

The role of China's managing directors in the current economic reform

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I. The economic reform

The 38 years since the founding of the People's Republic have witnessed industrial and economic achievements that would have been inconceivable in the old China. Those years of hard struggle have laid the essential material foundations for building a prosperous, modern and democratic socialist society. But the full potential of the socialist system has yet to be tapped – partly, it is true, for historical, political and ideological reasons, but also because the country's rigid economic structure has been ill adapted to production needs.

The major defects of this structure were basically five: (1) no clear-cut distinction was made between the functions of government and the functions of enterprises; (2) administrative barriers existed between different departments or regions, with resulting inefficiency; (3) the State exercised rigid and excessive control over the day-to-day operations of enterprises; (4) insufficient importance was attached to commodity production and to the matching of supply and demand, i.e. the regulatory role of the market; and (5) income distribution was characterised by absolute egalitarianism. Because of these rigidities enterprises lacked the necessary decision-making power, and in their relations both with the State and with their employees the practice of "eating out of the same big pot" came to prevail, with the consequence that the enthusiasm, initiative and creativeness of enterprises and employees alike were discouraged and the economy was deprived of much of the vitality essential for its efficient functioning.

It was clear that fundamental structural changes could be brought about only through a critical examination of the experience acquired and a realistic appraisal of the specific conditions needed for economic growth. Advanced methods of management would also have to be introduced, including those that had proved their worth in the developed capitalist countries,

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in so far as they were in line with the requirements for modern socialised production.

In December 1978 the Third Plenary Session of the 11th Central Committee of the Chinese Communist Party took the historic decision to shift the emphasis of the nation's efforts to the drive for economic development and the building of a socialist society in keeping with China's specific characteristics. Two fundamental points were stressed: the need to observe the four "cardinal principles" – adherence to the socialist path, leadership of the Chinese Communist Party, democratic dictatorship of the people, and loyalty to Marxism-Leninism and Mao Zedong thought – and the need both to implement policies that would open the country to the outside world and to carry out the necessary reforms at home. A reform of the economic structure meant transforming a highly centralised system into a well-planned socialist market economy that would permit a vigorous development of production and distribution.

That reform is now proceeding step by step in an orderly fashion under the leadership of the Party and the Government. Changes are being introduced in such a way as to avoid harmful disruptions and to enhance social stability, expand production, make more efficient use of national resources and achieve a higher standard of living for the people.

The targets for the year 2000

At its 12th Congress held in 1982 the Chinese Communist Party approved the country's economic goals for the coming two decades: to quadruple gross agricultural and industrial output and to increase annual per capita income from US\$250 in 1980 to \$800 or \$1,000 by the year 2000.¹ That would enable the Chinese people, though still far from affluent, to enjoy a fairly comfortable standard of living.

If these goals are to be achieved, gross agricultural and industrial output will have to grow on average by 7.2 per cent a year throughout the entire period. During the Sixth Five-Year Plan (1981-85) total output for the two sectors in fact increased at an average annual rate of 11 per cent and GNP at a rate of 10 per cent. Preliminary statistics for 1986, the first year of the Seventh Five-Year Plan, indicate an increase of 9.3 per cent over 1985 in gross agricultural and industrial output and an increase of 7.4 per cent in GNP.²

II. How enterprises are being revitalised

Urban enterprises alone account for over 80 per cent of state revenue in the form of taxes and profit remittances. It follows that the national economy can only be given the boost it needs, and the targets for the year 2000 achieved, if these enterprises, and especially the large and medium-sized ones, are revitalised. They are, in short, the cornerstone of the economic reform.

Of the almost 4.4 million enterprises in China in 1985 there were, in addition to those in the construction, transport, commercial and service sectors, 500,200 in manufacturing industry. In terms of types of ownership, these latter can be broken down as follows:

Ownership	No.
State-owned enterprises	96 800
Collective enterprises	401 000
Joint state-collective enterprises	1 266
Joint state-private enterprises	285
Joint collective-private enterprises	215
Joint Chinese-foreign ventures	391
Enterprises operated by overseas Chinese, including Hong Kong and Macao entrepreneurs	28
Enterprises owned wholly by foreign capital	34
Others	181

In addition, there were over 11.7 million very small private businesses benefiting from state incentives and legal protection.³

The rest of this article will focus on the first of the above categories, the state-owned enterprises.

By the late 1970s it had become clear that if these enterprises were to be revitalised, two types of relationships would have to be sorted out satisfactorily. First, the relationship between the State and the enterprises owned by it needed to be clarified by separating ownership from the authority to operate and manage, and by giving enterprises greater decision-making power. Second, the relationship between the enterprises and their employees also needed to be spelled out so as to safeguard the status of the latter as the masters in their own house.

The relationship between the State and the enterprise

The rigid control exercised by the State in the past was largely the consequence of the notion that the ownership of enterprises by the people as a whole should be reflected in their direct operation by state institutions. If the activities of enterprises were to further the general objective of economic growth, it was argued, state institutions had to manage, supervise, guide and regulate those activities through centralised planning and various other economic, administrative and legal means. Taxation and other fiscal measures had to be used to bring into the government treasury a substantial part of enterprises' net income for expenditure by the State according to centrally determined criteria. The State was responsible for appointing and removing top managers, or for approving their recruitment or election, for deciding on

the location of enterprises or their transfer elsewhere, on changes in product lines, mergers, suspensions and closures. However, since consumer demand is a highly complex and constantly changing phenomenon, and since conditions vary greatly from one enterprise to another and the economic links between them can be very complicated, no single institution can have a complete overview of the situation or deal with all problems promptly. There is bound to be a serious risk of excessively subjective judgements and excessive red tape when the State is directly responsible for administering and managing a multiplicity of enterprises; and the vitality of the enterprises themselves will inevitably suffer.

The main thrust of the reform, therefore, was to make a clear-cut distinction between enterprise ownership and the responsibility for enterprise operation and management so that the enterprise could become a relatively autonomous production unit responsible for its own profits and losses, capable of transformation and growth, and acting as a legal entity with clearly defined rights and duties.

It may be of interest to indicate at this point some of the specific ways in which this objective is being progressively achieved. For some 30 years enterprises had been required to hand over to the State the totality of their profits, and to make application to the State for finance to support any expansion of production. No funds whatsoever were left at their own disposal. A first step away from this restrictive system was taken in 1980 with the introduction of "profit retention", whereby a portion – admittedly only a very small one – of net profit after tax could be retained by enterprises for development, welfare and bonus fund purposes. Although a move in the right direction, providing as it did some small incentive for improved performance, this system offered no real scope for managerial independence, only 1 per cent of the net profit being available for development.

The second method involved a shift, as regards state receipts, from the concept of profit delivery by enterprises to tax payment. After payment of business and product (or value-added) tax, 55 per cent of the net profit was payable to the State as corporation tax, the residue being retained by the enterprise, subject to a further "regulatory" tax levied at rates varying from one enterprise to another. This system was undoubtedly a step forward, but it still meant that enterprises could not to any significant extent finance their own re-equipment and development programmes. Moreover, the system inevitably led to a conflict of interests between enterprises and the State, with the former pressing for tax reductions while the latter remained intent on ensuring a steady rise in revenue.

A way to reconcile these contradictory aspirations was found in the "contractual responsibility system", various forms of which have been operated experimentally over the past seven years, and which is now to be applied generally throughout the country. The essence of the system is that what the State is to receive is specified in advance, and this the enterprise undertakes by contract to deliver; but all profits over and above the specified

amount or quota are retained by the enterprise, which must, however, make up any shortfall that may occur. In this way, scope is given for enterprises to effect their own expansion while, at the same time, the State is assured of steady increases in its revenues.

The system has many variants, but the two main types are those based on fixed profit quotas and those based on progressive rates, the particular form adopted by an enterprise being decided by consultations with the State or the local authority. The Municipality of Beijing, for instance, has adopted a variant whereby any increase in profit beyond the point where targets for profit delivery and tax payments, on the one hand, and reinvestment on the other, are met is reflected in a proportional increase in the wage fund. The formula adopted by the giant Capital Iron and Steel Corporation requires it to deliver annually to the State a sum equivalent to a 7.2 per cent progressive yearly increase on a basic figure corresponding to the profit delivered in 1981, any increase beyond the target being left at the Corporation's disposal. The system has proved a major incentive to management and workforce, and annual profit increases of the order of 20 per cent have been achieved. The benefit to the State has been very considerable: counting the increase in fixed assets resulting from reinvestment by the Corporation, the State has, over the past eight years, received revenues totalling 5.8 billion yuan, as compared with a total of 3.6 billion yuan received over the preceding 30 years. Some idea of the increase in the director's decision-making powers can be gathered from the fact that most of the retained profit is available to the enterprise for production expansion. In Beijing a factory director is generally authorised to approve investment projects up to a value of 1 million yuan, and the Municipality may authorise projects worth up to 30 million yuan. Projects worth more than 30 million yuan require approval by the State.

The contractual responsibility system thus reconciles the interests of the State, the enterprise and the workforce, as well as encouraging the emergence of successful entrepreneurs. Moreover, it places enterprises in a stronger position to overcome problems resulting from energy, transport and materials shortages, by enabling them, for example, to invest in other enterprises supplying needed materials or to join in financing the construction of power stations. (They are also better able to resist pressures from local governments and communities to make "donations" to local projects – roads, public parks, etc. – which should properly be financed out of taxation.)

Of course, the only way to overcome shortages of materials and energy completely is to develop a socialist market mechanism and reform the pricing system to encourage their supply. The Government has already introduced a two-tier pricing system to stimulate the production of goods and materials in short supply, whereby enterprises producing certain raw and semi-finished materials are permitted to sell their above-quota production for more than the state-fixed price.

Such far-reaching reforms could not be rushed through simply by issuing administrative orders; they had to be carried out by stages so that conditions

would be ripe for each successive step. It was decided to select a few enterprises for experiment first, and then gradually extend successful experiments to others, group by group, while issuing from time to time appropriate rules and regulations to govern the process.

The experiment was launched in 1979, and over the next few years various sets of regulations were promulgated by the State Council (the Government), the most comprehensive being those of 5 December 1986, which laid down the measures to be taken with a view to further expanding enterprises' powers along the lines of the successful experiments already carried out. These regulations provide in particular for:

- (1) thoroughgoing implementation of all relevant principles and policies directed towards the revitalisation of enterprises promulgated by the State Council in previous years, the success achieved in expanding enterprises' powers to be taken into account in the job performance appraisals of government executives;
- (2) promoting various kinds of contracting systems, with provision for managing directors of enterprises to be given all necessary decision-making powers: small state-owned enterprises to be authorised to try out leasing or subcontracting arrangements; local authorities to be allowed to select a few large and medium-sized state-owned enterprises for experimenting with a system of shareholding whereby enterprises are entitled to invest in each other's businesses or to set up joint ventures (the shareholding system is thought to have much to recommend it; under it some small state-owned businesses and service industries may be auctioned or sold off in the form of shares, the proceeds going to the State, the shares being paid for by instalments if necessary);
- (3) accelerating the reform of the leadership system in enterprises (we shall come back to this later);
- (4) strengthening the capacity of enterprises to build up funds for transformation and development through the provision of tax relief, higher depreciation allowances and a reduction (from 55 to 40 per cent) in the levy on after-tax profits from productive investments;
- (5) improving the wage and bonus distribution system by allowing the enterprises themselves to decide the form and manner of distribution and dates of wage adjustments and staff promotion within the limits of the total wage bill approved by the Government; bonus earnings, however, to be taxable;
- (6) scaling down mandatory planning (e.g. obligatory output targets) and giving the enterprise the right to increase the proportion of its products for direct sale and to fix prices by simple agreement with the buyer; and
- (7) encouraging enterprises to form associations by establishing horizontal economic links with large enterprises or with those manufacturing high-

quality branded products, it being understood that such associations are to be formed on a voluntary basis, for the mutual benefit of their members, and without hindrance from government departments.

Reforming the leadership system in the enterprise

In the past the managing director of an enterprise was nominally responsible for its production and administration under the leadership of the Party committee within the enterprise, which in practice meant that all decisions on important matters – e.g. operation of the enterprise, promotion and dismissal of senior management and even their assignment to particular functions – had to be discussed and approved by the committee. Although the managing director was a member of the Party committee, he had only one vote and hence no more power than any other member; in short, this system of collective leadership meant that nobody was really responsible. With the expansion of its decision-making powers under the economic reform, the enterprise acquired legal personality and became responsible for its own operation and profits and losses. However, the managing director still had to obtain the approval of the Party committee on important matters and hence had little decision-making power and little control over the terms of employment of senior personnel, which was not consonant with his status as legal representative of the enterprise. Moreover, since the Party committee was called upon to discuss and approve a host of production and other matters falling outside its proper jurisdiction – which is to supervise Party members and to conduct educational and ideological activities among the workforce – it had no time or energy left for doing a good job in its own field. Both of these aspects called for reform.

After lengthy and extensive experiments, that reform was initiated under a series of regulations⁴ issued by the Central Committee of the Communist Party and the State Council in September 1986 aimed at giving the managing director, as head of the enterprise and its legal representative, full responsibility for its operation. The tasks assigned to the Party committee are to supervise the implementation of the principles and policies laid down by the Party and the Government, to provide support to the grass-roots organisations (trade unions, youth league, etc.) in carrying out their work and their ideological and political programmes, and to help Party members to play an exemplary vanguard role in ensuring that the enterprise keeps to the socialist path.

The relationship between the enterprise and its employees

Parallel to the measures taken to ensure that the managing director was given full responsibility for the enterprise, a number of measures were also adopted to improve the system of workers' congresses⁵ and other forms of participative management and to enhance the role played by the trade unions

and workers' representatives in examining and discussing the major decisions to be taken by the enterprise, in supervising its administration and in safeguarding the legitimate rights and interests of the workers.

The workers' congress has been assigned five functions: (1) to hear progress reports by the management, comment on such important matters as the guide-lines, plans and financial questions relating to the operation of the enterprise, and adopt resolutions on the implementation of programmes where this is thought necessary; (2) to examine and approve plans proposed by the managing director for the distribution of wages and bonuses; (3) to review and approve action relating to staff welfare, such as the use of welfare funds; (4) to appraise and monitor the activities of managerial and supervisory staff and make suggestions regarding rewards or penalties as well as staff appointments and dismissals; and (5) to recommend candidates for the board of directors and to elect the managing director, subject to the approval of the competent state institution.

A management committee has also been set up in each enterprise to help the managing director deal with major management issues. The committee is chaired by the managing director and composed of supervisors from the various departments and representatives elected by the workers' congress. The latter members, who include the trade union chairman, have one-third of the seats.

Reforming the enterprise's management and operation

As the national economy moves from a highly centralised system towards a planned socialist market economy, so enterprises too are tackling the challenge of changing their mode of operation and setting a new course. This may be illustrated by the work of production planning. Under the former system, production plans were transmitted to the enterprise by the State, raw materials were allocated by the State, and products were purchased and resold by the State (or state-run commercial institutions) – so that in effect the State could be likened to a trading company and the enterprise to a workshop within it (with no obligations and no marketing worries). Since the structural reform, however, the State has gradually scaled down mandatory planning in favour of indicative planning (non-mandatory production targets set as guideposts) and placed greater emphasis on market regulation, thus allowing enterprises to gear production to market demand. Hence three types of planning – mandatory, indicative and market-regulated planning – now exist side by side.

The relative weight of the three varies, however, according to the size of the enterprise and the type of production it is engaged in. Mandatory planning still prevails largely or entirely in the case of large enterprises producing commodities vital to the national economy and the well-being of the people. In many small and medium-sized enterprises, on the other hand, production can be geared largely to market demand and needs to be planned

accordingly. Such enterprises must make their own purchases of raw or semi-finished materials and see to the marketing of their products themselves. This entails reorganisation and a different approach to staffing since they have to carry out their own market surveys and forecasts, develop new products, ensure quality control and provide after-sales services. They also need to import advanced technology and management skills from abroad if they are to succeed in competitive domestic and international markets.

The system of income distribution also called for reform.⁶ There was little scope for motivating the workforce as long as extreme egalitarianism prevailed. The system of remuneration needed to be brought into line with the principle "to each according to his work". It has been found in recent years that the most effective way of accomplishing this is by implementing various forms of what we call the economic responsibility system. Enterprises increasingly use the method of management by objectives, breaking down the overall production target by units and sub-units so that each division and its workers identify themselves with their own particular production or operational targets. As a result, the earnings of the enterprise and its employees are closely linked to their particular contributions to the national economy; the greater the employee's contribution, the higher the wages and bonuses he receives. This method, which has met with an enthusiastic response from workers and management alike, has been an important factor in the rapid increase of national production in recent years.

All in all, the various measures taken to revitalise enterprises have produced highly positive results: they have given the managing director greater decision-making power over operation and production, enabled the Party committee to perform its leadership role more effectively and, thanks to a more democratic form of management, strengthened the commitment of the workers and given wide scope to their intelligence, skills and creativeness.

III. The new status of the managing director

As a result of the reforms now under way, the status of managing directors is undergoing a fundamental transformation.

First of all, with the separation of the enterprise from the State, and of authority to operate and manage from ownership, the managing director is no longer merely an administrator responsible for carrying out government orders. He has become instead a manufacturer and marketer of goods with full powers to decide on management matters and full responsibility for the enterprise's performance.

Second, with the reform of the leadership system in the enterprise and the separation of Party functions from administrative functions, he has become fully responsible for organising and running the enterprise. He is no longer a mere executor of Party committee decisions. If the enterprise is

badly run, he is held accountable; if its management and operation produce satisfactory results, and annual production quotas and other targets are met, his income may be anywhere between 100 and 300 per cent higher than the average earnings of the workforce (or even more if his contribution to the enterprise's performance is really outstanding). If, on the other hand, he fails to meet his "responsibility targets", his income will be cut. In short, following the reform, the managing director's responsibilities are commensurate with his powers, and the benefits he receives are commensurate with his success in discharging those responsibilities.

Of course, the fact that managing directors now enjoy greater decision-making power is not in itself a guarantee of sound management. A good manager must also know how to implement democratic practices fully, to listen to his subordinates, to weigh and act on suggestions for improvement put forward by the workforce, and to make fair, sound and appropriate decisions in specific circumstances. Moreover, he must maintain good relations with the Party committee and the workers' congress, relying on them for advice, respecting their judgement, and fostering their sense of responsibility. Only a manager who possesses these qualities can command the esteem of the workforce that is essential to the firm's success.

Although the economic reform has not been under way for long, many courageous and far-sighted managing directors have already emerged throughout the country. In true pioneering spirit, they have, on taking over the management of their enterprises, introduced sweeping reforms that have completely changed their product lines and standards, and many of these enterprises are now turning out high-quality products that sell well even on foreign markets.

The fact remains, however, that, in point of experience and skills, our managers still lag far behind those in the developed countries. Fully aware of the need for intensive study in order to close the gap, they look to professional exchanges with the technical services of the ILO and employers' associations abroad for an opportunity to learn from the experience of others so that they can make a more effective contribution to China's economic growth while strengthening friendly ties with their counterparts in other parts of the world.

Notes

¹ A target has since been set also for the period from 2030 to 2050: to raise average per capita income to \$4,000, which would place China among the intermediately developed countries.

² *Report on the work of the Government* by Prime Minister Zhao Ziyang delivered at the Sixth National People's Congress.

³ Figures supplied by the State Administration of Industry and Commerce. Incentives for private businesses take such forms as tax concessions and the removal of the ceiling on income that is applied to employees. It may be noted in passing that foreign entrepreneurs who have come to China to participate in joint ventures or to set up their own business enjoy various forms of preferential treatment, with the result that there has been a fairly rapid growth of these two types of enterprise in recent years.

⁴ Concerning the work of directors of state-owned industrial enterprises; concerning the work of Chinese Communist Party grass-roots organisations in state-owned industrial enterprises; and concerning the congresses of workers and staff members in industrial enterprises.

⁵ Delegates to the workers' congress are elected by secret ballot and meetings are held two to four times a year. The trade union committee, to which the congress's authority is delegated between meetings, is responsible for day-to-day matters. See *Social and Labour Bulletin* (Geneva, ILO), 1/82, pp. 35-36, 2/81, p. 144, and 3-4/86, pp. 437-438.

⁶ See also the discussion in Yue Guangzhao: "Employment, wages and social security in China", in *International Labour Review*, July-Aug. 1985, pp. 411-422.

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By Peter Hills and Paddy Bowie

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ISBN 92-2-105508-6

22.50 Swiss francs

Available from booksellers, ILO offices in many countries or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland.