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REFORM OF OWNERSHIP ORGANIZATION AND STOCK SYSTEMS IN CHINA

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I INTRODUCTION

A stock system was experimentally introduced in small business enterprises in some rural districts in 1984. Critics warned against its spread to state-owned enterprises, citing harmful effects on Chinese society. Nevertheless, collective enterprises or small enterprises have actively used this system up to the present to raise funds(1). Consequently, since 1985 we have seen one complete cycle of "stock fever-quiet-stock fever." Recently, interest in stocks is again on the rise, this time in large and middle state-owned enterprises.

According to *the Economic Daily,* outstanding stocks at the end of 1988 totaled 2 billion yuan, among which only one percent is exchanged. Among 2,483 stock companies in nine main provinces: Shanghai, Wuhan, Guangdong, and so on, 2,109 (93%) are collective enterprises(2). In connection with the recent upsurge of interest in stocks, one Chinese economist points out:

> The situation has gone through a "stock fever-quiet-stock fever" cycle concerning the proposal and implementation of a stock sharing system. At the start, many people positively approved; a "stock fever" appeared, a number of stock companies were established in some cities, and stock exchanges were opened. This caused a reaction from theorists and politicians, who declared their doubts about its success and cried out against it. But recently, the situation has shifted from that of "cloudy after fair weather" to "fair weather after cloudy(3)".

The recent interest is connected with Chairman of the Chinese Communist Party (CCP), Zhao Ziyang's report on "Forward Movements on the Road to Chinese Socialism" at the Thirteenth General Meeting of National Representatives of the CCP. In this report, he formally condoned the adoption of a stock sharing system in order to separate management from ownership and to vitalize national enterprises. He also pointed out:

> Stock systems arose from the Post-Mao economic reforms. There are many ways of organizing assets in socialistic enterprises: stocks may appear as an aspect of national

ownership ; participative stock may be held by departments, local government, or business enterprises ; stock may be purchased by individuals. People may introduce these systems and some small national enterprises can be handed over to collective enterprises or individuals with onerous contracts(4).

The recent stock fever differs from the previous periods. First, collective or small enterprises, seeking start-up capital can go ahead with stock systems with the support of the Chinese government. Second, though collective and small enterprises continue to issue stocks in rural districts, now large and middle national enterprises have also begun adopting stock systems(5). Third, capital acquisition through stock issue is in keeping with the general economic reforms, in contrast to previous "spontaneous," experimental issues.

At present, the main issue in dispute is not the propriety of a stock issue but the advisability of its application to large state-owned enterprises : is it right or wrong for large state-owned enterprises to introduce a stock system, because stock issues in large state-owned enterprises will have a great impact on the national economy(6). The following study examines the formative process of the present stock system and its special characteristics.

II THE CHARACTERISTICS OF THE PRESENT STOCK SYSTEM

The present Chinese stock system first arose when collective enterprises and individual joint businesses voluntarily adopted them in rural districts(7). In 1984, the Chinese government had to curtail national finances and control bank money owing to an expanding consumption demand and immoderate investments seeking fixed-capital assets. The government responded with a tight-money policy. The People's Bank raised interest rates and executed a selective lending policy to induce money into important enterprises. Collective and small enterprises in the rural districts found it very difficult to borrow money from banks. Consequently, they scrambled for money by using a stock system(8).

The formative period of the stock system revealed certain characteristics : first, and most prominently, the stock system was used to raise funds from the inside of enterprises (workers), independent of establishing joint-stock companies as going concerns or stock exchange markets. Second, stocks were forcibly allocated to workers by issuing companies but workers were not given voting rights. Thus, stocks were virtually the same as bonds.

The general public did not understand the implication of a stock system : limited liability, risk-bearing, and so on. Government leaders also had no experience controlling stock issuing or stock companies(9). Therefore, it was natural that stocks were almost the same as bonds.

To complicate matters, Chinese society as a whole was short of money and confronting a

Table 1 Stock Interest and Dividend in Shanghai Yanzhong Company

(per year)

	Interest	Dividend	Total	Tax	Actual Income
on collective stocks	4.32%	2.88%	7.2%		72*
on individual stocks	7.2%	9.05%	16.25%	32.5*	130*

Source: Wu Zhantong, "How Did We Audit the Financial Report in Shanghai Yanzhong Company," *Shanghai Accounting*, August 1987, p. 16.

Note: *=yuan per 1000 yuan

vicious inflation. Thus issuing companies were obliged to carry the burden of higher interest rates for stock capital above that of bank deposits in order to lure money away from bank deposits and into stock investment. To distribute income, issuing companies had to pay not only dividends, but also a fixed stock interest (see Table 1). The total rate of interest plus dividend usually exceeded that of enterprise's profits on invested capital: over thirty percent of invested capital in some enterprises, and a few companies paid 100 percent. These high distribution rates actually became another type of bonus, through which the enterprises were able to pay high wages to workers(10).

In short, stock systems at this start-up period were substantially the same as bonds in regards to interest and like bonds, paid off capital at maturity, even though they formally had a limited liability and the right to claim residual property. The development of the stock system was quite different from the original expectation(11). Because stockholders were unwilling to bear the risk of investment, without government regulation, issuers had to promise low risk to stockholders. Enterprises used stock capital to buy circulating assets or to distribute high dividends. The result was a short term point of view without establishing a going concern.

From that time on, the central and local governments promulgated regulations and laws to control the issue of stocks and bonds. Recently, some suggest that if the national enterprises adopt a modern stock system in which all stockholders bear risk and are able to exchange stocks at will, the enterprises will be more productive. Xiao Liang puts importance on stock systems to help the economic reforms and points out:

> The economic reforms have not improved the ownership structure of national enterprises, which everyone formally owns but nobody actually owns. These enterprises are willing only to allocate gains on prosperous days, and they dislike carrying deficits. In short, their view is the short term(12).

He believes that the introduction of a stock system can segregate management from ownership in the national enterprises and vitalize the enterprises. Li Yining also recommends that the national enterprises adopt stock systems to eliminate their deficient unification of interests, responsibilities, and rights. He says that a stock system is the best method to clarify property-relationships in large and middle national enterprises, and emphasizes that nobody has yet to discover a better system[13].

III THE STRUCTURE OF STOCK COMPANIES

There is scarcely any opposition to the adoption of a stock system by collective enterprises. Actually, stock systems have come into wide use by collectives. For example, among 21,755 rural collective enterprises (Xiangzhen enterprises) in Quanzhou City[14], 15,070 (69.27%) adopted stock systems. These enterprises employed 70 percent of all workers and paid 63.4 percent of all taxes and profits in all collective enterprises in Quanzhou City. The Xi'an Electric Parts Stock Company is a typical collective enterprise, and Qinpei Motors Stock Company is one of the first state-owned companies that offered stocks for public subscription.

1) Xi'an Electric Parts Stock Company[15]

This company appraises all assets on the basis of capital equity. The collective capital equity consists of fixed capital funds, liquid funds, and production-development funds, which the enterprise has created by itself. Individual capital equity consists of funds invested by workers employed by the enterprise.

Twenty percent of the collective capital equity is divided into each worker in proportion to the length of service ; the remaining eighty percent is divided into individual workers on the basis of "contribution" to the enterprise. The workers with five years of continuous service before 1985 are issued one share. If employed after 1985, workers get one share with each year of service regardless of the previous term of employment. For example, a worker employed in 1980 has received one share for service up to 1985 and receives one share for each year thereafter. A worker employed in 1981 has received no share for service up to 1985, but receives one share for each year thereafter. Eighty percent of the collective capital equity is divided into individual

Table 2 Division of Stock and Contribution to the Enterprise

Rank	Ratio
First and second grade factory labor	1
Third and fourth grade	1.2
Fifth and six grade	1.4
Seventh and eight grade	1.8
Vice-department managers	2.0
Chief department manager	2.0
Chief branch secretary of the CCP	2.2
Chief factory executive	2.5

workers on the basis of "contribution" to the enterprise: 2.5 for the chief factory executive with the highest rank to 1 for the worker with the lowest rank.

On top of the worker's salary and what is received under the division schedule of collective capital equity, a worker may also choose to receive individual stocks. Individual stocks come in two varieties: basic stocks and periodical stocks. The coercive element in the whole scheme is that every worker has to accept one basic share at a par of 200 yuan. If he does not do so, he cannot receive benefits from the division of collective capital equity. In other words, rights to collective capital equity (division by length of service and contribution to the enterprise) can be secured only by purchasing at least one basic share. The purpose is to gather capital from workers. He may withdraw from the stock company at retirement, dismissal, or death.

The voluntary element is that in addition to the basic share, every worker can buy five shares maximum of periodical stocks which have a 200 yuan face value and are freely changeable inside the enterprise before maturity (three years). In the distribution of earnings, stock interest is paid at 10.8 percent per year on basic stocks and nine percent on periodical stocks. On top of interest, a dividend is paid to each worker in proportion to capital equity: 70 percent on basic stocks and 30 percent on periodical stocks. After dividends are paid on basic shares and periodical shares, the remaining "profits" are distributed in the following way: forty percent is reserved for the production-development fund, thirty percent goes to a worker's welfare fund, and fifteen percent is paid as a dividend to collective stockholders (length of service and contribution to the enterprise). The remaining fifteen percent is unclear[16] (see Table 3).

Xi'an Electric Parts adopts the board of director system in which the directors are selected from a management committee consisting of management executives and workers' representatives, government officers, and representatives of stockholders.

As is obvious from the preceding, all assets are attributed to individual workers in this collective stock company. This characteristics seems to be common of collective stock companies. In short, collective companies are "owned" by workers. In this case, ownership is so closely connected with management that workers receive clear incentives to produce and

Table 3 Dividends and Reserve of Profit

dividend	on individual basic stocks	70%
	on individual periodical stocks	30%
reserve	for production-development fund	40%
reserve	for worker's welfare fund	30%
dividend	on collective stocks (division by length of service and contribution to enterprise)	15%
	unclear	15%

efficiently manage. The following study examines stock issuing in Qinpei Motors Stock Company.

2) Qinpei Motors Stock Company

Qinpei Motors employs fifty thousand workers in Shenyang and mainly produces light motor trucks. Their production accounts for 25 percent of all light motor trucks in the whole country. Besides trucks, Qinpei Motors produces micro-buses, car parts, and so on.

Qinpei Motors is one of the few national enterprises that offer public subscription of stocks(17). According to *The Economic Daily*, one thousand persons bought stocks amounting to 1.2 million yuan by four p. m. on the offering day (15 July 1988)(18). However, some are quite afraid that though nominal interest and dividends are certainly high, they are not actually so high when taking recent inflation rates into consideration. In addition, stockholders can not sell their stocks whenever they want.

Nevertheless, the company issued one million preferred stocks at face value of one hundred yuan on 15 July 1988. These stocks have priority over common stocks in distribution of earnings and residual property at reorganization and liquidation. It goes without saying that stockholders of these stocks take responsibility for the company within the limits of invested stock capital. The stockholder who has over ten thousand preferred shares, can participate in the general stockholders' meetings but without voting rights. These preferred stocks will be converted into common stocks with the same rights as common stocks after 1 January 1993.

Qinpei Motors is composed of stockholders of business enterprises, administrative organizations, and individuals in Shenyang, Beijing, and Shanghai. Recently, it was rumored that the company issued dollar stocks(19). In the distribution of earnings, the preferred stocks will get 16.5 percent fixed interest every year until 1 January 1993. If the company suffers a loss in a certain year and is not able to pay stock interest, it may make up for the deficient bad year in subsequent prosperous years. In Chinese accounting statements, stock interest is generally stated as cost or expense, not disposal of profit, but it actually depends upon the amount of profit and is paid out accordingly.

Qinpei Motors chose a stock system, because it was very difficult for it to borrow money from banks or to issue bonds owing to various government regulations. The preferred stocks were issued to raise funds for technical innovation, give its workers strong incentives, and extend its autonomy by means of strong self-finance. The stock system approach is so novel that most people still discuss its "effect" on society, while central and local governments have yet to regulate it. Beijing City and Guangzhou City already set about regulating methods of issuing stocks and dividend rates.

IV ENTERPRISE EQUITY AND PUBLIC OWNERSHIP

The important point to note is that a change of ownership constitution resulted from the issue of stocks.

In the following table, the proportion of government equity representing public ownership (socialism) decreased after issuing preferred stocks. In contrast, the comparative proportion of the enterprise equity increased and its position in decision-making became stronger through control of large-scale social property as a result of dispersing stocks (individual equity) without voting rights (53.5% + 17.1% = 70.6%). Even after 1 January 1993, when individual equity has voting rights, we can expect enterprise equity to dominate. Therefore, at least in this case if not in general, introducing a stock system into national enterprises leads to stronger enterprise equity. Does this mean that "public ownership" decreases? Who knows, but if the government and the people approve this situation, enterprises will try to go ahead with issuing stocks in order to shift the comparative proportion away from government and to enterprise ownership. The point of debate is not purely ideological, since some enterprises use the government depreciation funds, which reserve monies for a future renewal of assets, to pay for stock issues. If an enterprise cannot increase productivity and achieve high earnings while cannibalizing its depreciation fund, it will not renew its assets and self-destruct(20). The public is afraid that the enterprise equity will become stronger vis-a-vis public ownership by issuing preferred stocks, and acting from a short term point of view, eventually eliminate public ownership and, in the case of failures, squander public assets.

As in the case of Qinpei Motors, the power of the enterprise equity will become stronger if many state-owned enterprises volunteer to adopt a stock system. Other critics are against strengthening the enterprise entity for the reason that it violates the rights of stockholders. They emphasize that all stockholders ought to decide how to distribute profit after taxes, because if an enterprise uses reserved profits to increase its capital assets, it will deprive stockholders of the proprietary right of profit. Either by squandering depreciation funds or reserving profits, strengthening the enterprise equity will weaken government control over state-owned enterprises.

Table 4 Change of Equity Proportion for Each Holder after Stock Issue

	before issuing	after issuing
Goverment equity	35%	29.4%
Enterprise equity	65%	53.5%
Individual equity		17.1%

In opposition to this opinion, others approve the introduction of a stock system into state-owned enterprises. They point out that reserved profit or the enterprise fund is property which the enterprise holds autonomously. In this case, the enterprise equity consists of reserved profits and an enterprise fund. Receiving dividends in proportion to the enterprise equity is advantageous to prompt managers to use reserved profits or the reserve fund efficiently. They also advocate that the strength of the enterprise equity is not linked with any violation of state-owned enterprise rights since the equity substantially belongs to central and local government. As for this opinion, one economist emphasizes that the Government has to hold fifty percent of all stocks in order to secure public ownership(21). Li Yining points out that government does not need to hold more than fifty percent because of stock dispersion leaving individual stockholders with a small share. He also says that the enterprise equity is one form of national institution(22). The state-owned enterprise consists not only of managers of national assets, but also owners of the enterprise assets, which they have accumulated from income derived from production and management.

V ASSETS BETWEEN GOVERNMENT AND ENTERPRISE

We should turn now to examine how all assets in an enterprise are divided between the government equity and the enterprise equity. In the case of Zigong Foundry Company in Sichuang, the valuation committee to turn assets into stock consists of members of Zigong City Economic Committee, Finance Department, Tax Department, banks, and the enterprise(23). Its task is to assess the enterprise assets and divide them between the government equity and the enterprise equity. The government equity is first formed with two net fixed assets : all net fixed assets before 1980 when the government started to adopt the policy of reserving profit in state-owned enterprises, and all net fixed assets organized by governmental special subsidies and basic construction subsidies after 1980. Net fixed assets organized by special loans and special construction funds since 1980 are divided on the basis of paid profits to the government and reserved profits in the enterprise. The former forms the government equity while the latter the enterprise equity. All fixed assets organized by reserved net profits after 1980 form the enterprise equity.

Net fixed assets renewed with depreciation funds since 1980 are divided according to the ratios of the government equity and the enterprise equity. Liquid funds paid in by the government forms the government equity. Liquid funds organized from the enterprise reserved profits forms the enterprise equity.

In the company, the stockholders' meeting is formally the supreme voting organ. But actually, representatives elected from among stockholders exercise supreme voting rights. The representatives meeting is hold once a year. Nine directors elected among the representatives form a standing board of directors, which consists of two government-stockholders, five enterprise-stockholders and two worker-stockholders. One government-stockholder takes charge of the presidency symbolizing the largest owner. The government equity holds a forty percent voting right on the board. The enterprise and workers equities each have thirty percent. Clearly, this proportion rate does not reflect the ownership proportions.

In sum, state-owned enterprises do not adopt a direct stock democracy, but operate under indirect representation. As for voting rights, the proportion rates among the government equity, the enterprise equity, and the workers' equity are balanced to secure public ownership.

Economic reform, which aims to enhance enterprise autonomy and to separate management from ownership, here achieves prominence over direct stock democracy. Strengthening the enterprise equity does not necessarily seem to be thought connected with a denial of public ownership. In the long term, however, this strength tends to weaken government control over state-owned enterprises and to make them over into a completely different interest group[(24)].

VI STOCK SYSTEM AND MANAGEMENT CONTRACTING SYSTEM

The major problem to solve through economic reform is how to vitalize national enterprises. In the fray over stocks as a solution, a hybrid solution has been proposed that seeks to protect public ownership. The government has actively put a management contracting system forward in order to make managers take responsibility for their business practices. We will examine what relation the scheme has to the stock system.

Ninety percent of enterprises in China had already adopted a management contracting system by 1987[(25)]. For example, in Guangdong Province, ninety-eight percent of national enterprises attained high efficiency by using a management contracting system. However, there are two basic shortcomings in the management of national enterprises : insufficient separation of business management from local government administration control and severe administrative interference by central bureaucracies. Chinese economists point out that national enterprises may get over these shortcomings by means of a stock system[(26)]. Under a management contracting system national enterprises contract with the government for management responsibility, right of decision-making, and earnings distribution. The management contracting system creates a complete self-supporting structure with strong autonomy. In contrast to this system, stocks organize business property to raise funds from different and socially dispersed persons and to invest funds efficiently and pay dividends in proportion to investment[(27)]. The following table clarifies differences between the two systems (see Table 5).

Table 5　Contracting System and Stock System

	management contracting	stock system
content	Organization of management and mechanism of profit sharing.	Property ownership relations in state-owned enterprise.
form	contract	stock
relation with the Goverment	The Government reserves ownership and gives chief executive management autonomy: occupancy, control and use. Indirect control.	The Government directly controls management of enterprises through a stock equity on the basis of social ownership.

Chinese economists believe that if state-owned enterprises use the two systems successfully, the autonomy of management will be enhanced and this will make ownership relationships more definite. Li Yining, a Chinese economist who advocates a stock system as a main way to successful economic reform, recommends national enterprises combine the adoption of stocks with a management contracting system(28). Big and important enterprises in the national economy, however, should not adopt a stock system to protect the sanctity of public ownership.

VII CONCLUSION

Stock experiments in China became popular in 1985 as a device to raise funds when a tight money policy made it difficult for small or collective enterprises to borrow money from banks. Recently, the situation is changing. Medium-to-large-sized national enterprises have begun to adopt stock systems as a means to accelerate economic reform. The political problem is that the public seems to fear the social expansion of a stock system, though Chinese stocks differ but little from bonds(29).

Rather than a concern with political or ideological questions, these "social" concern are actually grounded in pragmatic economic questions. If money is strictly tightened and selectively loaned to enterprises by the Chinese government with the object of driving down the rate of inflation, many enterprises will be more eager to issue stocks. The public also will draw money from banks to buy stocks. In effect, it will be more difficult to control finance from a macroeconomic viewpoint. Eighty-one-thousand rural enterprises (Xiangzhen enterprises) recently went into bankruptcy owing to financial difficulty(30).

When a stock system is linked with highly productive stock-investment, it will accelerate economic reforms, but if it only changes the flow pattern of money from banks to enterprises, it will strengthen bad economic habits. In sum, the Chinese government has to establish a national stock law and strict regulations for accounting.

In evaluating Chinese stock experiments, we have taken note of whether a stock system is able to give impetus to separating management from ownership and to strengthening the autonomy of state-owned enterprises, or whether these new systems merely promote ways to avoid risk from a short term point of view. Of course, ideally, financial and price reforms must be carried out first to realize a system more in keeping with notions associated with the concept of stocks. The successes available to a full-stock system then will become possible(31). The reality is that we are presently witnessing hybrid experiments attempting to bridge socialism and a market economy. What finally emerges with the lessons learned may well portend the future for the world's socialist economies.

(At laying down my pen, I am grateful for helpful and valuable comments from Mr. James B. Lewis (University of Hawaii) on the draft of this paper). (March 20, 1989)

NOTE

(1) Akira Nishimura, "Recent Trends of Stock Systems in China." *Accounting*, Oct. 1988, pp. 570.
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(3) Jiang Yiwei, "Problems of Stocks." *Economic Management,* January 1989, p. 4.
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(10) Xu Jing'an "The Stock-Share System : A New Avenue for China's Economic Reform." *Journal of Comparative Economics,* September 1987, p. 510.
(11) *ibid*.
(12) Xiao Liang, "Reform of National Enterprises through Separation of Ownership and Management Rights." *Red Flag,* February 1988, p. 14.
(13) Li Yining, "Stock System as The Best System to Make Property Relationships Clear." *Red Flag,* January 1988, p. 21-2.
(14) Cai Zuqing & Guo Fengxuen, "Characteristics and Development of Stock Systems in Xiangzhen Companies in Quanzhou City." *Chinese Economic Problems,* March 1987, pp. 22-23.
(15) The following description is condensed from *Articles of Xi'an Electric Parts Company.*
(16) The total is not 100%, *The Articles* in note 15 does not explain this points.
(17) *Exposition of Stock Issue in Qinpei Motors Stock Company,* 15 July 1987.
(18) "The Public also Became Stockholders." *The Economic Daily,* 8 November 1988.
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(25) Yan Qialin, "Where Does a Stock System Go ?" *The Economic Daily*, 30 November 1988. "Ten Managers of Big Enterprises are for a Stock System." *The Economic Daily,* 15 August 1988.

(26) Yan Qialin, *ibid*.

(27) Yu Ji, "A Combination of a Contracting System with a Stock System." *The Economic Daily,* 22 November 1988.

(28) Li Yining, *ibid*.

(29) Liu Quandi, "Effects of Stock System on Strengthening Enterprise Reform." *Red Flag,* December 1988, p. 18.

(30) *Japanese Economic News,* 5 January 1989.

(31) Xu Jing'an, *ibid*., p. 512.