Privatization of State-Controlled Shareholding Companies and the Rise of Corporate Elites in China*

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Abstract

As the State still controls a large share of China's economy, the process of privatization of state-owned enterprises and the rise of corporate elites who control them should be traced and examined in a systematic and thorough way. As one of the first efforts to do so, this research collected and analyzed first-hand data on private-takeovers of 341 previously State-controlled listed firms on China's stock exchanges during the period of 1996-2008. Preliminary results show privatizations have most likely occurred amongst relatively small-sized firms, more prevalently in industries under less state oversight, and more in economically developed provinces. Further analysis reveals that the majority of the new private controlling shareholders are outsiders rather than insiders to the acquired firms, and as a whole they are highly educated, and politically and economically well positioned. This research suggests that a group of capable private entrepreneurs are assuming roles as new corporate elites by taking advantage of emerging merger and acquisition opportunities in China's stock market. It is the different route of privatization characterized by the above

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findings that China has embarked upon and is contributing to its relative success in economic reforms compared with its former communist counterparts.

Key words: privatization, M&A, listed firms, stock market, China

Introduction

When China started to reform its centralized urban economy in the mid-1980s, one the most challenging tasks was to reinvigorate its failing state-owned enterprises (hereafter SOEs). As the State realized it was impossible to turn around all SOEs, it pursued a more realistic policy with two differentiated approaches. On the one hand, it "grasped the large enterprises and let go of the small" known as "zhua da fang xiao" and privatized most small and medium sized SOEs. On the other hand, it encouraged larger SOEs to adopt a "modern enterprise system" by incorporating them into shareholding companies and listing them on stock exchanges. The main purpose of the stock market, which was established in the early 1990s, was to provide another source of funding to help its debt-burdened SOEs. Therefore, it should not come as a surprise that the State or SOEs are the controlling shareholders of the majority of the listed firms: only a few private enterprises were able to achieve IPOs over the years.[1)]

However, many private entrepreneurs or companies become the controlling shareholders of previously State-controlled listed firms over time. Between the period of 1996 and 2008, 341 previously State-controlled listed firms on China's stock exchange become under the control of private owners. This largely unexplored phenomenon has raised many important sociological questions. First, who are the private owners of these listed firms? Economic reforms have freed up once state-controlled assets and brought new opportunities to individuals with an entrepreneurial spirit. In line with the literature of status

1) It was not until October, 2009 that the Shenzhen Stock Exchange established the Growth Enterprises Board that mainly serves medium and small sized privately controlled corporations.

attainment and occupational mobility, it is important to examine who entered different elite positions as a market economy develops (Eyal et al., 1998; Walder et al., 2000; Wu and Treiman 2007). To what extent does human capital measured by education/working experience or political capital measured by one's party membership or posts in the People's Congress play a role, if any, in facilitating the privatization process? Answers to such questions hold the key to understanding the nature of the privatization. Second, how much can these equity transfers from the State to private owners be characterized as insider (i.e., former manager or employee) privatization or fair bidding? Sociologists who study China's transitions have long been fascinated by the possibility of communist insiders to obtain ownership of public assets in the course of market reform. Fairly well documented are cases in many former communist societies in which communist-era elites managed to convert their bureaucratic privileges into money by obtaining control over public property as it was privatized (McFaul 1995; Róna-Tas 1994). Different forms of privatization and origins of new owners have important consequences on the subsequent performance of these post-communist economies.

Our preliminary data analysis and fieldwork indicates that the new controlling shareholders of previously State-controlled companies tend to be outsiders rather than insiders of the companies. They are well-educated in the engineering or sciences fields, and half of them are running similar business lines with the acquired companies. This provides some preliminary evidence that a merger and acquisition market is emerging in China and has enabled capable private entrepreneurs, rather than insiders, to take over State-controlled public companies.

The structure of this paper is organized as follows: The first section introduces the theoretical motivations of this research. The second section is an overview of China's stock market. The third section presents findings from data analysis and interviews. Lastly, we draw our conclusions with discussion on the implications for the analyses and suggest possible directions of future research.

Charting the Transformations of Corporate China

China has undergone almost four decades of economic opening and reforms since the late 1970s. The 1990s witnessed a wave of privatization of small and medium-sized State-owned firms accompanied by a massive downsizing of the State sector. Subsequently, tens of millions of industrial workers lost their once guaranteed State jobs. The result has been the formation of a smaller number of large and profitable State-owned firms (Naughton 2008), and the economy has moved very much away from the former State socialist model. Consequently, the private sector has played a more important role in creating jobs and boosting economic growth than the State-owned sector.

To chart the future of China's economy and society, some studies have examined the privatization process of small and medium sized government owned firms and the collusion between governmental officials and entrepreneurial elites (Wank 1999, Lin 2001). Other studies have documented the rise of independent private entrepreneurs who were co-opted into the Party for the first time after 2000. These analysts note the higher levels of corruption and inequality that this trend has produced, but at the same time the researchers generally conclude that State officials and entrepreneurs become increasingly dependent upon each other to achieve State goals and to enrich themselves (Dickson 2003, 2008, Tsai 2007).

Since the early 1980s, China's State sector has shrunk as a proportion of overall economic activity with the addition of hundreds of thousands of new private and collective enterprises and through the privatization of many of the small and medium-sized State firms in late 1990s. The restructuring and privatization of core State assets was delayed for two decades largely because these assets were considered to be too important a foundation for the State. In the past decade however, China has finally begun to address the largest State enterprises that were long protected from market forces and kept under State ownership and management.

At the core of the process is the creation of new ownership forms in an economic system where all productive assets were until the late 1970s owned and controlled by some government jurisdiction. This is usually understood as "privatization", but it is only partly true. Besides the privatized State firms, there are by now tens of thousands of private firms founded by individual entrepreneurs from modest backgrounds. Some of these private firms have achieved large scale success and serve national and international markets. The privatization process has also gradually penetrated into large State corporations that create joint ventures with multinational firms or that have been restructured and listed on domestic and international stock exchanges attracting foreign institutional investors as their shareholders (Walter and Howie 2006: 85-130). The latter process represents a trajectory of China's socialist-era managerial elite into a new world that affords them much more wealth, independence, and power than ever before (Walder 2011). The broader implications for China's future are potentially very large, yet they have so far gone relatively unexplored.

Thus, China is finally changing in fundamental ways. In the process of the restructuring and privatization that accompanied the listing of Chinese firms on stock markets, many former State managers acquired significant equity stakes in the restructured firms through management buyouts and other means. Many listed firms whose controlling shareholders were the State or its proxies sold the controlling shares to private owners.

Yet we still know very little about the contours of this process or how far it has proceeded. More specifically, we lack precise measures of the overall shifts in ownership stakes, the extent to which management control is exercised by large equity stakes, and especially, lack a clear understanding of the origins of executives and their career patterns out of the State sector and into privatized firms. Therefore, one main objective of this study is to understand the emergence of the new corporate elite, a potentially key facet of China's evolving social structure. Meanwhile, China's privatization process would be better examined through a comparative perspective. Nations that formerly belonged to the "Communist Bloc" such as Hungary and Poland,