When the Party Means Business

Professor Li Zhen from NUS Business looked back to the late Qing dynasty when China lost two Opium Wars and had its share of global gross domestic product shaved from over 30% to less than five per cent. After being humiliated by a series of unfair treaties with western powers, the Qing regime initiated the Emulating Foreign Businesses from 1860 to 1890, during which the very first prototype of state-owned enterprises (SOEs) emerged.

However, it was not until the communist revolution that China’s central government had more effective control of the economy when it implemented “two lines of revenue and expenditure” policy for SOEs, leaving no space for production and management autonomy for nearly all companies including both SOEs and collectives. Thereafter, China stepped into the planned economy under which SOEs were assigned different political ranks in the national political system due to political, economic and military considerations. Political goals are often to be achieved in the design and allocation of firm rank as one side of the coin, the other side being the manager rank.

The economic opening and reform since 1978 not only open China’s market but also endowed SOEs with more managerial autonomy in terms of production, tax, shareholders and so on. After accession to the World Trade Organisation in 2001, China’s policies are to continue with merging and consolidating SOEs to make them larger and more powerful in global competition.

Professor Li indicated that China’s SOEs are quite efficient. Party representatives of SOEs can be members of the boards of directors and the committees of supervisors according to dual nominations. In fact, SOE managers work in a closed pyramidal managerial labour market where they enjoy non-transferable benefits if they choose to stay within this system at the price of fewer outside employment opportunities with higher labour market hierarchy.

Prioritising economic development, the Chinese government cultivates SOE managers and government officials who are business savvy to stay within the system to ensure the completion and execution of government goals. SOE managers with political ranks are hence more cautious to meet political agenda, received stricter government monitoring and are more inclined to be risk-averse.

Professor Li also examines the effect of managers’ political ranks on firms’ stock price crash risk. This effect mainly exists in firms with younger managers and managers with shorter tenure. Further, this effect is only significant in regions with weaker market forces, in firms without foreign investors and political connections, and during periods with no local government leaders’ or managers’ political promotions. Professor Li concludes that the political ranking system reduces stock
price crash risk.

Professor Li’s study supports that China’s current SOE system characterised by central control, economic development prioritisation, industrial policies, political ranking and growth-savvy officials largely fits its economic development objectives.