issue for private businesses participating in the SOE reform is that the decision-making power belongs to the board or the company’s Party cell. According to the Guidelines, the reform must be carried out under the leadership of the Party. This is a principle that must be upheld in the SOE reform. Of course, Party cells need to have a place in the companies. It must not be sidelined in the reform and development of SOEs. But the problem is, since the company is of mixed ownership, who gets to make the decisions, the board or the Party committee? Currently, many SOEs hold Party committee meetings before board meetings. Their board meetings are a mere formality. Board members representing private minority shareholders have little say in the decision-making. If private businesses and social capital hold shares in SOEs, who has greater power and the final say, the board or the Party cell? If the Party cell makes the final decision on major issues, how to ensure the rights and interests of private shareholders? Furthermore, in SOEs the cadres are placed under the supervision of the Party. What about the executives appointed by private shareholders? Are they subject to the evaluation and designation of the Party cell? If such questions are not clarified or addressed based on market rules, how can we remove the concerns of the private shareholders? How can we arouse their enthusiasm about the mixed ownership?

6. The proportion of private shareholding in SOEs and the number of private and social shareholders should be decided by market rules. We should not politicize some issues.

According to the Guidelines, there are no specific requirements on the proportion of shares owned by each category of shareholders. Private capital can either be the majority shareholder or the minority shareholder in commercial SOEs. Based on the wish of the two parties, private capital can holder 1% of the shares, or 99% of the shares. However, a few people still cling to rigid, obsolete and sometimes even politicized ideas. Especially in the academia, a small number of people still warn of privatization in the SOE reform. They still argue against privatization in the reform. Do they have a point? It might be subject to debate in theory, but in reality, it can be very difficult to put into practice. Based on their notion, it is impossible to carry out the reform of the SOEs. What is privatization of the SOE reform? Does it mean private businesses holding over 30% of the shares, or 50% of the shares? Does it mean the proportion of private businesses in an industry, or in a region exceed a certain threshold? In Shenzhen, private enterprises now make up over half or even 80% of the tax revenue, GDP and employment. Does this mean the Shenzhen Municipality has been privatized?

In short, one should not read too much into the equity investment or mixed ownership. Instead, decisions should be made based on market rules and the wish of both parties. Some specific issues should not be politicized. Otherwise it will cause a lot of problems. If we keep talking about preventing privatization, private businesses would be scared off.

7. We should set asset prices based on the market rules, and should not blame private businesses for the loss of state-owned assets.

In past SOE reforms and property transfers, some state-owned assets were lost due to defective rules and procedures, lack of market-based operation and transparency, or rent seeking. In recent years, as the SOE reform become more regulated, the evaluation, transfer and trading procedures have been perfected. Even if the property transfer is done in accordance with the due procedures, the people working on it could still face charges of incurring “losses of state assets”. This is because, although the Guidelines provide that the transfer price of state assets should be calculated based on the fair market price, the fair market price in the asset market is changing all the time. As a result, people working on SOE reform are constantly at the risk of facing unfair accusations.

I myself witnessed a very typical example. In 2003, the SASAC of Shenzhen Municipality sold some state-owned equities of a public company. At that time, they went through the standard procedures, including asset evaluation, invitation for bidding, competitive negotiation and market evaluation, before selling the equities to a public company in Hong Kong. Two years later, someone reported to the Central Discipline Inspection Commission of the CPC that the equity transfer caused 2 billion *yuan* of losses to state assets and asked the relevant people to be held accountable. Why? For one thing, when the transfer took place, the stock price of that company was low. At that time, the Shanghai Securities Composite Index was only a little over 1000 points. Two years later, the Index skyrocketed to 4000 points and even 5000 points, and the share price of that company also rose. For another, at the time of transfer, the land and property prices in Shenzhen was low. But by 2005 and 2006, the land and property prices have increased several times. Based on the stock price and land price two years later, the accuser claimed that the transfer caused 2 billion *yuan* of losses to state assets.

In response, the Central Discipline Inspection Commission and the SASAC under the State Council dispatched an investigation group to look into this case. They commissioned a major accounting firm to reevaluate the assets, and concluded that the transfer price was in line with the market price. Had they not conducted such an investigation, who would speak for the people working on the property transfer? What would happen to them?

Therefore, the price of state assets should be determined in accordance with market rules. If we always accuse people of causing “state asset losses”, it would pose a great impediment to both SOEs and private businesses, and the latter would be scared off from participating in the SOE reform.

8. We need to guarantee the lawful rights and interests and operational independence of private businesses whose shares are held by the state capital.

The Guidelines encourages state capital to hold shares in non-state enterprises and develop mixed ownership. This is of course right. But the problem is, after an SOE acquires shares in private companies, it might want to impose its management system and regulations on those companies, with the excuse of protecting the interests of state properties, thus interfering with their operational independence. This is something that needs to be prevented. Currently there have been a number of such cases. Only a small proportion of private companies have shares held by SOEs, and these SOEs are often not majority shareholders. Nonetheless, some SOEs impose their own regulations and supervision methods on those private companies, under the pretext of safeguarding state assets. Some repeatedly carry out asset evaluation or auditing. Some even ask the private companies to follow the eight-point regulation on practicing frugality and ban the top executives from inviting others to business banquets or playing golf, although this regulation only applies to leaders of SOEs. This undoubtedly impairs the internal operations of those private businesses and undermines their operational independence. It has become a very realistic issue that needs to be prevented in the development mixed ownership.

9. We need to establish reasonable compensation mechanisms for private businesses and social capital to hold shares of SOEs in the public service sector

The Guidelines points out that enterprises in the public service sector can be of single or diversified ownership. In principle, such companies should be controlled by the state, but they can also invite private businesses and social capital to be their shareholders. This provision is correct. In fact, companies of mixed ownership tend to provide better public services than wholly state-owned companies. For instance, the water supply, bus and gas supply companies in Shenzhen all have diversified ownership. They now offer better services than in the past when they were wholly owned by the state. But the problem is, according to the Guidelines, the state-owned public service companies should not pursue profits; instead, they should only focus on parameters like costs, quality and safety. This will of course benefit the residents. However, after private businesses become shareholders, how to ensure that they get their due share of interests and profits? Without the interests and profits, there would be little incentive for the private companies to hold shares of the state-owned public service companies.

I once encountered such a scenario. A water-supply company in Shenzhen invited a well-known multi-national corporation based in French to be its shareholder and promised an annual return of 6% based on municipal regulations. After the French company joined, however, it only got an annual return of 2% due to low water price. The French party contacted the government in the hope of raising the water price so that it could get the 6% return. However, the National Development and Reform Commission had released a document that bans local governments from raising the water price because of the high consumer prices. Meanwhile, according to the regulations, local governments need to hold hearings before raising water, power and gas prices. At the hearing, almost all local residents were object to the proposed price rise. Failure to raise the water price actually hurt the lawful interests of the overseas investor and undermined the credibility of the government. So far this problem has not been solved. If the prices cannot be adjusted to safeguard the lawful interests of investors, the government should fill the gap by providing subsidies. In practice, however, such subsidies are hardly in place. For instance, in Shenzhen bus companies of mixed ownership should be entitled to subsidies from the municipal budget. However, they always spend years pleading to the authorities before getting the money. With such policies, it would be very difficult encourage private businesses to participate in the SOE reform.

Therefore, the government needs to establish a set of compensation mechanisms that are reliable, reasonable and transparent. The cost of public service should not be borne by private investors.

10. We need to emancipate our mind and create an enabling environment for the SOE reform, so that they can evolve from managing assets to managing capital and fully participate in the market competition.

According to the Guidelines, state-asset management should be transformed from managing assets to managing capital. This represents a major break through. The concepts of managing assets and managing capital are fundamentally different. Managing capital focuses on the distribution, operation, value increase, and safety of the capital. It does not involve the management of specific human, financial or material resources. If this is realized in SOEs, the operation and management of the enterprises, including the operation of human, financial and material resources, will be carried out in accordance with market rules. This will enable state asset management institutions to be converted into capital management institutions. Temasek in Singapore is a good example. It is only responsible for selecting profitable companies to invest in. The human, financial and material resources of those companies as well as other assets are entirely subject to market-based operations.

This transformation is by no means easy. It cannot be solved by simply setting up a number of investment companies. This has been borne out by Shenzhen’s experience. From the 1990s to 2003, Shenzhen established a three-tier state asset management system composed of the municipal SASAC, asset management companies and ordinary companies. However, those companies did not fully participate in market competitions, and were managed through administrative methods. As a result, things did not work out as people had expected. Instead of realizing the transformation, it reduced the efficiency. Later the three-tiered management system was abolished.

The transformation from managing assets to managing capital involves a series of major issues, which needs to be adjusted or overhauled. The principle of “placing cadres under the supervision of the Party” needs to be redefined. Company executives should not be evaluated, recommended or selected by the Organization Department. Rather, they should be selected by the board from the market. But without changing the mindset, this would not be possible. In some regions, including Shenzhen, the authorities prefer turning to the old ways of managing SOEs executives rather than pressing ahead with the market reform. Besides, if the state no longer participates in company operations, the remuneration of executives should be determined by the market. If so, why did the relevant departments still impose regulations on the remuneration of SOE executives? There are many such problems. If not solved, the transformation from managing capital would not be realized, and we would not create a better environment for the private capital to participate in the SOE reform.

The documents released by the central government deserve our applause, for they set the course for the SOE reform and create ample space and opportunities for private capital. However, to press ahead with the reform and give full play to role of private capital, there are many theoretical, perceptual and policy issues that need to be addressed. We should continue to emancipate our mind and take a down-to-earth approach to truly make the reform a success.