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Redundancy of Chinese state-owned enterprises: A literature review

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Abstract
During the process of pushing forward the reform of Chinese state-owned enterprise, one of the most important problems is how to solve the redundancy in Chinese state-owned enterprises.
By reviewing the literature at home and abroad, this paper found that political interference result in redundancy in Chinese state-owned enterprises. The ways of political intervention includes the state-owned controlling shareholders, the governmental departments and the grass-roots communist party organizations in state-owned enterprises. Redundancy not only reduces the performance of state-owned enterprises, but also significantly increase the agency costs of state-owned enterprise. On the basis of summarizing the existing literature, this paper points out several issues that may need to be paid attention to in the future.

Keywords: redundancy of state-owned enterprises, State-owned enterprise reform, China

1. Introduction

In the process of the Chinese economic transformation, Chinese state-owned enterprises is always at the core position (Liu, 2013) [16]. Since China's reform and opening up to outside world, state-owned enterprise reform has been deepened. State-owned enterprises have integrated with the system of market economy, which improved the competition of state-owned enterprises. However, there are still some outstanding contradictions and problems to be solved urgently in state-owned enterprises. One of the most important problems is how to solve the redundancy in Chinese state-owned enterprises. In the planned economy period, Chinses state-owned enterprises assumed important social functions and developed on the way of involution with disguised unemployment. Even now, China has transformed from a planned economy to a socialist market economy, Chinese state-owned enterprises still bear a heavy redundant employees forced by the central and local government employment pressure. As a result, Chinese state-owned enterprises have many redundant employees. For example, when the oil price declined, dozens of international oil companies let staff go in both US and Europe. But, the redundancies never happen in China National Petroleum Corporation (CNPC). According to the survey, both CNPC and ExxonMobil had revenue of $ 260 billion in 2015, but the former employs 6.67 times as many people as the latter. Not surprisingly, CNPC's net profit is only one third of ExxonMobil's.

A de facto "implicit contract" has been formed between the state-owned enterprises and the government, which makes the state-owned enterprises can not adjust the number of employees according to economic fluctuations. A large number of long-standing redundancy hinders the improvement of efficiency of state-owned enterprises. How to Solve Redundancy is a Challenge for State-owned Enterprises. It is generally known that a large number of state-owned enterprises in China. It means that the existence of too many redundant staff is one of the most serious problems in Chinese state-owned enterprises. With the promotion of the reform of China's state-owned enterprises, scholars had found somethings new. It is an important and meaningful work to sort out these literatures. Even though there were several similarities studies, many scholars paid more attention to the efficiency of state-owned enterprises (Sachs & Woo, 2001; Hovey & Naughton, 2007) [8, 7]. Megginson & Netter (2001) [17] combed systematically literatures about enterprise performance under different ownership systems in different countries. They found the average benefit of private enterprises is higher than that of state-owned enterprises, and the performance of state-owned enterprises would be improved after privatization (Djankov & Murrel, 2002) [4]. Different from the current literature, this paper focuses on the redundancy of state-owned enterprises in China.

2. The causes and ways of redundancy in state-owned enterprises

2.1 The cause of redundancy in state-owned enterprises

Essential mechanisms for redundancy in Chinese state-owned enterprises remains controversial. Some scholars believe that the redundancy of Chinese state-owned enterprises is China's historical legacy. However, most scholars hold that the redundancy of Chinese state-owned enterprises is the outcome of constant intervening of central government and local government.

In the age of the planned economy, "Catch up with Britain and surpass the United States" became a state goal for China. As a result, the central government chose to invest in capital-intensive heavy industries rather than labor-intensive industries with comparative advantages. And the central government has the responsibility to arrange the employment of urban labor force, which leads to a large number of redundant employees in state-owned enterprises (Lin *et al*., 1998) [13]. With the transformation of economic of system from planned economy to market regulation in China, state-owned enterprises have not been able to lay off redundant staff (Lin & Tan, 1999) [14]. Some experienced studies confirmed that the redundancy of Chinese state-owned enterprises is history's legacy. Using a panel data of China's listed companies from 1999 to 2002, Zeng & Chen (2006) [22] found that state-owned companies employed more employees than non-state-owned companies. And the excess employees of state-owned companies were not the result of new employees after listing, but the result of redundant employees of state-owned enterprises before listing.

Contrary to the above viewpoints, some scholars hold that the redundant employees of state-owned enterprises is not a legacy of history. Dong & Putterman (2001) [5] found that the employees of Chinses state-owned enterprises were insufficient rather than redundant. And the redundant employees in Chinses state-owned enterprises have increased significantly since 1993, which is caused by a variety of factors. The major factors include the reduction of funds available to state-owned enterprises, the restrictions of the government on staff reduction, the intensification of product market competition and the continuous increase of wages in non-state-owned enterprises and so on. These factors lead to the decrease of non-labor input in state-owned enterprises, which leads to the emergence of redundant employees in state-owned enterprises and aggravation (Dong & Putterman, 2003) [5].

Taken together, due to historical reasons, Chinese state-owned enterprises bear policy objectives, such as expanding employment to maintain social stability (Lin *et al*., 2004) [15]. With the advancement of the reform of state-owned enterprises, the social burden of Chinese state-owned enterprises has been reduced, but it always exists. One of the important reasons is that the government has the motivation to share employment pressure with state-owned enterprises by political intervention, especially with the increasingly serious employment situation. This means that state-owned enterprises do not completely strip or release redundant personnel in the process of reform (Zeng & Chen, 2006) [22]. In other words, because government officials solve the problem of social employment through state-owned enterprises, the phenomenon of excessive employees usually exists in state-owned enterprises. Donahue (1989) provided that the ratio of employees per unit of output was higher in municipal services provided by public companies. Frydman *et al*. (1998) [6] found that political pressure prevented state-owned companies from laying off workers. Dewenter & Malatesta (2001) [3] found that the ratio of the number of employees to assets and the ratio of the number of employees to sales income in state-owned enterprises were higher than those in private enterprises, and found that after privatization, the labor intensity of companies decreased.

The degrees of government intervention in state-owned enterprises is up to the ability of government intervention and the motivation of government intervention. The regions with higher level of marketization in China, the boundary between government and state-owned enterprises is clear. Those state-owned enterprises employ the market-oriented scientific management, which is seldom interrupted by government. When the job market is getting tighter and tighter, the government has strong motivation to intervene in human resources management of state-owned enterprises. For example, the government tends to dissuade state-owned enterprises from firing staff, or the government requires or encourages state-owned enterprises to increase their employees. Pan *et al*. (2008) provided evidence that the sate-owned enterprises with more government intervention have more redundant employees. At the regional level, the higher the unemployment rate, the higher the redundancy level of state-owned enterprises.

2.2 The ways of political intervention

The ways of political intervention includes the state-owned controlling shareholders, the governmental departments and the grass-roots communist party organizations in Chinese state-owned enterprises (Chang & Wong, 2004).

This first option for political intervention is the state-owned controlling shareholders. In China, state-owned stock have comparative advantage in shareholding equity because most listed companies were reformed from the former state-owned enterprises (Chen & Wang, 2005) [2]. In these circumstance, the state-owned controlling shareholders are prone to encroach on the interests of minority shareholders (Shleifer & Vishny, 1997) [19]. As the actual controller of state-owned enterprises, the government's embezzlement behavior has its particularity. The government's goals are diverse, including economic and social goals. For example, in addition to economic growth, reducing unemployment is also an important goal of the government. In the long run, the achievement of government goals depends on the sustained growth of state-owned enterprises. Therefore, the conflict between government and minority shareholders is not serious.

The second option for political intervention comes from government department directly. In China, whether it is the central government or the local government, which always enjoy certain prestige and authority among the state-owned enterprises. Although China has accelerated the process of separating government from enterprise since the construction of socialist market economy in 1992, but government departments and relevant administrative agencies have not completely cut off the ties between them and state-owned enterprises. In fact, the Chinese government influences state-owned enterprises through the allocation of important resources, such as loans and land. More importantly, the GDP and employment social stability based top-down centralized assessment system makes local governments in the promotion tournament more competitive in China. The local officials have strong motivation to implement short-term behavior (Zhou, 2007) [23]. For the government, the state-owned enterprises are powerful tools to promote employment stability.

The third option for political intervention comes from grass-roots organizations of the Communist Party of China (CPC) in state-owned enterprises. In China, the management authorities of state-owned enterprise had to take the views of committee of the CPC into full consideration in making decisions since the early 1950s (Ji, 1998). Campbell (2007) [1] pointed out that as a kind of institutional force, the grass-roots organizations of the CPC are conducive to assuming greater responsibility for the harmonious development of the whole society. As a way of political intervention, the grass-roots organizations of the CPC are to some extent the embodiment of the will of the state. The political pattern of the integration of CPC and government and the political core position of CPC committees in state-owned enterprises have not changed. CPC organizations at all levels form a systematic network, covering all social units. As a manifestation of Chinese characteristics, CPC organizations will inevitably influence and check and balance the business decision-making of state-owned enterprises (Liang *et al*., 2010), including the employment behavior of state-owned enterprises. Taking state-owned listed companies whose members of CPC committees in the company's board of directors, board of supervisors and management information from 2008 to 2010 as samples, Ma *et al*. (2013) found that the participation of Party committees in corporate governance would increase the scale of redundant employees.

Generally speaking, it is generally accepted that political intervention is the main reason for the redundancy of Chinese state-owned enterprises. However, do state-owned enterprises have the implicit motivation to bear the policy burden voluntarily? This is crucial to the smooth realization of the government's policy burden to state-owned enterprises. It is generally believed that the government can impose a policy burden on enterprises through the power of appointment and removal of personnel (Chen, 2002). However, senior managers of state-owned enterprises can make use of the information advantage to exaggerate the damage caused by the government's burden to enterprises, and force the government to reduce or even stop the allocation of policy burden to state-owned enterprises. Therefore, even if the government grasps the personnel power, it also needs an incentive compatible mechanism to smoothly promote the state-owned enterprises to bear the policy burden. This incentive compatible mechanism is the one that promotes the enterprises volunteer to bear the policy burden.

Not surprisingly, when designing the promotion incentive mechanism in state-owned enterprises, the government also takes in two kinds of assessment indicators: the financial performance and the policy burden. In order to get promotion, executives of state-owned enterprises have the motivation to bear more policy burden. That is to say, to strive for more promotion opportunities is an important implicit motivation for state-owned enterprises to bear policy burden. Furthermore, the incentive intensity of promotion motivation to bear policy burden on state-owned enterprises depends on the strength of political intervention. When the government intervenes strongly, the government requires the state-owned enterprises to bear more policy burdens. The means is to increase the weight of the policy burdens in promotion assessment. Using excess employees to measure policy burden and taking state-owned listed companies in China from 2005 to 2011 as samples, Liao & Shen (2004) [10] found that the policy burden of state-owned enterprises contributes to the promotion of CEOs, and when the degree of political intervention and unemployment is high in the company's region, the policy burden has a greater impact on the promotion of CEOs.

3. The effect of redundancy in state-owned enterprises

3.1 The impact of redundancy in state-owned enterprises on the firm performance

After the state-owned enterprise's share-holding system is reformed, Chinese state-owned enterprises have formally established a modern enterprise system aiming at maximizing the value of enterprises. However, political intervention from the central government or the local government seriously weakens the effectiveness of corporate governance. As a result, the modern corporate governance mechanisms in state-owned enterprises becomes mere formality. The main manifestation of political intervention is that state-owned enterprises bear a larger number of policy burdens, such as redundancy, employee welfare and so on (Lin &Li, 2004) [15]. Even if the listed state-owned enterprises, their parent companies also bear a large number of retired workers pension, medical and other costs. Lin (2004) [15] pointed out that those reform schemes aimed at improving the internal governance mechanism of state-owned enterprises are difficult to play a role because the state-owned enterprises have not solved the policy burden. The policy burden will lead to policy loss. Under the condition of asymmetric information, it is difficult for the government to distinguish whether the loss of state-owned enterprises is caused by the failure of operation or the policy burden. This provides conditions for the managers to shirk their responsibilities and easily leads to the problem of soft budget constraint.

The main reason for the inefficiency of state-owned enterprises is that government officials use state-owned enterprises to achieve their political goals. Especially expanding employment rather than maximizing social welfare (Shleifer & Vishny, 1994) [19]. Employment expansion is a major goal of Chinese governments at all levels. Many documents provide evidence that the government's influence on the size of employees in state-owned enterprises reduces the performance of Chinese state-owned enterprises and even leads to losses (Li & Liang, 1998; Xu *et al*., 2005) [12, 20]. Li and Liang (1998) [12]found that redundant unproductive workers were a major cause of losses in state-owned enterprises, and state-owned enterprises did not respond to layoffs after losses. Based on the survey data of China's industrial state-owned enterprises in 1997 and the first quarter of 1998, Xu *et al*. (2005) [20] found that the moderate flexibility of state-owned enterprises' executives in layoffs not only significantly positively improves their performance, but also quantitatively. Their research revealed that the political costs associated with labor issues in state-owned enterprises are particularly high, and whether executives have the power to lay off employees is particularly important to the performance of state-owned enterprises.

Zeng & Chen (2006) [22] believed that excess employees and high wage rates together lead to higher labor costs for stated-owned companies than non-state-owned companies. In addition, they also found that state-owned enterprises controlled by the State-owned Assets Supervision and Administration Commission (SASAC) have the largest number of excess employees and the highest labor costs. And compared with other state-owned enterprises, the state-owned enterprises controlled by SASAC might continue to have excess employees after listing. Therefore, one of the main reasons why Chinese state-owned enterprises are less efficient than private enterprises is that state-owned enterprises use more labor force (Boycko *et al*., 1996). That is to say, the existence of too many redundant staff is one of the most serious problems in Chinese state-owned enterprises.

3.2 The impact of redundancy in state-owned enterprises on the agency cost

These studies imply that the wage rate of state-owned would not be reduced with the increase of redundant employees. Namely, the reason why redundant employees lead to inefficiency of state-owned enterprises is the increase of labor costs. However, redundant employees may not necessarily lead to higher labor costs, which are determined by both the number of employees and the wage rate. In fact, another possible cause of inefficiency of state-owned enterprises caused by redundant employees is the increase in agency costs of managers.

In China, the ultimate decision-making power of appointment, assessment and remuneration of state-owned enterprise executives lies in the State Council, provincial

SASAC or municipal SASAC. The compensation management and the performance assessment of executives in the state-owned is regulated by the *Interim Measures for Compensation Management* (IMCM) and the *Interim Measures for Performance Assessment* (IMPA) which formulated by the SASAC. According to the IMCM, the executives' compensation in state-owned enterprises consists of base compensation, performance-based compensation and mid-long term incentive mechanism. The base compensation paid monthly is mainly determined by the enterprise's scale of operation, difficulty of operation and management, the strategic responsibility it undertakes, the average wage of the enterprise in the region, the average wage of the industry and the average wage of the enterprise. The performance compensation and mid-long term incentive mechanism are linked to the results of performance assessment. The IMCM specify that the executives' compensation in state-owned must be linked to the results of performance assessment.

When the main goal of government officials who control the personnel power of state-owned enterprises is to reduce the regional unemployment rate, they may be more concerned about how many employees the state-owned enterprises can employ, rather than the performance of the enterprises. As a result, the government officials tend to hire executives who are easy to be influenced rather than have managerial ability. At the same time, the government officials expect that when the executives of state-owned enterprises assume redundant employees, they will have incentives to reduce the wage rate of employees to control labor costs, while SASAC imposes certain restrictions on executives' compensation. For example, the current applicable regulations are that executive compensation should not exceed 14 times the average wage of employees. Therefore, government officials have the incentive to set a lower base salary for executives of state-owned enterprises with more redundant employees.

On the other side, when the performance compensation of enterprises executives is determined by the government officials, the assessment index will deviate from the firm performance. In this case, the enterprises executives will choose to be lazy and consume on the job instead of supervising and managing employees to improve performance. And redundant employees also increase the moral hazard of executives, who can classify the losses of enterprises as redundant employees, rather than their own poor management. That is to say, redundant employees weaken the incentive of compensation to executives and increase agency costs. Therefore, redundant employees reduce the performance of enterprises.

To this ambiguity is added the complication that the compensation of executives in state-owned enterprises and the security of their positions depend not only on whether they can help government officials achieve their political goals, but also on the performance of enterprises to a certain extent. It means that executives of state-owned enterprises are motivated to lower wage rates to control labor costs while assuming redundant employees. Although the Chinese government have stipulated the minimum wage standard for enterprises. However, the average wage rate in the talent market is much higher than the minimum wage standard, so enterprises still have great flexibility to depress employees' wage rate. The low wage rate of employees and the lack of motivation of executives to supervise and manage, which will lead to higher agency costs between employees and managers. Employees' waste of raw materials, increase of defective products and bad service attitude increase the non-labor cost of state-owned enterprises, and ultimately lead to a decline in performance.

Therefore, redundant employees will lead to the increase of labor costs, the increase of agency costs between ultimate controllers and executives, and the increase of agency costs between executives and employees. These factors will have a negative impact on corporate performance. At the same time, state-owned enterprises with redundant staff may also receive more government subsidies, which will undoubtedly improve their performance. However, government subsidies may not completely offset the negative impact of redundant employees on performance. Xue & Bai (2008) [20] found that the state-owned enterprises in high unemployment areas bear more redundant employees. As compensation, the government gave more financial subsidies to the state-owned enterprises with more redundant employees. They also found that the more redundant employees there are in state-owned enterprises, the lower the average wage rate of employees. Therefore, redundant employees do not make state-owned enterprises bear more labor costs. At the same time, redundant employees significantly reduce the average salary of state-owned enterprise executives, and also significantly reduce the sensitivity between executives' compensation and firm performance. It is concluded that the negative effect of redundant employees on the performance of state-owned enterprises is not that redundant employees increase additional labor costs, but that redundant employees increase the agency costs.

4. Conclusion

During the process of pushing forward the reform of Chinese state-owned enterprise, one of the most important problems is how to solve the redundancy in Chinese state-owned enterprises. Looking back on the changes of China's labor employment system, from the traditional planned economy under the unified employment system to the gradually established market-oriented employment system in recent years, the problem of redundant employees in state-owned enterprises is constantly releasing with the vigorous implementation of the policy of layoffs diversion and reduction of staff. However, the scale and speed of layoffs are still strictly controlled by the government (Chen & Lu, 2003). This paper found that political interference result in redundancy in Chinese state-owned enterprises. The ways of political intervention includes the state-owned controlling shareholders, the governmental departments and the grass-roots communist party organizations in state-owned enterprises. Redundancy not only reduces the performance of state-owned enterprises, but also significantly increase the agency costs of state-owned enterprise.

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