

**DOES PRIVATISATION AFFECT EARNINGS
MANAGEMENT OF STATE-OWNED
ENTERPRISES IN CHINA?**

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Executive Summary

1. In the 1980s, developed countries began to privatise their state-owned enterprises (SOEs), and the developing and transitional economies soon followed suit.
2. Although China kicked off its privatisation of SOEs in the early 1990s, large-scale privatisation took place only in the late 1990s. Due to political connections, some SOEs were acquired inexpensively.
3. Privatisation has been equated with improving the operational performance of SOEs and enabling them to achieve sustainable growth over the long term.
4. In principle, a privatised SOE no longer belongs to the government solely as it now belongs to various shareholders and needs to report its earnings in accordance to the company's responsibilities to its shareholders.
5. Once privatised, SOEs are operating in a market with free competition; their reported earnings become an important indicator of the enterprise's operational performance.
6. The degree of control that the state is able to exert over the company will diminish after privatisation. The more autonomy an enterprise enjoys, the more likely it will resort to earnings management.
7. The higher the percentage of a company's equity that is held by institutional investors, the less likely the company managers will make use of earnings management.
8. There is a tendency for a company's controlling shareholders to try to siphon off the company's assets and property by using earnings management techniques while keeping small shareholders in the dark.

9. The concentrated ownership structure and the strong political and economic connections between the government and listed companies are the main causes of earnings management in China.
10. If a SOE has been privatised with the state still holding the largest single share, then “privatisation” will have little effect on the enterprise.
11. The establishment of sound accounting systems could prevent earnings management; it will be necessary to strengthen the provisions of China’s laws and accounting principles relating to disclosure.