Current Situation and Direction for the Reform of State-owned Enterprises in China

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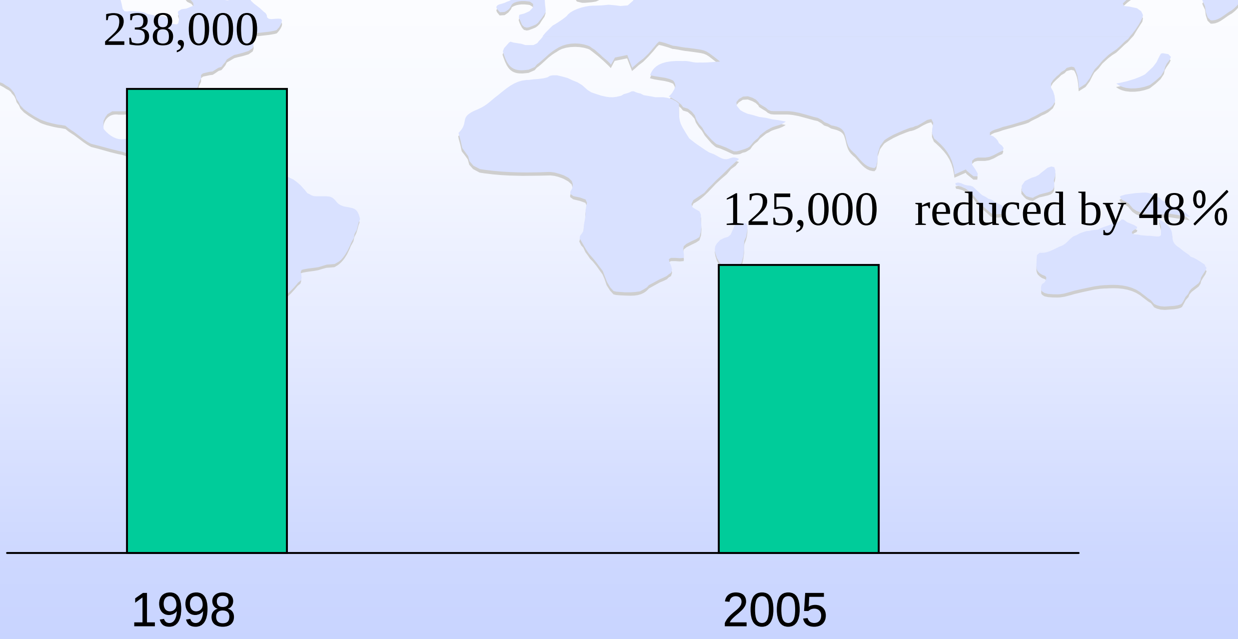
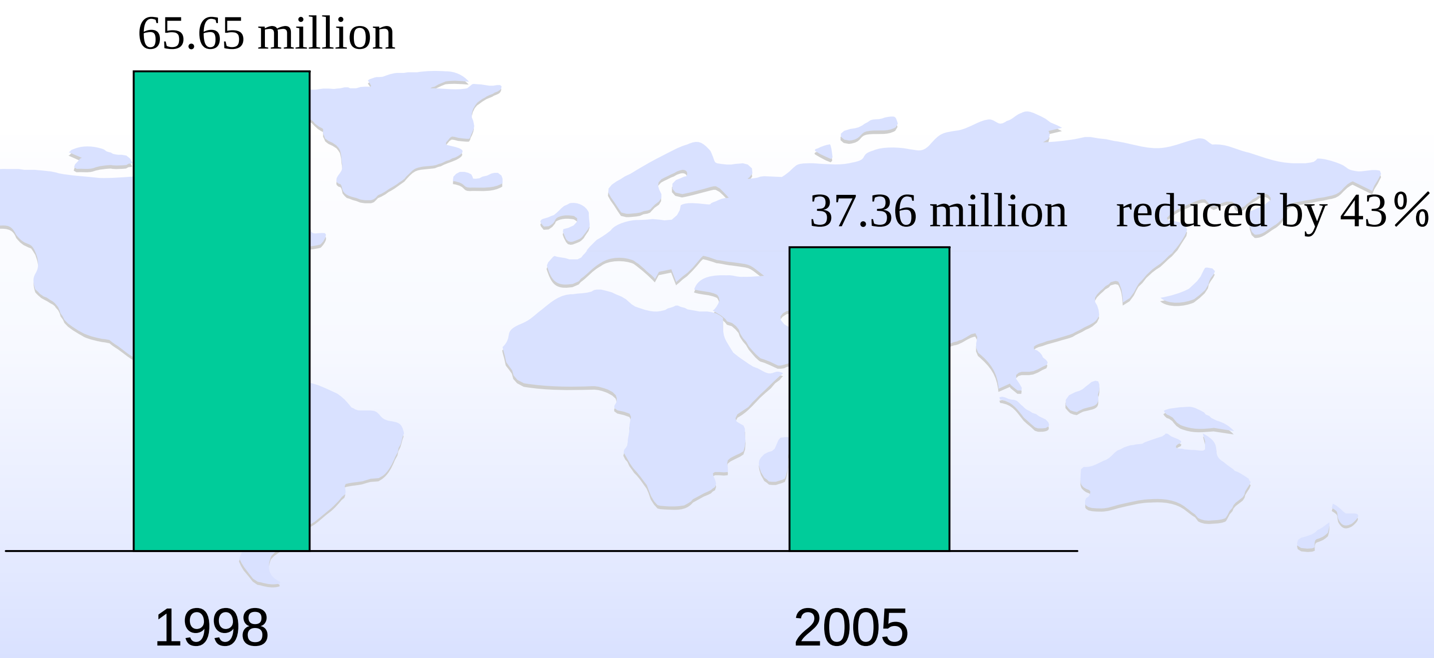
I. The Adjustment of Overall Arrangement and Structure of the State-owned Economy

Before 1997, the guideline for the reform of state-owned enterprises (SOE) in China was to manage well each large-and-medium-sized SOEs. Since 1998, the guideline for the reform has become the adjustment of overall arrangement and structure of the state-owned economy. After many years' efforts, this work has turned out to be effective.

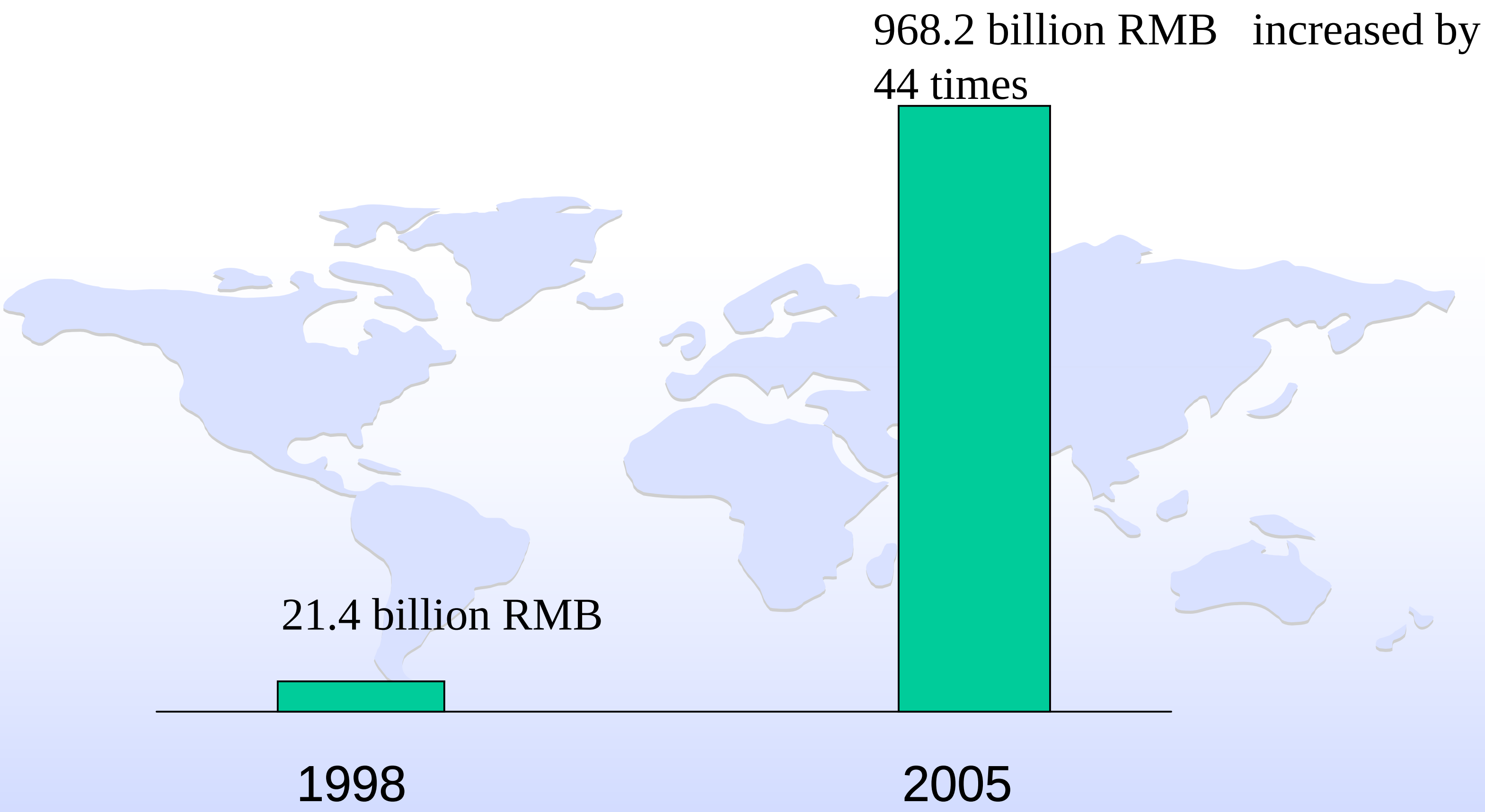
1. The number of SOEs in China has been greatly reduced.



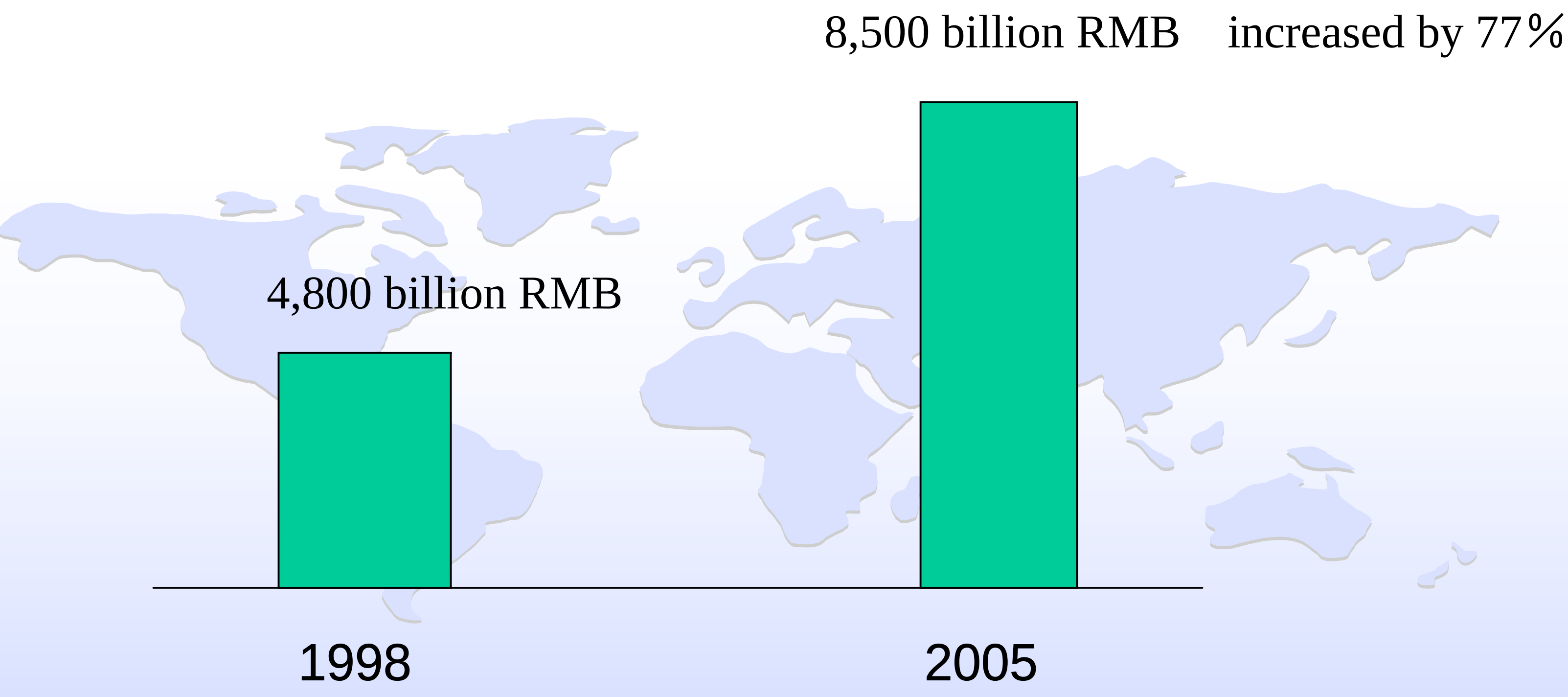
2. The number of the employees of SOEs in China has been greatly reduced.



3. The profit of SOEs in China has been increased by many times.



4. The total value of the assets of SOEs in China has been increased greatly.



Future Direction:

In December, 2006, with the consent of the State Council, General Office of the State Council promulgated SASAC's *Guidelines on the Promotion of the Adjustment of State-owned Assets and the Restructure of SOEs* (No. [2006] 97 document of General Office of the State Council), which brought forward a series of objectives and measures for the adjustment of overall arrangement and structure of state-owned economy.

1. State-owned economy should control "important industries and key sectors" concerning national security and national economy.

Which industries and enterprises fall into "important industries and key sectors"? Currently there is not a list for these industries and sectors. There is a principle description in No. 97 document.

According to No. 97 document, "important industries and key sectors" include: (1) industries concerning national security; (2) key infrastructures and important mineral resources; (3) industries providing important public products and services; (4) backbone enterprises in key industries and high-tech industries.

Regulation No.97 requires that "relevant departments should take quick research to determine specific industries and areas, and formulate relevant catalogues of industries and enterprises".

Current specific catalogues for reference include *Catalogue for the Encouragement of Foreign Investment Industries* co-issued by National Development and Reform Commission and Ministry of Commerce, which clearly specifies the industries and products which forbid share holding or share controlling, or permit share controlling of foreign investors.

In accordance with above principles and catalogues, it is usually undisputable to judge whether it belongs to "important industries and key areas" for most SOEs, but is not easy to judge this for a few large and some medium SOEs, for whose system transformation it is still to be explored whether state-owned shares should take control.

Currently national industrial policies restrict non-public capital and foreign capital entering some industries and areas or natural monopoly business therein. However, such industries and areas will decrease in future.

For example, *Several Opinions of the State Council on Encouraging, Supporting and Guiding the Development of Individual and Private Economy and Other Non-Public Sectors of the Economy* issued in February 2005 "allows non-public capital to enter monopoly industries and areas" and "areas of construction for defense science and technology industry", and "encourages non-public economies to participate in structural adjustment of state-owned economy and restructuring of SOEs".

2. Large SOEs will be gradually transformed into multi-shareholder companies, except enterprises concerning national security, enterprises that must be state operated with monopoly, and companies specialized in operating state-owned assets.

3. For state-owned capital that does not belong to "important industries and key areas", the state-owned property right should be transferred in accordance with the principle of increasing it to some sectors and withdrawing it from others to ensure an appropriate flow.

4. Most medium and small SOEs will be granted more freedom for more vigor.

Granting medium and small SOEs more freedom for more vigor will be centered around property right. The state-owned property right of an such SOE could be transferred to various investors including its operators and employees.

Such process should take into consideration the employment of original employees, out of the need of economic development and social stability.

The same will be done with the medium and small enterprises wholly owned or controlled by large SOEs.

5. The policy-based closure and bankruptcy of SOEs with longtime insolvency that are hopeless to turn loss into gain will be completed before the end of 2008.

6. The number of national enterprises with State-owned Assets Supervision and Administration Commission of the State Council as investor will be reduced to 80-100.

II. Large SOEs establishing Modern Enterprise System

There are three main aspects:

----achieve shareholding system,

----improve corporate governance structure with emphasis on establishing standard Board,

----marketize enterprise internal labor, personnel, and distribution systems.

(I) Shareholding system reform

1942 of China's 2524 large SOEs have been transformed into multi-shareholder companies, at a percentage of 76.9%.

There are 1100 stated-owned capital controlled companies listed home and overseas, whose state-owed property right and profit take up 17 % and 46% of China's SOEs respectively. The large SOEs in industries like petroleum, petroleum chemical, metallurgy, power generation, telecommunication, civil aviation, and shipping, have almost all achieved listing of their assets of main businesses.

2. Establish regulatory-managed board

SASAC of the State Council has furthered the reform plan since 2004, until present, pilot implementation of the plan has taken place in 19 enterprises such as Baoshan Iron & Steel(Group) Corp., Shanghai, Shenhua Group Corp. Ltd., etc. Major systemic arrangements include:

(1) The number of external director including independent director shall exceed half number of board's member, all management personnel except General Manager shall not hold concurrent position as director. Under this arrangement, decision-making power is separated from execution power in large company, there is no " lead" and "be led by" relations among directors, every director is allowed to independently state on air his/her personal views.

（2）The Board is responsible for determination of operation performance appraisal plan, earnings policy, appointment and dismissal regarding management personnel.

（3）To fill up the duties of General Manager and the management. The Board shall only be responsible for major decision-making, all the ordinary decision-making and relevant execution are to be left for the management. When making a decision, the board shall deal seriously with management's suggestion, management shall be involved in the corporation's decision-making of direction and speed of development.

3. **Reform of enterprise's management systems for labor, personnel, earnings distribution**

Besides the objective conditions, enterprise's competitiveness is also based on quality, the active, initiative and creativity of its staffs especially management personnel, and the three systems for labor, personnel and earnings distribution are the most influent measures in adjusting the above factors.

The three said systems that had been formed and run in SOEs during the period of "planned economy" are not applicable to the present market with intensive competition. It is suggested to gradually put up by reform a mechanism by which "depending on one's performance, an operator may possibly be not only promoted, but also demoted, a hired member of staff may be fired or resigned, and one's salary may possibly be increased or decreased."

Measures to Reform the System

1. To adopt a market-way policy to select talent people, push widely the system of " internal talent selection by competition mechanism, external selection by public recruitment";
2. To form gradually a talent motivation and restriction system in conformity with prevailing trend of market, bring market earning level determined by the whole society into the enterprise, enhance the performance appraisal system, regulate position- related expenditure, progressively enable the earnings level of various talent people to connect the rails of market, strengthen earnings motivation system for key position and for the talent people making outstanding contribution to the enterprise;
3. To establish a new model of earnings motivation mechanism featured by: sets on a basis of appraisal and evaluation, links to positional duty, risk and working performance, combines short term motivation plan with middle term motivation plan, earnings distribution policy is to be influenced by factors such as capital, technology, management etc.;
4. Through reform of auxiliary business, to split flow of staff and settle the redundant personnel.

III. Establish and Complete Administrative System for State-owned Assets

1. Frame of the System

(1) The premise is state’s unified ownership, the Central Government and local governments respectively perform the duty of equity investor on behalf of the state, enjoy the owner’s equity;

(2)“Three-leveled organization”: the Central Government, regional government and municipal government set respectively state-owned assets supervision and administration institute(hereafter called “the Institute”), owing to the small amount/number of stated-owned assets/enterprise in some certain regions or municipalities, the Institute has not yet been founded in these areas.

(3) The Institute implement the principal called as “combination of management on assets, personnel and work” and “unified three factors: obligation, right and responsibility”;

(4) Separate government’s public administration function from its duty as equity investor of SOE, namely, public administration department should not perform the duty as equity investor of SOE, and the Institute should not perform public administration function anymore.

2. Major duties of the Institute

(1) Performs duty of equity investor in the SOEs invested by it;

(2) Guides and furthers the reform and realignment of SOEs;

(3) Appoints partial members of the board of supervisors of the SOEs invested by it;

(4) Be responsible for appointment and removal, evaluation and appraisal, rewards and punishment on the person in charge of the SOEs invested by it;

(5)Supervises the value preservation and increment of SOEs' assets.

Thank you!