

1. Five problems with Chinese state-owned factories of medium and large sizes

For the time being, Chinese state-owned factories of medium and large sizes (referred to as CMLFs hereafter) are facing five major problems: poor business performance, poor management, heavy burden of social obligations, heavy burden of debts and small scale of production.

Firstly, most CMLFs have poor performance. According to statistics, the total profit and tax payment realized by the state-owned industrial sector rose from Y120 billion in 1990 to Y273.3 billion in 1995; and the net profit rose from Y26.6 billion to 74.6 billion during the



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same period. In the first half of 1996, however, this sector suffered a total net loss of Y2.5 billion. Profit from successful factories was Y2,471.6 billion lower than what was realized in the same period of the previous year, decreasing by 70.3%. The business performance was improved last year but it didn't come up to expectations.

Secondly, the management level of most CMLFs should be enhanced. Their assets-sales ratio has running down and the volume of unsaleable goods is on the increase. According to a rough estimate in late 1997, the total volume of unsaleable goods held by the state-owned industrial sector was worth some Y500 billion, increasing by 16.8% in comparison with the same period of 1996; only 93.75% of the output from this sector was sold. The narrowed market, of course, has affected the situation, but one of important causes is the fact that products from the industrial sector didn't meet consumers' tastes. The State Economic and Trading Committee has carried

out a research into the big inventory and losses suffered by state-owned factories and come to the conclusion that the main cause of the situation was the bad management of factories. Most CMLFs were badly managed and organized, lacked experience and knowledge, produced unreasonable lines of products and refused to venture into the market and as a result, they were doomed to failure when confronting changes in the market.

Thirdly, all CMLFs are burdened with social obligations. The three heaviest ones are: (1) Each of them has to build a certain amount of classrooms and they have provided 6,1 pupils and students with 18,000 classrooms. The Chongqing Steelworks has spent Y20 million in building 26 schools and paying salaries to their teaching staff. (2) They have to pay an army of unneeded laborers. This army represents some 30% of the workforce employed by state-owned factories and the total wage they receive amounted to Y100 billion. (3) State-

owned factories have to pay pensions and other expenses to retired laborers. This expenditure rose from 4 billion in 1980 to some 60 billion in 1996 when the whole state-owned industrial sector could make a total profit of 110 billion only.

Fourthly, the CMLF burden of debt is too heavy. The liability-asset ratio of the state-owned industrial sector rose from 18.7% (the liability-current asset ratio was 48.7%) in 1980 to 67.5% (the liability-current asset ratio was 95.6%) in 1993. In late 1994, the State Assets Agency inspected 110 state-owned factories and found that their liability-asset ratio was 79% and this figure kept on rising in 1995 when the liability-current asset increased to 96.7%, from 45% to 60% higher than that in industrialized countries.

Fifthly, the production scale isn't really large. Most state-owned factories considered as large couldn't bear comparison with foreign ones. The total sales realized by the world biggest company in 1994

reached US\$17,580 billion while the sales by 500 Chinese large factories amounted only to US\$15,650 billion (the exchange rate was Y8.3 to the dollar). When the international trade is really globalized, to expand the production scale becomes a matter of great importance to the economy in the twenty-first century.

2. Measures to solve these problems

Analyses of the above-mentioned problems can help work out measures

scale ones), improving the business environment for state-owned factories and encouraging them to increase their profits or reduce their losses.

b. Better management

The management of state-owned factories should be beefed up and full attention paid to the five following problems:

- + Enhancing managerial skills of factories' leadership: those who lack knowledge and skills needed for their positions should be dismissed.

- + More investment should be

d. Separation from social obligations

All state-owned factories should be free from social obligations by (1) having them saved from the task of building schools, and (2) finding out a solution to the army of unnecessary laborers. Factories should have the right to reduce their workforce if need be or they could be allowed to diversify their production or enter the service industry in order to create new jobs for redundancies. As for retired workers, the Government had better develop its own social security scheme and encourage wage earners to take part in this scheme instead of adopting the policy to ensure lifetime employment for workers of state-owned factories.

e. Freedom from debts

The Government had better take the following measures:

- (1) Continuing with the pilot scheme to optimize the structure of capital in state-owned factories by providing them with necessary working capital,

- (2) Turning surplus capital generated by the policy "changing refinanced capital to loans" into stakes in factories held by the Government in order to make the asset-liability ratio more reasonable,

- (3) Changing CMLFs into companies in order to attract investors from the public,

- (4) Encouraging all factories to use retained profit to make intensive investments and develop by themselves instead of depending on government subsidies.

f. Investment in scientific researches

In China, new investments account for some 61% of the GDP growth while this figure is 23.8% in Japan and 19.7% in the U.S. However, techno-scientific advances account for less than 30% of the GDP growth in China as compared with 55% and 44.7% in Japan and the U.S. respectively. These figures show that China should pay more attention to scientific researches instead of depending on savings and natural resources. Investing intensively in scientific researches is the best way to develop new products, increase the added value of goods, improve the competitiveness of state-owned factories and ensure the sustainable economic growth.

(Source: Lam Shun Lin & Mew Kin Guang, *Financial and Accounting Journal*, No 4, 1998)

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to deal with them.

a. More profit and less loss

Based on the central government's demand for "a mechanism for identifying responsibilities and targets of the task of increasing profit and reducing loss" we can see that:

- The management of the company should bear responsibility for the business performance and identify increasing profit and reducing loss as main targets.

- Size and objectives of studies should be made clear and results of the studies should be publicized periodically.

- A measure to give incentives and punishment after the studies are made should be worked out. On other words, the task of increasing profit and reducing loss should be linked with results of studies and incentive scheme undertaken by the leadership of economic zones and research centers. The task of increasing profit and reducing loss should aim mainly at CMLFs, thereby sorting out profit-making factories from loss-making ones (especially medium- and small-

put in R&D activities because developing new products is a matter of life and death to all factories.

- + State-owned factories should be organized according to modern models appropriate to the market mechanism. Reforms in organization can help deal with technical, planning and financial issues more effectively.

- + Company leadership should introduce more technical innovations in order to change the structure of products supplied after considering the market demand and production capacity.

- + Delegation of authority should be linked with responsibility. All incentives and punishments should be realized properly and fairly.

c. Bankruptcy and merger

Because all resources are limited and the spending power couldn't increase incessantly. The Government had better close or declare loss making and badly managed factories bankrupt in order to help the rest, especially medium- and large-scale factories develop and expand their market shares at home and abroad.