

**ANTECEDENTS OF STATE-OWNED-ENTERPRISES ACQUISITION BY PRIVATE
BUSINESS GROUPS IN CHINA**

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ABSTRACT

Antecedents of State-Owned-Enterprises Acquisition by Private Business Groups in China

Yun Zhang

During China's gradual transition from a centrally planned economy to a market-based economy, the acquisition of State-Owned Enterprises (SOE) by private enterprises has been an eye catching phenomenon and regarded a key growth means for Chinese private business groups (PBG). SOE acquisitions in such unique institutional embeddings are expected to be motivated by two distinct while complementary rationalities — economic rationality (acquisition of efficiency enhancing resources such as property-based and knowledge-based resources endowed in target SOEs) and social capital rationality (acquisition of governmental networking resources inherited in target SOEs).

Two models are proposed to examine the correlation between SOEs' resource endowments and PBGs' degree of acquisitiveness on a sample of 49 SOE acquisition cases taken place in China's stock markets during 1997 to 2000. The results suggest that, in general, SOEs' social capital endowment has significant positive impacts on PBGs' degree of acquisitiveness, while property-based and knowledge-based resources are barely influential. However, PBGs demonstrate different acquisitive preferences at different stages of group development. Acquisitive preferences also differ greatly if founders of PBGs carry different social characteristics.

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Nomenclature

ACFIC = All China Federation of Industry and Commerce

ACSPER = All China Society of Private Economy Research

ADB = Asian Development Bank

AVE = Averaged Variance Extracted

BLS = Bank-Led System

BOD = Board of Directors

CCP = Chinese Communist Party

CEO = Chief Executive Officer

CNY = Chinese Yuan

CSRC = China Securities Regulatory Commission

DA = Degree of Acquisitiveness

EMS = Equity Market System

FBS = Family-Based System

FDI = Foreign direct investment

GDP = Gross Domestic Product

KBR = Knowledge Based Resources

MOF = Ministry of Finance

MOFTEC = Ministry of Foreign Trade and Economic Cooperation

NPC = National People's Congress

OLS = Ordinary Least Squares

PBG = Private business group

PBOC = People's Bank of China

PBR = Property-Based Resources

PLS = Partial Least Squares

PRC = People's Republic of China

RBV = Resource-Based View

RMB = *Renminbi* (Chinese Yuan)
SAMC = State Asset Management Committee
SBG = State-owned / controlled business groups
SC = Social Capital
SEM = Structural Equation Modeling
SETC = State Economic Trade Commission
SME = small and medium-sized enterprise
SOCB = State-Owned Commercial Banks
SOE = State owned enterprises
SPC = State Planning Commission
TMT = Top Management Team
TVE = Town and Village Enterprises
VIP = Variable Importance for Projection

1 Introduction

Business group, a form of network organization (Grandori & Soda, 1995) intermediating between the market and individual firms, has attracted special attention for its emergence and growth in emerging markets that are featured by underdeveloped institutions (i.e. Leff, 1978; Khanna & Palepu, 1997-2001). However, only a handful of research has shed the light on business groups in transition economies that suffer from not only institutional imperfections, but also the confliction between the dual economic systems—the centrally planned economy and gradually marketized economy.

During China's transition from a command economy to a quasi-market economy, business groups have progressed rapidly from experiments to dominant economic actors. Nevertheless, they remain relatively underexploited subjects. Among the numbered studies, focus has been primarily on business groups owned or controlled by the state (SBG) (Li, 1995; Keister, 1998, 2000; Huchet, 1999; Mako & Zhang, 2002; Yiu, Hoskisson & Lu, 2003). Private business groups (PBG), as the other category of Chinese business groups, have not yet been under systemic analysis. Although occasionally they have been briefly reviewed for comparative purpose (i.e. being compared to large Chinese SBGs or overseas Chinese family business groups), how the antecedents, evolutionary trajectory, and consequences of PBGs deviate from their more eye-catching counterparts yet remain unexplored.

This paper, however, focuses exclusively on Chinese PBGs in an attempt to explain a unique growing strategy of theirs—acquisition of state-owned enterprises (SOEs). Unlike SBGs that are normally grouped in a coerced, state-led, top-down manner for social welfare purpose, PBGs have evolved in a rather voluntary and bottom up manner, and are expected to follow profit maximizing logics owing to the private nature of their ownership. However, on the contrary to the conventional wisdom, PBGs have been actively engaging in the acquisition of loss making SOEs to expand group boundaries. Some have done extraordinary jobs in revitalizing those poorly performed targets, while others have been accused as “vicious state assets strippers”. The bipolarized acquisition consequences raise the questions: “What were the motives of those private acquirers?” “Were they being driven by substantive rationality, pure economic logics, or other factors?”

Taking an institutional perspective, this study inquires the rationales for PBGs’ SOE acquisition in the context of transition economy. Two models on the antecedents of SOE acquisition will be proposed, building on resource-based view and institutional theories.

2 PBG in China

2.1 Identification of PBG in China

It's not an easy task to identify PBGs in China, given the complex ownership structure as well as the ever changing official definition of private sector owing to gradual property rights reform and on-going SOE restructuring.

2.1.1 Ownership typology of Chinese enterprises

The ownership structure of Chinese enterprises has evolved from sole state ownership to the coexistence of multiple types of ownership during China's gradual transition from a highly centralized economy to a socialist market economy (a partially marketized economy). In general, Chinese enterprises fall into two sectors—the state sector and the non-state sector (Table 1).

Table 1: Ownership typology of Chinese enterprises

State Sector	Non-State Sector			
	Collective		Individual	Others
	Local government involved	Private		
SOE	Urban Collective enterprises & Town and Village Enterprises (TVE)		Individual-employed or self-employed	private enterprises joint-stock companies or Shareholding cooperative enterprises joint ventures (including joint ventures with FDI) Wholly owned foreign enterprises and

Source: Qian and Xu, 1993

The state sector is composed of SOEs with the state remaining the sole or dominant shareholder¹. SOEs were the exclusive economic players in the command economy, and remain their dominant status in strategic industries² in the partially marketized economy. The non-state sector, under the official classification, can be further divided into three categories: "collective ownership", "individual ownership," and "other types of ownership".

Private sector is a sub set of non state sector (the shaded area in Table 1), including individual ownership, private collective ownership, and other types of ownership³. Although data pertaining to private companies vary in different sources, the private business is within the range of domestic private sector, excluding those owned by foreign or overseas Chinese investors (i.e. Hong Kong, Macao, and Taiwan). Thus, the PBGs hereinafter refer to those owned by domestic private shareholders.

¹ By the constitution, the assets of state-owned enterprises (SOEs) are owned by the "whole people." Given the absence of clear identification of owners (property rights), in practice, the ownership rights are exercised by the different levels of government from central to various sub-national, as well as the wide range of authorized asset management agencies representing the state.

Since 1992, thousands of SOEs have been converted to joint-stock companies or limited liability companies (so called SOE "corporatization" or "restructuring") or become joint ventures. Such restructured SOEs were reclassified into the category of "others" and not regarded as "state-owned" anymore, despite the fact that the state may still own the majority interests. To avoid confusion, this paper treats all the companies with state holding major interests as SOEs.

For a detailed description of the evolution of the ownership structure of SOE and related corporate laws, see Schipani and Liu, 2001. For description of exercise of state shareholder rights and management of state assets, see series of works of Mako and Zhang, 2002, 2003.

² Strategic industries refer to industries that are related to national security; industries that are naturally monopolized; industries that supply major products and services for the public; and industries in high and new technology sectors. (Schipani and Liu, 2001)

³ Appendix 1 gives definition and description of various types of companies in the private sector.

2.1.2 Working definition of business groups

Identifying PBGs in China also calls for clear definition of business group. The business group, as a ubiquitous economic phenomenon under various names⁴, has existed for decades. However, the literature has struggled with the precise working definition of a business group (Khanna, 2000). The criteria used to define the boundary of a group and to identify its members vary considerably across countries and studies.

The definitions most frequently cited are the ones appeared in the early works on business groups, each reflecting the unique cognition of the researchers based on confined empirical evidence. Strachan (1976) defines a group as a “long-term association of firms and the men who own and manage them”, and points out that a group cannot be identified purely on the basis of a single metric. There are three characteristics of business groups: 1) the great diversity of constituent enterprises; 2) an ownership coalition of several wealthy businessmen and families; and 3) intra-group ties based on loyalty and trust. Leff (1978:663) refers to a business group as “a multi-company firm which transacts in different markets... under common entrepreneurial and financial control”. Member firms are interrelated with “interpersonal trust, on the basis of a similar personal, ethnic or commercial background”. Williamson (1985) claims that business groups lay between markets

⁴ i.e. the old zaibatsu and their modern successors -- the keiretsu -- in Japan; the chaebol in Korea, the grupos economicos in Latin America, the business houses in India, the "twenty-two families" of Pakistan, guanxi qiye in Taiwan, qiye jituan in China, and so on.

and hierarchies. Granovetter (1995) defines business groups as an intermediate level of binding (integrated neither completely nor barely at all), excluding firms either bounded merely by short-term alliances, or legally consolidated into a single unit. Nonetheless, some marginal cases (i.e. conglomerates except most American ones, holding companies and trusts, and stable cartels) are considered business groups because the constituent firms are tied with stable operational and social links (in addition to financial ones), yet keep their own management and identity to some extent.

Building on prior works, Khanna and Rivkin (2001) define business group as “a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties and are accustomed to taking coordinated action.” Ties can be in multiple forms such as social and economic ties among group affiliates (Khanna, 2000). This is a relatively loose and flexible definition, yet accommodating the wide variety of business groups across different economies. Therefore, this study adopts this working definition for the identification of PBGs in China.

2.1.3 Identification of Chinese PBG

According to the official stipulation by the State Administration for Industry and Commerce in China, four major criteria are required, although not mandatory⁵, for enterprises getting registered as a group—1, Registration capital should be equal or greater than 50 million RMB; 2, The group should have at least five affiliated companies (excluding the parent); 3, The core or parent company can be either a pure holding or business holding, but should have identifiable ownership tie with its affiliates; 4, All the companies in a group should be legally independent entities that are partly or wholly owned by a parent firm and registered as affiliated firms of that parent. In essence, the officially defined Chinese PBGs are more of conglomerates than business groups as the component firms are connected by common financial origins rather than the common social solidarity.

However, the actual boundary of a PBG extends far beyond what its name covers. As the afore cited literature suggests, business groups are featured by social ties and shared normative belief (i.e. mutual trust, loyalty) that goes beyond economic or legal incentives. These two characteristics, with recent interpretations as “particularism” and “substantive rationality” (Biggart & Delbridge, 2004), distinguish business groups from other forms of organizational networks that are based on “universalism” and “instrumental rationality” (ibid), especially the American style conglomerates.

⁵ A report on business groups' development from Sichuan province (2002) revealed that some State-owned business groups did not meet the requirement of registered capital.

It is these social ties that provide the basis for identity in these close-knit associations. Such clearly identifiable axes of social solidarity include kinship / family, ethnicity, region, foreign status, political party, and interlocking directorate (Granovetter, 1995). In China, the predominant social tie for identifying private business groups is kinship⁶, (Hamilton and Biggart 1988; Boisot and Child 1996; Whyte, 1995). In effect, it is believed that the rising of China's private economy is attributed to the enduring social institution of kinship-based obligations and trust (Whyte, 1995) because the family is the dominant organizational form of private economic undertakings, and family and pseudo-family networks are the basic channels of resource mobilization⁷.

Moreover, Chinese private business groups typically realize control through complex pyramidal structure⁸ (a chain of ownership relations) to hide information from outsiders (in particular the supervisory state organs) and to expropriate minority shareholders. Therefore, the de facto boundary of PBG should include the ones established, acquired, or joint-ventured by the dominant shareholding family, even though they are at the very bottom of the pyramid, not being explicit members .

This study adopts kinship as the key criterion for the identification of the ultimate PBG to reflect their real business boundary.

⁶ including immediate family and extended families (known as "lineage")

⁷ See the social roots account by Whyte (1995, 1996)

⁸ There are three major forms of group ownership structure -- cross-ownership ties, a dual-class share structure, and stock pyramids (Bebchuk, Kraakman, and Triantis, 2000).

2.2 Antecedents of PBG in China

2.2.1 *Antecedents of business groups in transition economy*

Antecedents of business groups can be explained from various perspectives, from pure economic logics to sociology theory⁹. This study, however, takes an institutional perspective to reflect the unique transitional settings in which Chinese PBGs are embedded.

⁹ The four major theories are :

1. *Economics/ market failure theory*: Business groups emerge as a response to market failure to substitute for more well developed financial markets and obtain scarce resources (Leff, 1978; Khanna & Palepu, 1997), offer increasing returns to scale due to deficiencies in underdeveloped institutions (Khanna & Palepu, 1997; Davis et al, 2001), economize on transaction costs and respond to agency problem (Caves, 1989); contend more effectively with foreign competition (e.g., Aoki 1982). Overall, social welfare enhancing benefits of groups exceed the costs to groups (Goto, 1982; Khanna & Palepu, 1997, 2000a, b).

2. *Sociology / social structure theory* — Business groups are formed around clearly identifiable social solidarity (Granovetter, 1995), which suggests that business organizations tend to correspond to the social structure in which they operate. Thus the business group organization is typical of an autocratic social structure (Guillén, 2000).

3. *Politics / late development theory/ the state autonomy theory*-- Business groups are related to the level of autonomy of states and to the level of corruption (Guillen, 2000). Khanna and Palepu (2000b) refer to this theory as political economy or the rent-seeking view, that is, business groups seek economic rent through exchanging bribing and lobbying in exchange for favours such as escaping curbing regulations. However, relatively weak evidence has been found in supporting this view (Fisman, 2000, Khanna & Rivkin, 2001; Khanna, 2000; Guillen, 2000).

4. *The resource-based view* (Guillén, 2000) explains the importance of the business group structure in terms of access to resources. It suggests that business groups possess the skills required for repeated entry into new industries. These skills become valuable when government policy makes access to resource difficult, such as when foreign trade and investment policies are asymmetric. Under such circumstances, those possessing the skills required for repeated entry into new industries will employ these valuable assets, leading to the creation of the business group.

Institutions are sets of rules providing the framework of constraints that shape economic, political, and social organizations (North, 1990). They are either formally stipulated and enforced by authorities (i.e. constitutions, laws, and property rights), or informally sanctioned and socially implied by society members (i.e. conventions, norms, and self-imposed codes of conduct which are contingent upon historical path dependency). Once socially defined institutional environments are in place, they are very difficult to dislodge (Fligstein and Freeland, 1995).

“Usually an institutional transition is initiated by a change in formal institutions and then followed by subsequent changes in informal institutions. However, while the initiation of the institutional change can be decided quickly, the process of change is overwhelmingly incremental and consists of marginal adjustments to the rules, norms, and enforcement that constitute the institutional framework” (North, 1990). In particular, the new political, legal, and economic institutions have to be legitimated by new underlying values and norms (Newman, 2000).

Business groups, therefore, can be viewed as the informal institutions arisen to fill in the voids of formal institutions at the institutional transition stage, and in particular responding to imperfections in the capital, labor, and product markets (Khanna & Palepu, 1997; Qian, 2000), as well as “inertia and resistance from the society at large” (Peng, 2003).

2.2.2 The financial markets in transitional China

The transition economy in China, like any emerging economies with less developed and inefficient institutional infrastructures, suffers from three major sources of market failure—information problems, misguided regulations and inefficient judicial systems (Khanna & Palepu, 1997). Albeit similar problems abound in product and labor markets, it is well-conceived that the ineffectiveness of financial markets is the primary cause for the emergence of business groups in capital scarce emerging economies (Leff, 1978; Khanna & Palepu, 1997, 2000a, b; Davis et al, 2001).

Financial markets in China, similar to those in other emerging economies, are featured by high risk, high transaction costs, lack of liquidity, asymmetric information, and agency problems due to inadequate disclosure, inappropriate trading systems, underdeveloped intermediaries and weak corporate governance and control. Moreover, owing to the institutional legacy of central planning system, Chinese financial markets have a tradition of ownership discrimination against private sector (Qian, 1994). The hostility has not yet been diminished (Wang, 2004).

Generally speaking, business groups in a market economy can rely on three major sources of financing: the Equity Market System (EMS), Bank-Led System (BLS), and the Family-Based System (FBS). Under EMS, equity markets are the major source of financing. Companies are disciplined through action of investors in the stock market. An “equity culture” channels equity funds to companies that are then made accountable for those funds by a fairly strong legal and regulatory framework of

shareholder protection and disclosure standards. The US and the United Kingdom clearly fall under EMS. Under BLS, banks play a central role in providing financing and controlling corporate management. Germany, Japan and Korea are examples of BLS. Under FBS, family wealth is the major financing source. Most Asian business groups rely heavily on FBS due to traditional inheritance patterns (Biggart and Hamilton, 1992; Wilkinsion, 1996).

During different stages in the development process, a business group might rely on different system to finance and sustain growth. In the early stages of growth, FBS can contribute sufficient capital and entrepreneurial skills. As the company grows further, it calls upon BLS to provide credit, on the strength of which banks get to participate in some of the corporate governance process. As companies outgrow their banks, they might need to raise equity from the public investors so that they have to adopt aspects of EMS-style governance to gain entry into the capital market.

In China, however, a unique SOE system was designed as the major viable financing source to ensure the maximum mobilization of all kinds of resources to support the development of SOEs. Before the fiscal reform carried out in 1994, the state was the sole resource redistributors. The State Planning Commission (SPC), on the behalf of the state, made all decisions on investment, production and finance. All the long tem investment financing were channeled through state budgets. Up to 90% of the losses made by SOEs were subsidized by the state budgets (Table 1 in Appendix 3).

Even though banking system evolved as the dominant capital provider after the fiscal reform, banks still play subordinate roles in the economy under tight central control. Following the plans from SPC, banks extend policy lending rather than profit lending. The dominant majority (more than 80%) of bank loans are granted to state sector. The emergence of EMS during the transition stage was initiated to help restructuring insolvent SOEs. Providing less than 10% of total capital, EMS still plays a marginal role in financial markets (Table 2 in Appendix 3).

Chinese PBGs, therefore, have relied heavily on FBS. Before the fiscal reform, the sole sources of finance available for private firms had been the self-funding type and illicit channels such as rural and urban credit cooperatives under the name of “popular credit market” (*minjian jiedai shichang*) that offers tontines and loans from private individuals and families (Zhu and Hu, 1997; Huchet, 1999). After the reform, FDI has served as a major alternative source of capital for the expanding private enterprises (Green, 2004). However, private sector has to compete head-to-head with the state sector in attracting foreign investors. Moreover, the dominant majority of foreign capital inflows have been concentrated in the rich south-east coastal regions where private business has prospered for years. The private enterprises that desperate for foreign resources are actually those located in the poor inner land, unfortunately, having not yet benefited from foreign capital.

Although the government removed discriminatory financing as a public policy¹⁰, private enterprises still suffer from general rejection of bank loans. Historically, the amount of credits granted to private sector by the four major state owned commercial banks (SOCB)¹¹ has never exceeded 5% of the total amount of credits handed out¹². At present, the ratio is lower than 7% (Wang, 2004). Banks refrain from granting loans because they suspect the private firms' ability to provide good quality collateral.

The establishment of the stock market, which supposedly might open an avenue for speedy financing, however, with the primary objective to finance SOEs, did not contribute too much for the growing private sector. Moreover, equity markets are rather ineffective due to the lack of a fairly strong legal and regulatory framework of shareholder protection and disclosure standards, and the weak function of banks (Qian, 1994).

¹⁰ Until 1999, the economic importance of private sector was recognized by the constitution, and the government announced to lift all forms of restriction and discrimination against the private sector. Appendix 2 -- Policy Milestones of Private Sector Development

¹¹ The banking system currently consists of the four State Owned Commercial Banks, three state-owned policy banks (State Development Bank, Export and Import Bank, and Agricultural Development Bank), ten joint stock commercial banks (other commercial banks), 111 urban credit cooperatives (known as city commercial banks), and 181 operations offices of foreign banks.

¹² Appendix 3 -- Historical Overview of the bank loans granted to private sector

2.2.3 Grouping and growing trajectory of PBG in China

Suffering from insufficient financing, short of managerial skills¹³, and being barely protected by the legal and regulatory system¹⁴; Chinese private enterprises are usually small in size, having short life cycle, engaging in relatively focused production, and surviving by cost efficiency. In order to survive and thrive, these small-scaled private firms started to form groups, believing that the establishment of internal market enables them accumulating and mobilizing scarce resources in a more cost effective manner.

Three major grouping methods of PBG in China

Private firms usually follow three grouping methods as following:

- 1) *Spin-off*: A group is formed when the core or parent private firm establishes wholly owned subsidiaries. This grouping method is also referred to as “endogenous growth strategy” (Goodman, 1999), meaning relying on self funding

¹³ Most private enterprises are owned and controlled by a family or a single businessman. As a result, nearly all key management positions are occupied by family members or relatives. According to a 1999 study of 1,900 medium and large enterprises by the China Academy of Social Sciences, 48% of the relatives of entrepreneurs were employed in managing private enterprises, including 51% of the spouses and 20% of the adult children. Another study by All China Federation of Industry and Commerce (ACFIC) found that 98% of enterprises were family managed. This practice not only means that the best managers are not employed, but undermines motivation among company employees. This results in weak corporate governance and impedes private firms' further growth.

¹⁴ Reform of the legal system has focused on the “operation” of a market economy rather than on laws promoting the private sector. The principle of protecting private property has yet to be enshrined in the Constitution or other basic laws. Also the private sector have been facing the difficulties in accessing promulgated laws and regulations in published forms, and bearing with policy bias and discrimination, as well as the weak and inconsistent enforcement of laws and regulations.

and resource accumulating. This was the major grouping mode in the early stage of economic reform when financial markets barely existed. Groups formed in this manner rely exclusively on family wealth, therefore, are firmly bonded with trust and loyalty. The chief advantage of this grouping method is that the core company ensures full control over the affiliates. However, the limitations associated with endogenous growth, such as resource homogeneity and over diversification, will impede group development in the long run.

- 2) *Joint venture*: A group can also expand its boundary through joint venture with FDI. This is referred to as “exogenous growth strategy” (Goodman, 1999)—building up resources and business strategies with the help of foreigners or overseas Chinese. In this way, private firms have to exchange partial control over the property for the complementary resources brought by the foreign partners.
- 3) *SOE acquisition*: Exogenous growth can also be achieved by grouping via SOE acquisition, which means a private firm acquiring controlling interest of an SOE through a payment of cash or stocks, or some combination of the two.

Ostensibly, SOE acquisition appears to be the least favourable option for grouping. First of all, what left for privatization were small and medium-sized SOEs being described as perpetual loss makers. This was the objective of the reform strategy of

“grasp the large and let go the small”¹⁵, meaning consolidating the industry to form large SBG and privatizing those ill-performed SMEs¹⁶. The strategy resulted in 88,000 decrease in total SOEs from 1997 to 2001, among which 84,000 were loss-making SOEs. The worst performers were the listed SMEs. Most listed SMEs in China are spin-offs from large SOEs with parent groups serving as their largest shareholders. Because the boundaries between listed firms and parent groups are “relatively new and often artificial” (Tenev and Zhang, 2002:75) and there is an implicit assumption that “listed companies will and should help a parent company if the need arises” (Tenev et al., 2002:101), many listed firms were treated as cash cows and left heavily indebted.

Moreover, the acquisition was subject to strict scrutiny of the State Asset Management Committee (ASMC). The acquiring private company was required not only to have sufficient capital, but also to submit an action plan on restructuring or refinancing the focal SOE. Only those who demonstrated capability and willingness to revitalize the ill-performed SOEs were qualified for acquisition. The objective of such stringent requirements was to safeguard state assets, which are always considered the highest

¹⁵ The strategy was adopted at the Third Plenary Session of the 14th Central Committee in 1995.

¹⁶ According to the Ministry of Finance, among 238,000 non-commercial SOEs in 1998, there were only 9,357 large SOEs, and 96% of total SOEs were medium and small-sized SOEs (with registered capital less than 50 million RMB), which in many cases engaged in low-level repetitive production and were not competitive. In early 1999, "about 49% of Chinese large and medium-sized SOEs are suffering the loss." Sector data show that overall liabilities/assets ratio of 0.61 for China's SOEs at end-2001. Aggregate data for 1997-2001 show that locally-administered SOEs remained more highly indebted, with liabilities/assets ratio of 0.69 versus 0.56 for centrally-administered SOEs. (Mako and Zhang, 2004)

form of public property, and thus should be protected from private enterprises' value capturing behaviour.

The harsh prerequisites, however, did not discourage private buyers. SOE acquisition movement started from 1995 had been quite an eye catching phenomenon in capital markets. A recent survey¹⁷ (2003) of 3258 Chinese private companies shows that 8% of the sample had participated in helping restructuring loss making SOEs (including taking over bankrupted SMEs or acquiring partial SOE shares) and 13.9% of them were in the process of acquiring negotiation. Also worth noting is that more than one third of top 500 largest incumbent PBGs have been actively engaged in such SOE acquisition and some have reportedly attributed their leading positions to their acquisition experiences at enfant stage¹⁸.

Even though private acquirers have often been accused as state assets strippers owing to the value capturing behaviour of some private acquirers, private sector as a whole has done extraordinary jobs in revitalizing the SOEs. Many private acquirers have turned around the profit losing targets by injecting capitals, repaying the historical unperformed debts, and accommodating a large amount of unemployment. According to the same survey, 90.6% of the private firms absorbed SOE layoffs, which

¹⁷ the Fifth National Sample Survey on Private Enterprises conducted by the All China Federation of Industry and Commerce (ACFIC) and the All China Society of Private Economy Research (ACSPER) (available at <http://www.chinapec.com.cn/websites/yanjiucg/sampleddata/index.asp>)

¹⁸ In a series of meetings held by ACFIC with the objective to encourage private enterprises participate SOE restructuring, 23 renowned PBGs were invited to share their successful experiences on restructuring loss making SOEs. They were promoted as role models for the private sector to follow.

accounted for an average of 20% of the total employment in each private firm. In this sense, privatization was considered one of the major causes for the overall improvement of the SOEs' profitability¹⁹ (Mako & Zhang, 2004).

Unlike the majority of SBG that were grouped in a coerced, state-led, top-down manner²⁰ for social welfare purpose, PBG's grouping is in a rather voluntary and bottom up manner, and is expected to follow profit maximizing logics owing to the private nature of its ownership. However, given the resources constraints the private sector was facing, the SOE acquisitions seemed to be driven by substantive rationality rather than economic rationality. Therefore, it calls for inquiry into the real motives of the private acquirers.

¹⁹ SOE profitability has increased since 1998. Net profitability has roughly doubled to 3.7% and the proportion of loss-making SOEs has been reduced from about two-thirds to about half. (Mako and Zhang, 2004)

²⁰ The State Council has, since 1994, approved the creation of 156 supra large state owned business groups in the hope for improving SOE efficiency.

3 SOE acquisition theories

3.1 Resource-based view

The Resource-based View (RBV) offers a fundamental, institutional context-free rationale for acquisition at a dyadic level, that is, private firms acquire valuable resources to reach the goal of sustainable growth.

3.1.1 *Type of resources*

From the RBV, a firm can be considered as a bundle of resources that enable a firm to conceive and implement its strategies efficiently and effectively (Penrose, 1959; Daft, 1983; Dierickx and Cool, 1989; Barney, 1991). Acquisition, therefore, can be regarded as acquirers purchasing targets' resources in bundles.

Building on Barney's (1991, 1997) often-cited four category typology--financial capital, physical capital, human capital and organizational capital; resources can be classified in many ways²¹. However, the essence of the resource-based view is not simply the type and amount of resources at one's disposal. More important is the extent to which the resources or the combination of resources can bring sustainable competitive advantage to the beholder. Such resources must be valuable, rare and/or imperfectly imitable by direct duplication or substitution (Barney, 1991; 1997; Teece *et al.*, 1997). Based on the notion of barriers to imitability, resources can be classified

²¹ Chatterjee and Wernerfelt 1991 identified physical resources vs. intangible assets; Grant (1998) categorized resources as tangible, intangible and human resources. Galunic and Rodan 1998) specified tangible vs. knowledge-based resources.

as property-based resources, knowledge-based resources (Miller and Shamsie, 1996), and social capital (Barney, 1991, 1997; Greene, Brush and Hart, 1999; *cf.* Greene and Brown 1997; Honig and Davidsson 2000; Nahapiet and Ghosal 1998; Yli-Renko *et al.* 1999).

Property-based resources (PBR) refer to tangible or physical properties such as plants, buildings, land, equipments and similar resources for manufacturing, marketing, and servicing. Knowledge based resources (KBR), on the contrary, refer to the intangible know-how, capability and skills that span production, management and marketing. Social capital (SC) is relational resources embedded in personal or organizational ties.

PBR are often physically describable, while KBR and SC are typically tacit and unobservable, developed over a long period of time through complex social interactions within organizations, and embedded within organizations, groups of individuals, and systems. While PBR are tradable and obtainable on the market and can be easily duplicated, KBR and SC defy such easy acquisitions or replication due to path-dependence, causal ambiguity, and social complexity (Barney, 1991, 1997; Greene, Brush and Hart, 1999; *cf.* Greene and Brown 1997). Being equally valuable, KBR and SC resources lead to a more sustainable competitive advantage than PBR does (Barney, 1991, 1997; Greene and Brown 1997).

3.1.2 Organizational growth through resources acquisition

From acquirers' perspective, acquisition enables firms to trade otherwise non-marketable resources and provides an opportunity to revitalize acquirers and enhance their sustainability. Sustainability can be achieved by either value creation or value capture.

The dominant theory of value creation suggests that new value is to be created by the reallocation of productive assets (Salter and Weinhold, 1979) through three major channels—domain strengthening, domain extending, or domain exploring (Haspeslaugh and Jemison, 1991). In a domain strengthening acquisition, firms acquire other firms in related businesses, thereby taking advantage of resource synergies between the acquiring and the target firm. For instance, the SOE possesses the resources that are well aligned with the private firm's current resource deposition or strategic direction. In a domain extending or exploring acquisition, the acquiring firm seeks to enhance its capabilities with complementing resources endowed in the target firm or change the product-market in which the target firms' existing capabilities are applied. Resource complementarities can also be represented as the SOE possessing the resources that the private firm lacks such as accessibility to wide varieties of financing and networking with the government. Acquisition based on resource synergy are often symmetric; while the acquisition based on resource complementarities are often asymmetric, involving firms of different industry, size, and strategies.

An acquisition can also be motivated by value capture, which involves one-time transactions to acquire undervalued assets, tax benefits, increase debt and strip assets. The seller, future owners, the government, and existing creditors are the most common sources of such captured value. (Haspeslaugh and Jemison, 1991)

Regardless which method the private acquirers taking to capitalize the resources acquired, the underlying motive is to acquire valuable resources endowed in the target SOE to sustain the acquirer's growth. Therefore, it is rational to infer that SOE acquisition is primarily driven by target firm's resource endowment. The better resources (including PBR, KBR and SC) an SOE possesses, the more favourable it appeals to the private acquirer.

3.2 Institutional theories

Even though at a general level, RBV can be used to rationalize any acquisition, it does not answer the question why overall poorly-endowed SOEs were hot targets. Incorporating the unique institutional embeddings of China, institutional theories offer an alternative explanation that social capital inherited in SOE plays a decisive role in affecting private acquirers' decision.

3.2.1 Political institutions

3.2.1.1 Business groups and the state

As mentioned in the section of “Antecedents of Business Groups in Transition Economy”, business groups are identified as the informal institutions responding to the market imperfections by establishing internal markets to accumulate and exchange resources among group members in a more efficient manner (Qian, 2000). Governments, as the best formal institutions, respond to the market imperfections by establishing the parameters of legitimate actions, providing the institutional mold within which emergent business norms and networks operate (Nee, 1998), and functioning as third party to coerce the enforcement of agreements between transacting parties (North, 1990).

It is empirically proven that the general orientation of the state toward economic development and business help shape the structure and developmental trajectory of

business groups (Hamilton and Biggart, 1988). The state can discourage routinized cooperation among firms by being a regulator to safeguard perfect competition (i.e. US). The state may facilitate large-scaled inter-market business groups building by acting as a coordinator and mediator (i.e. Japan). The state, being a leading economic actor, can lead to a highly centralized, top-down group hierarchy (i.e. Korea, China).

Also, as theories have been put forth, the state can have double-edged sword effects on business groups' performance level in terms of the standard criterion of value maximization (Qian, 1996). On the one hand, the state can extend "grabbing hand" to deteriorate firm performance by imposing multiple political and social objectives²² to maintain the overall social stability in the transition stage. On the other hand, the state can extend "helping hand" to improve firm performance by helping secure scarce resources and mitigate agency problems in firms with poor corporate governance.

²² Such objectives include the political objective (i.e. respect of the controlling party's goals and political patronage), economic nationalism (i.e. defending national industry, the advancement of the cause of "national technological champions" at the expense of technological and economic efficiency, or protecting other SOEs' markets), and social welfare increase (like minimizing layoffs, the growth in the work unit, and the preservation for wage-earners of the advantages inherited from the socialist period).

3.2.1.2 Three sources of political influence on Chinese enterprises

As China's economic reform was undertaken under the central leadership of the Chinese Communist Party (CCP), the state still retains the absolute redistributive power over various resources (Nee, 1998). All types of enterprises in terms of ownership are subject to the influence of three sources of political control— local party committees, local governments and line ministries, and state shareholders (Chang & Wong, 2004). They have an influence on not only the SOEs, but also the listed firms, which are propagated as role models for China's modern firm system and are supposed to be subject to less political control than traditional SOEs.

Local party committees had been involved in all major corporate decisions, particularly personnel decisions, since the early 1950s²³ (Qian, 1999; Wong, Opper and Hu, 2002), and are still allowed to maintain their organizational presence in shareholding firms by the Company Law²⁴ (Tenev et al., 2002).

²³ Party control over personnel has remained basically unchanged for decades. The Party has exercised control over the selection and dismissal of SOE managers through its Organization Departments at different levels. For example, the Central Party Organization Department has the authority over appointments of the top managers of very large SOEs (minister or deputy minister level), as does the Provincial (or Municipality) Party Organization Department for most large and medium-sized SOEs (bureau level). This authority applies to joint-stock companies as long as the state has the majority share, even if they are listed on the stock market or are located in the special economic zones. The appointment and dismissal process represents the most important channel of political influence over enterprises by the Party apparatus.

²⁴ The Company Law promulgated in 1993 preserves local party committees' influence over firms' decision-making. Art. 17 states that "the activities of the local party committees of the CCP in a firm shall be carried out in accordance with the constitution of the CCP." Art. 31, section 7 of the constitution of the CCP, however, explicitly assigns local party committees a supervisory and monitoring role in shareholding firms by reserving the right to "supervise party cadres and any other personnel."

Government and ministries also have maintained a certain degree of authority over firms. Although China's central leadership has accelerated the process of withdrawing governmental influences from the enterprises since the economic reform in 1994, numerous case studies have shown that government administration and line ministries have not completely cut ties with firms (Hu, 2001). According to CSRC, about 56 percent of listed firms still maintain formal ties with local governments and ministries, with the latter acting as the firms' administrative superiors. Local governments at all levels are also entitled the right to formulate preferential policies for the enterprises in their jurisdictions. Such preferential treatments include tax refunds, preferential permission for company listings in the stock market, relocation of excess employees, and access to capital through loan provisions (China Statistical Yearbook, 1999). All these are imperative for the development of private enterprises²⁵.

State shareholding also enables the government to remain involved in, and often even to dominate firms' decision-making. Since 1992, thousands of SOE have been converted to joint-stock companies or limited liability companies under the strategy of SOE "corporatization" or "restructuring". Such restructured SOEs were reclassified into the category of "non state sector" and not regarded as "state-owned" anymore; however the state still owns the majority interests. As state ownership is considered

²⁵ Private businesses rank tax and non-tax financial burdens as one of the main obstacles to further development. Although by international standards the tax level for private enterprises in the PRC is low, arbitrary taxes burden (i.e. fees, arbitrary fines, forced investments, forced donations) was nearly twice the amount of paid tax in 1998 (Wang, 2004).

the highest form of public ownership²⁶ and the goal of socialism, to preserve the economy's socialist structure, SOEs have to issue shares to the government or solely government-owned enterprises. The proportion is substantial, representing over 30% of the total shares on average. By 1999, 42 percent of the largest shareholders in China's listed firms were state holders, and 57 percent were legal person share holders, the dominant majority of whom were in fact SOEs rather than private investors²⁷. Studies of Liu and Sun (2003) also showed that by the end of 2001, approximately 84% of a total of 1160 listed firms are ultimately controlled by the state, via either direct control of the government departments or agencies; or the indirect control of SOEs. The average shares held by the largest shareholder was as high as 46.5%.

Even the private firms and foreign joint ventures are not free of the political control. The only two associations representing private sector, one for individual businesses and the other for private enterprises, are represented nationally by the very official All Federation of Industry and Commerce which is very largely under the control of the CCP (Bruun, 1993).

²⁶ The state ownership is superior to collective ownership, which is superior again to individual ownership.

²⁷ CSRC (2003) reveals that, at the end of 1999, more than 90 percent of the largest legal person shareholders were controlled by the state.

3.2.2 *Transition economy theories*

Given the fact that the state remains the major player in China's quasi-market economy, transition economy theories assert that tight cooperation between private sector and the state is the optimal solution for both parties.

Rational choice approach based on transaction cost theory (Nee, 1989, 1992, 1996) argues that macro changes are the product of successive and incremental deals being struck by actors to achieve their goals at the lowest costs, and actors are differentially rewarded and selected by their environments. Even though in transition economy the power over economic resources has gradually transited from "redistributors" (the state) to "direct producers" (private entrepreneurs), the state still retains the absolute redistributive power over various resources. Moreover, China's privatization can be perceived as the clarification and reassignment of ownership rights among multiple economic actors (i.e. government agencies, public or private corporations, households, or individuals). The property rights reform featured by informal mechanisms of negotiation and compromise left significant ownership control in the hands of governmental jurisdictions and agencies²⁸ (Walder, 1994). Thus, the mixed form of property characterized by the combination of state property and private ownership evolved as an efficient solution to an intermediate stage where the old system is no

²⁸ Qian (1996) contributed a full description of the process of allocation of control rights. Past reforms of state-owned enterprises in China have, in theory, delegated many *effective control rights* to agents (i.e., managers) to improve the efficiency and performance of their respective organizations. The common features of control rights over assets include the right to use state assets and to distribute and enjoy incomes generated by these assets. However, the *ultimate control rights*, such as the selection and dismissal of top managers, approval of large investment projects and veto of large asset disposals, still remain the prerogative of the government.

longer viable, but a fully institutionalized market economy is not possible.

Also, the “clientelist capitalism” or the market-bureaucracy interaction approach (Wank et al, 1995, 1996, 1999; Bruun, 1993, 1995; Pearson, 1997) claims a symbiotic (interdependent), clientelist tie between China’s local state officials and private entrepreneurs. Private entrepreneurs rely on the economic resources and business opportunities controlled by officials to initiate and develop their businesses. By the same token, officials also rely on private entrepreneurs for developing local economies (increasing employments and local income), as well as reaping private gains²⁹.

3.2.3 Cultural institutions

The unique institutional legacy of China also helps to explain the close ties between private sector and the state. Chinese private business’ relation to officialdom is featured by Chinese businessmen’s endless efforts to establish and reinforce the personal ties with the political circle. This is due to two institutional legacy of China—first, Chinese government’s tradition of omission and suppression of private business; and second, the cultural institution of Confucian ethic that virtue is associated with agricultural work and superiority is associated with education, thus industry and commerce are of the last important (Redding, 1993).

²⁹ In spite of government efforts, corruption remains a serious problem. According to one study, during the latter half of the 1990s corruption resulted in economic losses ranging from 13.2% to 16.8% of GDP (Wong et al., 2002).

Even though private sector has been officially recognized as an important complimentary to the economy since 1997, it still plays a marginal role in the entire economy and barely protected by legislation and legal system. Chinese private businessmen bear witness to the need to have the political power on side for their business success and growth (Huchet, 1999). Building and maintaining the ties with officials are unanimously perceived as the primary operational principles of private undertakings.

Acquisition of ill performed SOE provides a viable channel to access to the social capital that is not available by other grouping means. After the decentralization strategy being carried out in the early 90s, 90% of SOEs are under direct control of local government, meaning, local government assumes full responsibility for the performance of the SOEs. Therefore, the poorly performed SOE were not only heavy burdens to the local government's budgets, but also casting direct threats to the local officials' political future. By repaying debts and accommodating unemployment, private firms who acquire such SOE actually lift the burden from the government's shoulder, and thus will be rewarded in many ways such as being granted preferential policies, more business opportunities, treated by less strict standards, etc. SOE acquisition, thus, enables PBGs to gain access to resource endowments available from local governments in addition to the SOE's resource endowments. As a result, they have the potential to accumulate substantial slack resources. Organization theory suggests that a central purpose of organizational slack is to allow firms to forgo

short-term gains in favor of long-term outcomes (Cyert & March, 1963), thus facilitate the sustainability of private business groups.

In addition to the need to sustain business growth, the private businessmen's aspire to the political circle from which they had long been excluded (Redding, 1993) also leads to tight government-private sector connection. Even though the majority of private entrepreneurs are superior in terms of economic status, the political and social minority status of private sector has never been changed. The five surveys conducted in the past 10 years by ACFIC revealed the consistent low self perception of the private entrepreneurs (last two columns of the Table 2). The salient disparity between the economic and social resource possession made private businessmen willingly to trade some of their economic resources for social capital, in particular social recognition and respectability. Acquiring bankrupted SOEs may offer such opportunity as on one hand, private entrepreneurs can establish their social image and win respect by reallocating the layoffs from SOEs and paying off the debts; on the other hand, they can possibly gain entry to the political circle because of the contribution they made to the community. Also, the personal ties bonded with the government officials in the process of acquisition may facilitate the entry. In effect, in recent years, quite a number of private entrepreneurs have followed this strategy and started their political life. As the same survey showed, 30.2% of private entrepreneurs were CCP members³⁰, doubled the number in 10 years.

³⁰ On 1 July 2001, at ceremonies marking the 80th anniversary of the founding of the CCP, President Jiang Zemin announced that for the first time private entrepreneurs could become party members. One

Table 2: Social characteristics of Chinese private entrepreneurs

	Sample size	CCP member %	Self perception (average score 1- 10)		
			Economic status	Social status	Political Involvement
1993	1394	13.1	4.5	4.0	4.6
1995	1461	17.1	4.5	4.2	5.1
1997	1918	18.1	4.7	4.6	5.7
2000	3041	19.9	4.7	4.3	5.0
2002	3258	30.2	4.7	4.1	5.0

Source: Compiled from the results from the Fifth National Sample Survey on Private Enterprises conducted by the China Private Enterprise Study Group and the China Federation on the Private Economy (Beijing Review 2003).

Given the unique social and cultural embeddings in transitional China, SOE's social capital endowment, political or governmental networking in particular, is imperative to not only the sustainability of the private business, but also the entrepreneurs' goal to enter the elite circle. SOE acquisition, therefore, was not purely based on the property or knowledge-based resources, but rather on the political capital inherited in both the organizational and the personal networks. Private firms can literally take the chance of SOE acquisition to seek invaluable potential benefits brought by the political capital for both the business and the entrepreneurs themselves.

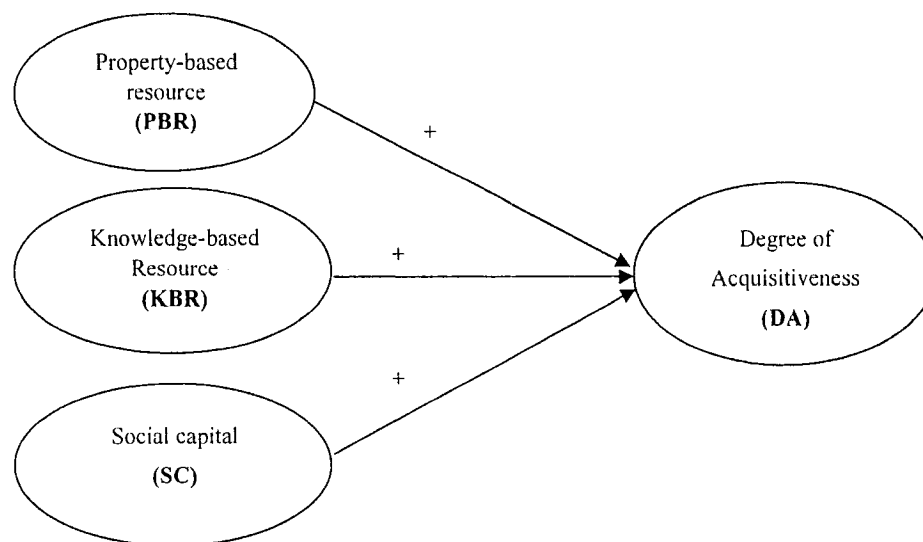
of the principles of Jiang's "Three Represents Theory" provides that the CCP must represent all of the PRC's advanced productive forces (including private sector), thus allowing businessmen join the CCP.

4 Conceptual framework and Hypotheses

Based on the previous accounts, two conceptual frameworks (models) are proposed to reflect complex motives of the SOE acquisition. Model 1 draws on the theory of RBV to stress the economic logics of SOE acquisition, whereas Model 2 is built on institutional theories to emphasize the social capital rationality.

4.1 Model 1 and hypotheses

Figure 1: Antecedents of SOE acquisition -- Model 1



Building on Resource-based View, Model 1 proposed that SOE acquisition is driven by the overall endowment in an SOE's property-based resources, knowledge-based resources, and social capital (Figure 1). Given the fact that all three types of organizational resources—PBR, KBR, and SC—are intertwined with each other, it is rational to hypothesize that the more valuable resources an SOE endows, the more

attractive the said SOE will be as an acquisition target. In transaction, the attractiveness is represented by the degree of acquisitiveness, which can be reflected as the amount of capital the private firm would like to invest for acquisition, or the percentage of control rights private firms are willing to obtain. Therefore, the three dimensions of the resources have additive effects on private firm's degree of acquisitiveness. Better resources endowment is expected to be associated with higher degree of acquisitiveness.

Each single resource endowment is expected to be positively related to the private firm's degree of acquisitiveness:

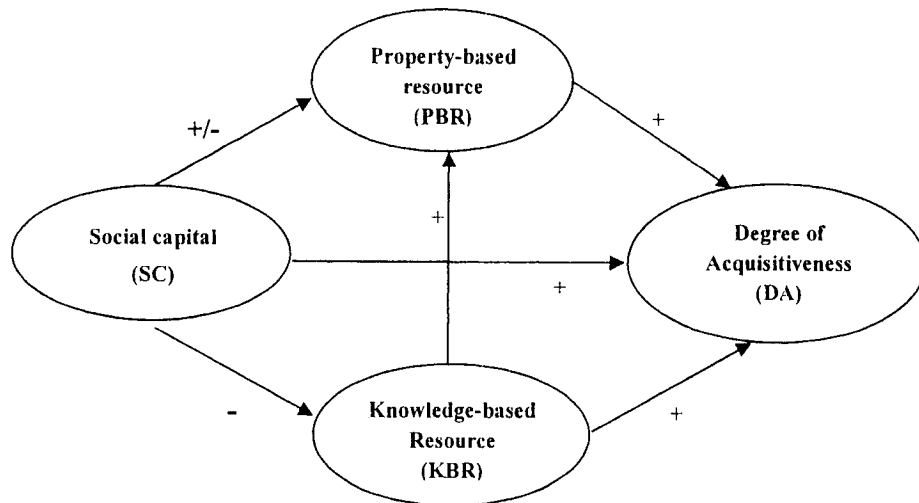
H1-1 -- Property-based resources of the target SOE are positively related to the private firm's degree of acquisitiveness;

H1-2 -- Knowledge-based resources of the target SOE are positively related to the private firm's degree of acquisitiveness;

H1-3 -- Social capital resources of the target SOE are positively related to the private firm's degree of acquisitiveness.

4.2 Model 2 and hypotheses

Figure 2: Antecedents of SOE acquisition -- Model 2



Model 2 (Figure 2) proposes that the unique social and cultural embeddings in transitional China determine that SOE's social capital endowment, reflected as political or governmental networking, is the primary driving force for private firm's acquisition behavior. SC has not only direct impact on private firm's degree of acquisitiveness, but also indirect effects, mediating via PBR and KBR endowment. In this regard, Model 2 is an elaboration of Model 1, while seeking for compounded effects of social capital.

H2-1: Social capital resources of the target SOE have direct, positive impacts on the degree of acquisitiveness of the private firm. Moreover, among the three variables (SC, PBR and KBR), social capital is expected to exert strongest impact on degree of acquisitiveness by demonstrating highest correlation efficiency.

However, as depicted in prior section, an SOE's political heritage can literally affect its ability to utilize the PBR and KBR within the organization. As predicted by double-edged sword effects of the government, an SOE subject to strong state interference may either deploy resources efficiently or waste the resources, which might indirectly affect private acquires' decision making. Holding the level of SC endowment constant, an SOE with better PBR or KBR is expected to be more attractive than that with worse PBR or KBR. Therefore, in addition to its direct effects on the degree of acquisitiveness, social capital can indirectly influence the degree of acquisitiveness through PBR and KBR, which thus serve as mediating variables. The ultimate degree of acquisitiveness is then determined by the compounded effects of social capital, by its own or through PBR and KBR.

H2-2: SC has either positive or negative effects on PBR ($SC \rightarrow PBR$), then will be positively or negatively associated with DA ($SC \rightarrow PBR \rightarrow DA$), if Hypothesis H1-1 holds true (PBR is expected to have positive relation to DA).

As it is well perceived that government interference on management process has negative impacts on managerial ability³¹, it is then hypothesized that

³¹ It has been well documented that government interference (i.e. Steinfeld, 1998; Wong, 2002; Xu & Wang, 1997). In his study of the State-owned enterprises in the steel industry, Steinfeld (1998) observed that, despite closer attention being paid to financial profitability, the managerial behaviour of the firms under study basically follows in the tradition of the major socialist firms. Managers are still juggling with the multiple and contradictory objectives imposed by the state. Also, their career is first and foremost political, since being part of a company's management is often a springboard for moving up the hierarchy of the CCP and the State. These contradictory objectives encourage waste and other misuses of funds or deplete the State's resources, either to the benefit of wage-earners.

H2-3: SC has negative impacts on KBR ($SC \rightarrow KBR$), then will be negatively associated with DA ($SC \rightarrow KBR \rightarrow DA$), if Hypothesis H1-2 holds true (KBR is expected to have positive relation to DA).

According to RBV, knowledge and capability related resources may amplify the value of others (Autio and Parhakangas 1999), thus

H2-4: KBR is expected to positively related to PBR ($KBR \rightarrow PBR$), then SC has negative impacts on DA ($SC \rightarrow KBR \rightarrow PBR \rightarrow DA$), if H1-1 holds true (PBR is expected to have positive relation to DA).

All the hypothesized relationships in both models are summarized in Table 3:

Table 3: Summary of hypothesized relations in Model 1 & 2

Hypothesized relationship	
Model 1	
H1-1	$PBR \rightarrow DA$ (+)
H1-2	$KBR \rightarrow DA$ (+)
H1-3	$SC \rightarrow DA$ (+)
Model 2	
H2-1	$SC \rightarrow DA$ (+)
H2-2a	$SC \rightarrow PBR$ (+/-)
H2-2b	$PBR \rightarrow DA$ (+)
H2-3a	$SC \rightarrow KBR$ (-)
H2-3b	$KBR \rightarrow DA$ (+)
H2-4	$KBR \rightarrow PBR$ (+)

5 Methodology

5.1 Empirical research on SOE acquisition

5.1.1 *Brief review and critique*

Even though SOE acquisition by private sector has been attention-grabbing, only a few empirical studies address this topic (Jiang et al., 2002; Li et al., 2002; Wang, Xu & Zhu, 2004; Xu, 2004; Feng & Wu, 2001; Zhu & Wang, 2002), while all focusing exclusively on the last step of acquisition process—the consequence of SOE acquisition, especially the performance of the acquired SOEs. With an objective to see whether the change of ownership type (from the state to private owners) leading to the change of SOE performance, these studies compared performance data (financial, operational, and market) of the target SOE's before and after acquisition. Owing to the inconsistent measurement of performance, the results were unsurprisingly inconclusive. Despite inconsistent findings, the prevailing argument related to SOE acquisition motive is value capturing— private firms stripping state assets for self expansion or for private entrepreneurs' personal wealth augmentation. Such accusation can plausibly be attributed to the anecdotal evidence of some well-known illicit business conducts of some private entrepreneurs³², the value capturing

³² The typical illegal or immoral practices include committing fraud in their disclosure of information, providing unreliable or unaudited financial data on their performance, manipulating profits or losses, and having ambiguous claims on assets that might be used as collateral for loans. There have been dozens of well-known private entrepreneurs arrested and sentenced to imprisonment in recent years, which resulted in widespread doubt over the credibility of the private sector. For example, in the case against Yinguangxia, a CSRC investigation found that it had falsely disclosed more than CNY540 million (\$65.24 million) in profits for prior years to qualify for acquiring when in fact the company had

behaviours of some private acquirers”, as well as the “state asset safeguard” perspective of some researchers.

At a general level, an acquisition process entails the phases of acquisition justification³⁴, acquisition transaction, and acquisition implementation (Haspeslaugh and Jemison, 1991). Acquisition motives are actually involved in the first stage of acquisition justification, while firm performance is part of the last stage. It is inappropriate to evaluate acquisition motives solely by the ex-post evidence of the target firm’s performance because there are so many factors influencing the whole acquisition process, especially the post acquisition integration, not to mention that the ultimate performance is contingent upon numerous unpredictable elements. Therefore, this paper will take a fresh stand point to test the acquisition motives based on ex ante firm level resource endowment of the target SOEs.

suffered huge losses. After listing, the company used more than 80% of the proceeds raised to pay off its debts rather than in accordance with the stated purpose as disclosed in the prospectus.

³³ Documented abuses by private shareholders include issuing shares for speedy financing, obtaining soft loans from listed firms; using listed firms as guarantors to borrow money from banks; and buying and selling goods, services, and assets at unfair prices (Tenev et al., 2002)

³⁴ Acquisition justification phase includes the motives, search, selection and valuation of acquisition targets.

5.1.2 Unit and level of analysis

It is worth noting that all the previous studies treated the private acquirers as autonomous, non-affiliated firms and analyzed SOE acquisition at a dyadic level, overlooking the organizational networks in which the private acquirers were embedded. However, it is imperative to note that using different unit and level of analysis can lead to different interpretation of the empirical findings.

As described in the section of “Identification of PBG in China”, Chinese PBGs are bonded primarily by kinship and structure themselves as pyramids. Therefore, many group affiliated private firms may not be readily identifiable as they are at the very bottom of the pyramidal structure. Also, as the statistics show, the majority of the private acquirers are found to have group background, explicit or implicit. Therefore, conclusions based on findings at firm level can be seriously biased by overlooking the broader group context.

The conclusion that the performance of SOE being acquired deteriorated after acquisition may not be held if the level of analysis is moved up to the group level. A member firm’s performance can not be solely evaluated by its financial data because the group performance is not a simple sum of all its affiliates’ financial statements. The internal market of finance, labor, and managerial sources is the *raison d’être* of business group to fill the voids of the underdeveloped institutions. Therefore, poor performance of a certain affiliate firm can be justified if its resource has been

efficiently shared with other member firms to reach the overall improvement of the group.

By the same token, acquisition motives should also be contingent upon the network the individual private acquirer is embedded in. This, again, calls for careful identification of the ultimate family the individual acquiring firm belongs to, and subject interpretation to the group level findings.

5.2 Sample and data collection

The sample comprises 49 SOE acquisition cases taken place at China's two security exchanges—Shenzhen and Shanghai Exchange, from January 1st, 1997 to December 31st, 2000.

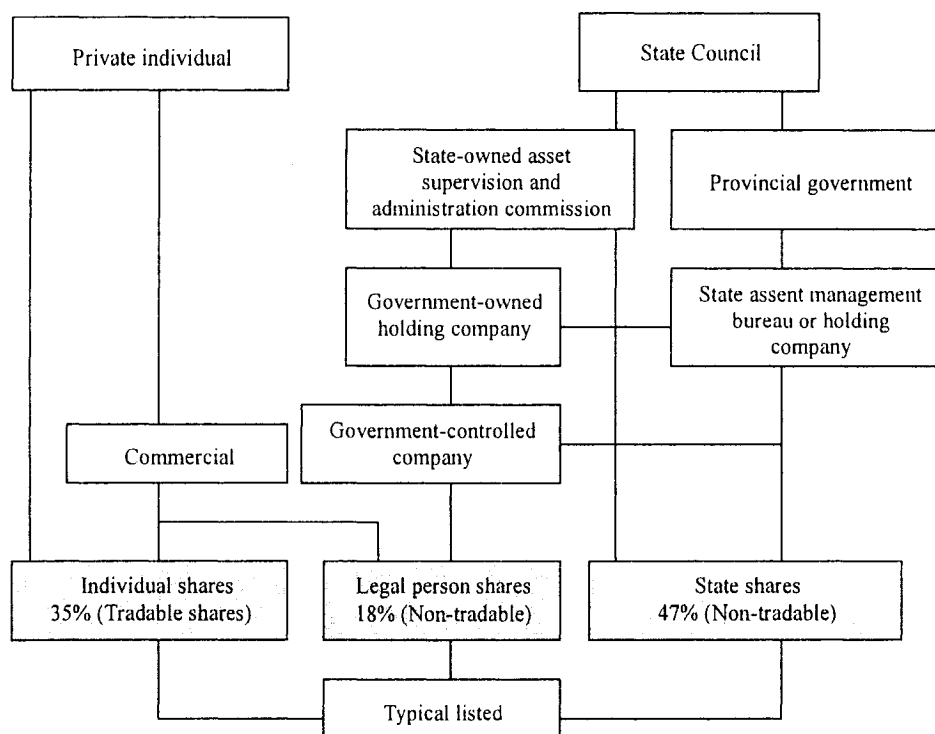
5.2.1 “Agreed-transfer of state-owned shares”

“SOE acquisition” refers to the transaction of state-owned share from the target SOEs to the private acquirers based on agreements; or in the Chinese terms of “agreed-transfer of state-owned shares”. As shown in Figure 3, Chinese listed companies have a unique shareholding structure with roughly equal amount of state, legal person and individual shares³⁵. According to China's Company Law, state and

³⁵ State shares are mainly held by state asset management agencies or SOEs. Legal person shares are owned by both domestic and foreign legal persons. Individual shares are held by domestic or foreign individual investors, and can be further classified as A, B, H shares. A-shares are held mainly by domestic individual investors. B-shares are held exclusively by foreign investors and are traded against foreign currency. H shares are for the firms listed abroad.

legal person shares are non-tradable, and individual shares are tradable. As revealed by China Securities Regulatory Commission, a Chinese listed firm typically holds around 65% non-tradable shares (47% state share, 18% legal person share in 2002), and 35% tradable share³⁶.

Figure 3: Shareholding structure of a typical listed firm in China



Source: Mako and Zhang, 2003

The official web site of China Securities Regulatory Commission (CSRSC)

<http://www.csrc.gov.cn>.

Moreover, shareholding in China's listed firms is highly concentrated. More than 95% of companies listed on the Exchanges are SOEs and more than 70% of shares issued

³⁶ Appendix 4 provides a historical overview of share structure of China's listed companies.

by listed issuers are state and legal person shares. At the end of 2001, the average shareholding of the largest shareholders stood at 44.94 percent, the second largest at 8.56 percent, and the third largest at 3.27 percent. About 42.53 percent of the largest shareholders held more than 50 percent of shares (Shanghai Stock Exchange, 2003).

Most listed firms in China are spin-offs from large SOEs with parent groups serving as their largest shareholders. As the statistics cited in the section of “Three sources of political influence on Chinese enterprises” demonstrate, more than 80% of the largest shareholders were state entities. Therefore, for a private enterprise to gain access to the control of a SOE, acquiring non-tradable shares is the only viable means.

Among the various methods of non-tradable shares transaction³⁷, agreed-transfer is the most commonly adopted means. By the end of 2001, among the total of 322 cases of non-tradable shares transaction, 311 cases were carried out by agreed-transfer, accounting for more than 95 percent (Jiang et al, 2002).

The selection process involves identifying the ownership type of these 311 acquirers, teasing out those private acquirers, and tracking back to the ultimate parent groups these private acquirers belonging to. The selection resulted in a sample of 49 cases that were involved in transferring of state-owned shares from a controlling state shareholder to a private enterprise that belongs to a private business group.

³⁷ Other means of non-tradable share transaction include free transfer (involved the administrative transfer of shares from one government entity to another), judicial decision and forced implementation (court-ordered auction).

5.2.2 Timeframe

Data were collected during the period from 1997 to 2000, which was a suitable time to capture the institutional and business group effects. Starting from 1994, China's Economic Reform entered the transition stage where the old institutions were gradually phased out and new institutions were introduced (Qian, 2000). Furthermore, this period of time was characterized by the consolidation of private sector, proliferation of PBGs, and the emergence of large PBGs. Since "let-go SME" strategy was proposed in 1996, there has been a trend of industrial consolidation to formulate large SOE groups, leaving around 150,000 SME for merger and acquisition. Private enterprises for the first time were encouraged to take over ill-performed small and medium sized SOEs. And from then on, private sector reached the stage of expansion, the establishment of private enterprises increased dramatically (Appendix 5), and relatively large sized PBG began to emerge and to grow side by side with the large SOE business groups. As shown by China Economic Yearbook (1997), 1996 was the year when most Chinese business groups were formed. In 1998, Bureau of Industry and Commerce Administration stipulated requirements for the registration of business groups.

Other factors taken into consideration are 1) Starting from 1997 China Securities Regulatory Commission (CSRC) set information disclosure requirements for share transactions of all listed companies; 2) Starting from 1997, the number of state owned shares transactions increased dramatically, and the number of transactions in 1997

was as four times as that of the previous year (Appendix 6); 3) State shares were not allowed to be transferred to private owners after August 2000, and the restriction was lifted until August 2002.

5.2.3 Sources of data

All the sample data are archival and taken from the Internet owing to the accessibility. Five websites³⁸ are chosen as the major sources because they are official websites appointed by CSRC for information disclosure. Other sources include the websites of the sample companies.

5.2.4 Brief description of sample firms

The selection process resulted in a sample of 49 SOE acquisition cases, with 49 listed SOEs and 44 private business groups involved³⁹. The sample groups are representative of medium and large scale private enterprises⁴⁰ in China, with the average total asset of 162 million RMB at the time of acquisition. There were 14 groups with individual total assets exceeding 500 million RMB. All the groups are still incumbents, 11 of them being among the top 100 private enterprise list. There are a balanced number of firms in each industry (Table 1 of Appendix 7). The target SOEs

³⁸ www.cninfo.com.cn; www.shareholder.com.cn; www.p5w.net; www.gfzr.com.cn; and www.cnlist.com

³⁹ Five business groups acquired ten SOEs (each acquiring two) during this period of time.

⁴⁰ In a survey for medium and large scale private enterprises conducted by All Federation of Industry and Commerce in 1999, the total number of PBG was 1680 (with register capital more than 50 million RMB). The average total asset of the top 500 groups was 411.35million RMB. There were 61 groups being labelled as large scale private enterprises, with average total revenue and total asset greater than 500 million RMB respectively.

were all small and medium sized SOEs from sunset industries⁴¹ (Table 2 of Appendix 7). Therefore, the asset and industry effects are controlled.

5.3 Variables and measurement

5.3.1 The issue of construct validity

The extent to which the private firms acquire Property-based Resources (PBR), Knowledge-based Resources (KBR) and social capital Resources (SC) are measured using a second-order construct approach rather than a first-order construct approach adopted in previous studies on firm level resources acquisition (Chandler and Hanks, 1994⁴²). A first-order construct refers to how the focal individuals conceptualize the phenomenon of interest, while a second-order construct typically refers to how the researcher makes sense of the phenomenon (Taber, 1991). Even though it is recommended to apply empirically validated measurement of constructs, unfortunately, owing to time and budget constraints, the first-order constructs (the private acquirers' justification of the acquisition motives) is not investigated in this study. A deductive strategy, an investigating "from the outside" (Roger & Louis, 1981), is applied in stead. A future study examining the enterprises' self evaluation of

⁴¹ Sunset industries refer to those most distressed SOE sectors (i.e. building materials, chemicals, food processing, textiles, machinery, construction, storage, and commerce) that were highly leveraged with liabilities/ assets ratio in excess of 0.67.

⁴² A set of items of resources acquisition, representing a variety of resources acquired by the acquirer was measured by questionnaires. Respondents were asked to indicate how much the acquisition of each of these items reached their expectation based on a five-point rating scale (1 = far less than expected, 5 = far more than expected). (Chandler and Hanks, 1994)

the acquisition motives can remedy the exclusion of first-order constructs. This issue will be further discussed in the conclusion.

5.3.2 Measurement of the variables

In an ideal way, each type of resources should be reflected by as many aspects as possible and measured by multi-sub-dimensions. However, it is empirically impossible to assess all aspects. Therefore, choices have to be made concerning which aspects to be assessed in a more elaborate way, while which will be excluded. All the measures proposed for each resource endowment are based on the principle of resource-based view that assessing the value, rareness and limitability of resources should be far more important than assessing the existence and amount of resources.

5.3.2.1 Property-based Resources (PBR)

According to Barney (1997), PBR can be further divided into two broad categories—financial capital and physical capital. Financial capital refers to all different money resources available for the development of the company. Physical capital refers to varieties of tangible assets. PBR may be directly measured by summing up the amount of money invested by various shareholders and calculating the monetary value of the land and equipment. However such direct assessment will lead to over valuation of PBR in Chinese SOEs because most of them are loaded with a large amount of “unhealthy assets”⁴³ (Maco & Zhang, 2004) that are counter productive

⁴³ i.e. outmoded fixed assets, uncollectible receivables, overstocking of un-saleable inventory

and tying up the working capital. Moreover, the share price, as the indicator of the value of the resources, is determined by the performance of the target SOE rather than the quantities of assets it possesses. Therefore, the face value of the assets by no means captures the real value of the property. As liquidity and profitability are two leading problems of Chinese SOEs and the top concerns of the private buyers, it is rational to represent the value of PBR by the cash flow and profitability brought by the assets of the target SOE.

Financial capital is measured by liquidity and solvency, with the former reflecting the cash value of the SOE in the short run, while the latter reflecting the cash value of the SOE in the long run. *Liquidity* is measured by "Acid-test" Ratio or Quick Ratio⁴⁴. *Solvency* is measured by debt / asset ratio⁴⁵.

Physical capital is measured by asset utilization, operational profitability, and attractiveness of potential investment. *Asset utilization*⁴⁶ and *Operational Profitability*⁴⁷, capture the extent to which the SOE's assets are able to generate profits, either gross or net. *Attractiveness of investment* is measured by the Return on Net Asset⁴⁸. Since 1996, only those listed companies with RONA more

⁴⁴ Quick Ratio [(Total Current Assets – Inventory) / Total Current Liabilities] is one of the best measures of liquidity. By excluding inventories, it concentrates on the really liquid assets, with value that is fairly certain. It helps answer the question: "If all sales revenues should disappear, could the business meet its current obligations with the readily convertible 'quick' funds on hand?" An acid-test of 1:1 is considered satisfactory unless the majority of a company's "quick assets" are in accounts receivable, and the pattern of accounts receivable collection lags behind the schedule for paying current liabilities.

⁴⁵ Debt/ Asset Ratio=Total Debt / Total Assets

⁴⁶ Asset Utilization = Annual Sales / Total Assets

⁴⁷ Profit Margin = (Operating Income / Operating Revenue)

⁴⁸ RONA = Net Income / (Fixed Assets + Net Working Capital)

than 10% in three consecutive years have been qualified for issuing additional shares⁴⁹. RONA of 10% is, thus, considered a performance threshold in China's stock market, and represents the probability for future capital injection. *Attractiveness of investment*, therefore, predicts the sustainability of the target SOE.

It is important to note that the above mentioned conventional financial performance indices are appropriate measurements for PBR in this study because all the sample SOEs were in the industries that demanded considerable amount of fixed assets or inventories. It is inappropriate to use these indices to measure PBR of the firms engaging in financial service or consulting service whose prior property is knowledge based.

All the ratios were taken from the financial statements of the year before acquisition, except RONA, which is calculated into three year average before acquisition. Except for debt/ asset ratio, higher ratio represents better PBR endowment.

5.3.2.2 Knowledge-based Resources (KBR)

Knowledge-based Resources are measured by four indices—the top management team (TMT) expertise, TMT expertise retention, and the corporate governance structure.

⁴⁹ According to the security law, Chinese listed firms are entitled the rights to issue shares at IPO. Additional share issuing is subject to their three year average RONA.

As organization theory argues, a significant portion of the organizational knowledge and capabilities are embodied within the human capital of employees (Grant, 1996; Nahapiet and Ghoshal, 1998). The size of the management team, the members' past experience together and the members' heterogeneity in industry experience are considered valuable organizational knowledge and capabilities and found to be linked with higher growth (Gundry and Welsch, 2001). Therefore, following the conventional measure of human capital, *the top management team expertise* is measured by three criteria—the level of TMT education (university and above level education), the related professional qualification (i.e. financial analyst, engineer, etc.), and the number of years of working experience in related area. The members of TMT whose meet at least two criteria were considered experts. The TMT expertise index was the percentage of TMT experts out of the total number of TMT. *The TMT expertise retention* was then the actual TMT experts retained after acquisition, representing the actual value of the TMT expertise.

The corporate governance structure is determined by whether there was overlapping of the CEO and director of the board. Coupled control and ownership was very common in SOEs by the same person serving as both the CEO and the director of the board, who was often hand picked by the government based on political criteria. Therefore, better corporate governance was represented by different person assuming the role of CEO and board director.

5.3.2.3 *Social Capital (SC)*

Defined as relational resources embedded in personal or organizational ties (Coleman 1990; Burt 1992), it is worth noting that social capital is not an attribute of someone, but rather someone has social capital to the extent that they have social relations with others, through whom they can gain access to important resources. Due to the multiple facets of the construct, a widely adopted measure of social capital is lacking in the current literature. Nevertheless, at a general level, assessment of SC involves what resources the network provides, the strength of the ties, and the value of the ties.

Empirical measurements of SC may vary considerably according to the context of network. Yet, as mentioned previously, the unique institutional settings of China narrow down the boundary of valuable SC in the eyes of the private acquirers to the political capital embedded in the SOEs— both organizational and personal.

Assessment of political capital, therefore, should aim at explicit operationalizations of the strength of ties. According to Granovetter (1995), the strength of a tie in interpersonal networks depends on the amount of time spent on it, the emotional intensity, intimacy and the reciprocity characterizing the tie. In the more recent research the frequency or intensity of contact, referring to amount of resource exchange, and irreplaceability of the parties has been seen as indicators of the strength of a tie (Johannisson 1995; Zhao and Aram 1995, c.f. Mainela, 2002).

Organizational SC is represented by the relationship with the government through state ownership, which is measured by the percentage of state share retained and the number of state share holder retained.

Personal SC is measured by total number of cadre TMT, cadre TMT retention, and cadre BOD retention. As previously mentioned, almost all of the listed SOEs are transferred from former state-owned enterprises and industrial bureaus. Therefore, the TMTs and board of directors of these firms are usually either former government officials who headed the industrial bureaus or otherwise were selected due to government political influence. In either case, they were senior cadres at a relatively high position. Being the former government officials, the existing TMT pool might lack the corporate mindsets as professional managers or their capabilities and experience may become obsolete if the firm changes its business line after being acquired, nevertheless, their personal networking with their previously attached governmental entities and current government administrators at the corresponding level were invaluable individual social capital that can be capitalized.

As Uzzi (1997) argues, unlike the organizational social networks that are often instrumental, lacking reciprocity and repeatedness and concerning narrow economic matters; personal social networks are close ties characterized by strong emotional obligations, trust, exchange of tacit know-how and joint problem solving with respect to critical business matters. That is also the reason the cadre at relative high level

were very popular at the labor market⁵⁰.

The constructs and their indicators are summarized in Table 4.

Table 4: Summary of the variables and measures

Independent variables	Coding and Scaling
Property-based resources (PBR)	
Liquidity: cash value of the assets in the short run	Acid Test ratio = (TCA - Inventory) / TCL
Asset Utilization: Assets' ability to generate gross profit	Annual Sales / Total Assets
Profitability: Assets' ability to generate net profit	Operating Margin= EBIT / Op Rev
Solvency: cash value of the assets in the long run	Debt/ Asset Ratio= Total Debt / Total Assets
Attractiveness of investment: cash inflow in the future	3 yr average RONA
Knowledge-based resources (KBR)	
Knowledge, skills, and abilities embodied within TMT (university degree or above education, professional qualification, >5 yrs of related experience)	TMT expertise total (% of TMT who meet at least 2 requirements)
	% of expertise TMT retained
Corporate governance structure	Does different person assume the role of CEO and board director? 1 = yes 0 =no
Social capital (SC)	
Political capital embedded in organizational networks	% of state share holders among top 10 share holders
	% of state-owned share retained after acquisition
Political capital embedded in personal networks	% of cadre TMT ratio
	% of cadre TMT retained
	% of cadre BOD retained
Dependent variable	
Degree of acquisitiveness	
Acquisition costs	Investment for the acquisition / total assets of the acquirer
Share acquired	% of state-owned share acquired

⁵⁰ In their study on the state of civil society in China, Gordon White & al. cited for the early 1990s the figure of 200,000 members of the CCP registered as private company directors (White, Howell & Shang, 1996, pp. 241).

5.4 Statistical Analysis

5.4.1 *Partial least squares (PLS) analysis*

Partial Least Squares (PLS) regression analysis is chosen to validate the proposed models and test the relationship between SOE's resource endowments and private acquirers' degree of acquisitiveness. The rationale is based on the consideration that the sample size is relatively small, each variable is measured by multidimensional indicators, and this research is exploratory in nature.

PLS⁵¹ model has been applied in wide varieties of fields since 80s, and has gained popularity in the area of strategic management in recent years (Hulland, 1999; Birkinshaw, Morrison and Hulland, 1995; Johansson and Yip, 1994; Fornell, Lorange, and Roos, 1990; Cool, Dierickx, and Jemison, 1989). It is an alternative to OLS regression, canonical correlation, or structural equation modeling (SEM) for relating a system of latent variables, with each latent variable measured by more than one indicator. PLS is able to analyze the layers simultaneously and give more accurate estimates of inter latent relationship by conducting factor analysis with liner regression.

⁵¹ PLS was developed by Wold in the 60s. Extensive discussion can be found in Joreskog and Wold (1982), and Chin (1997).

PLS shares with the other better known causal models (e.g. LISREL, AMOS and EQS) the key advantage of being able to construct and test both theory and measures at the same time (Hulland, 1999). However, unlike the others, PLS requires much less stringent assumptions to allow small sample size, high multicollinearity, non-normal data distribution, omission of regressors (Chin, 1998),etc. The general rule of thumb is that a sample size five times the size of the largest number of structural paths directed at a particular construct in the structural model is sufficient for PLS analysis⁵² (Chin, 1998). The extreme case was an analysis of two latent variables using 27 indicators with a data sample of 10 cases (Wold, 1989). In this study, the largest number of structural paths is three, therefore, a sample size of 49 is considered well justified.

Also, PLS permits multiple measures of both dependent and independent variables, represented as a block of predictors in a latent variable. It can “estimate the individual item weightings in the context of the theoretical model rather than in isolation” (Birkinshaw, Morrison & Hulland, 1995). Moreover, PLS is especially suitable for exploratory purpose in the absence of strong prior theory. Therefore, PLS is an ideal choice for this research which attempts to explore the untested relationship between social capital endowment and degree of acquisitiveness.

⁵² A more conservative guideline is 10 times the largest number of structural paths.

The PLS analysis of this research is implemented by the SAS statistical software under PROC PLS and CALIS procedure⁵³.

5.4.2 Reliability and validity check

5.4.2.1 Item reliability

As PROC PLS is able to extract independent latents directly on the basis of cross products involving the response variable(s), a preliminary factor analysis was performed for all 13 proposed indicators (P1-P13 in Table 5) to validate whether the proposed number of constructs and the reflective relationship between the constructs and their indicators are appropriate. The results basically confirm the proposed model. As shown in Table 5, three factors were identified with Kaiser's eigenvalues greater than 1.0, explaining 52.691 percent of total variance of the model.

Factor 1 consists of three items (SC5, SC4, SC2) with factor loading greater than 0.50⁵⁴, all measuring the construct of social capital endowment. Similarly, factor 2 consists of four items (PBR4, PBR3, PBR1, PBR5) measuring the Property-based

⁵³ PROC PLS fits only predictive partial least squares models where one block of predictors (represented in a latent variable) is used to predict a block of responses represented in another latent variable. This is more limited than LVPLS originally developed by Wold, which supports for modeling paths of causal relation between any number of "blocks" of variables. However, the CALIS procedure of SAS is appropriate for more complex models of this type.

⁵⁴ The items mentioned in this paragraph are those with factor loading greater than 0.5, implying more shared variance between the construct and its predictors. As a rule of thumb, items with loadings of less than 0.4 or 0.5 should be dropped.

Resources endowment; and Factor 3 consists of three items (KBR3, KBR2, KBR1) measuring Knowledge-based Resources endowment. Therefore, the conceptual separation between the three independent variables was supported and is consistent with the prior theory.

Table 5: Preliminary factor analysis results

Predictor (indicator)	code	Factor 1	Factor 2	Factor 3
P1 liquidity	PBR1	.208	.582	-.050
P2 asset utilization	PBR2	.257	.181	-.013
P3 profitability	PBR3	.217	.614	.126
P4 solvency	PBR4	-.311	-.648	.178
P5 attractiveness of investment	PBR5	.334	.505	-.003
P6 TMT expertise	KBR1	.080	.200	.451
P7 TMT expertise retention	KBR2	.133	.249	.556
P8 corporate governance	KBR3	.074	-.016	-.613
P9 # of gov'n't share holders among top 10 share holders	SC1	.305	-.179	.389
P10 % gov'n't share retained after acquisition	SC2	.524	.052	.031
P11 % of cadre TMT total	SC3	.246	-.248	.373
P12 % of cadre TMT retained	SC4	.676	.208	.100
P13 % of cadre BOD retained	SC5	.813	.221	.214
	Factor name	social capital	property based resources	Knowledge based resources
	Eigenvalues	3.904	1.974	1.499
	% Variance explained	27.887	14.098	10.706
	% Cumulative variance explained	27.887	41.985	52.691

The preliminary test also indicates that three predictors (PBR2, SC1, and SC3) have relatively weak factor loadings to the constructs they represent, and SC1 and SC3 have potential cross loadings. Nevertheless, to explore further which predictors can be eliminated, analyses of the “absolute values of regression coefficients” and “variable

importance for projection (VIP)” were preceded. The absolute value of the regression coefficients represent the importance each predictor has in the prediction of the response(dependent variable), whereas the VIP represents the value of each predictor in fitting the PLS model for both predictors and response. Only those predictors having relatively small absolute coefficient (less than 0.1) and a small value of VIP (less than 0.8) should be considered prime candidates for deletion (Wold, 1994). As highlighted in Table 6, none of the indicators meets the criteria. Therefore, dropping the three indicators might result in loss of internal consistency and model fit. In addition, given the expletory nature of this research, it is preferred to retain the “redundant” indicators because it is believed that a construct should be an “open concept” that is better triangulated by multiple indicators (O'Connor, 2001). Thus, subsequent analysis was undertaken using the three factors with all proposed indicators, as shown in Table 7.

Table 6: Absolute values of regression coefficients and VIP

	Abs(DA1)		Abs(DA2)		Abs(VIP)	
P9	0.20353		p11	0.32624	P9	1.83775
p11	0.19354		p10	0.20392	p11	1.31273
p10	0.13045		P9	0.18617	p10	1.24893
p7	0.11371		p1	0.16834	p13	1.16756
p13	0.10785	← Cutoff value	p5	0.0981	p12	1.12602
p4	0.09409		p4	0.08649	p5	1.07442
p5	0.08752		p12	0.08374	p1	1.03338
p6	0.08254		p7	0.06125	p4	0.93897
p8	0.07964		p6	0.05314	p2	0.83066
p3	0.07622		p13	0.05036	p3	0.81513
p1	0.04594		p8	0.04746	p6	0.71539
p2	0.01394		p2	0.02835	p7	0.60802
p12	0.0105		p3	0.00532	p8	0.43436

Table 7: Summary of all measurement model factors

Constructs and Predictors	code	Factor loadings
social capital (factor 1)		
# of government Share holders among top 10 share holders	SC1	.305
% government share retained after acquisition	SC2	.524
% of cadre TMT total	SC3	.246
% of cadre TMT retained	SC4	.676
% of cadre BOD retained	SC5	.813
property based resources (factor 2)		
liquidity	PBR1	.582
asset utilization	PBR2	.181
profitability	PBR3	.614
solvency	PBR4	-.648
attractiveness of investment	PBR5	.505
Knowledge based resources (factor 3)		
TMT expertise	KBR1	.451
TMT expertise retention	KBR2	.556
corporate governance	KBR3	-.613
degree of acquisitiveness (factor 4)		
* asset acquired / total assets	DA1	.802
share transferred	DA2	.804

5.4.2.2 *Convergent and discriminant validity*

The convergent validity (internal consistency among items measuring the same construct) of the above three constructs was confirmed by the Cronbach's alpha ranging from 0.719 to 0.873, as shown in Table 9. Following Nunnally's (1978) guidelines, alpha value not less than 0.7 is considered acceptable for exploratory research.

However, high internal consistencies do not necessarily indicate unidimensionality, or discriminant validity, which means a construct sharing more variance with its predictors than it sharing with other constructs in a given model. In a PLS context, discriminant validity is assessed by the value of Averaged Variance Extracted (AVE—the average variance shared between a construct and its predictors). Adequate discriminant validity is achieved if square root of AVE is significantly greater than the correlation between any two constructs. In the correlation matrix displayed in Table 8, along the diagonal are Root AVEs for each of the constructs, off the diagonal are the correlations between different constructs. Each Root AVE is significantly larger than the all other entries in the corresponding rows and columns, suggesting adequate discriminant validity.

Table 8: Correlations among constructs

Correlations among constructs				
social capital	.890			
Property-based Resources	.038	.793		
Knowledge-based Resources	.083	.058	.707	
degree of acquisitiveness	.043	-.022	.025	.606

Table 9: Summary of convergent and discriminant validity

Constructs	Number of predictors	Convergent validity (Cronbach's α)	discriminant validity (Root AVE)
social capital	5	.873	.890
Property-based Resources	5	.868	.793
Knowledge-based Resources	3	.745	.707
degree of acquisitiveness	2	.719	.606

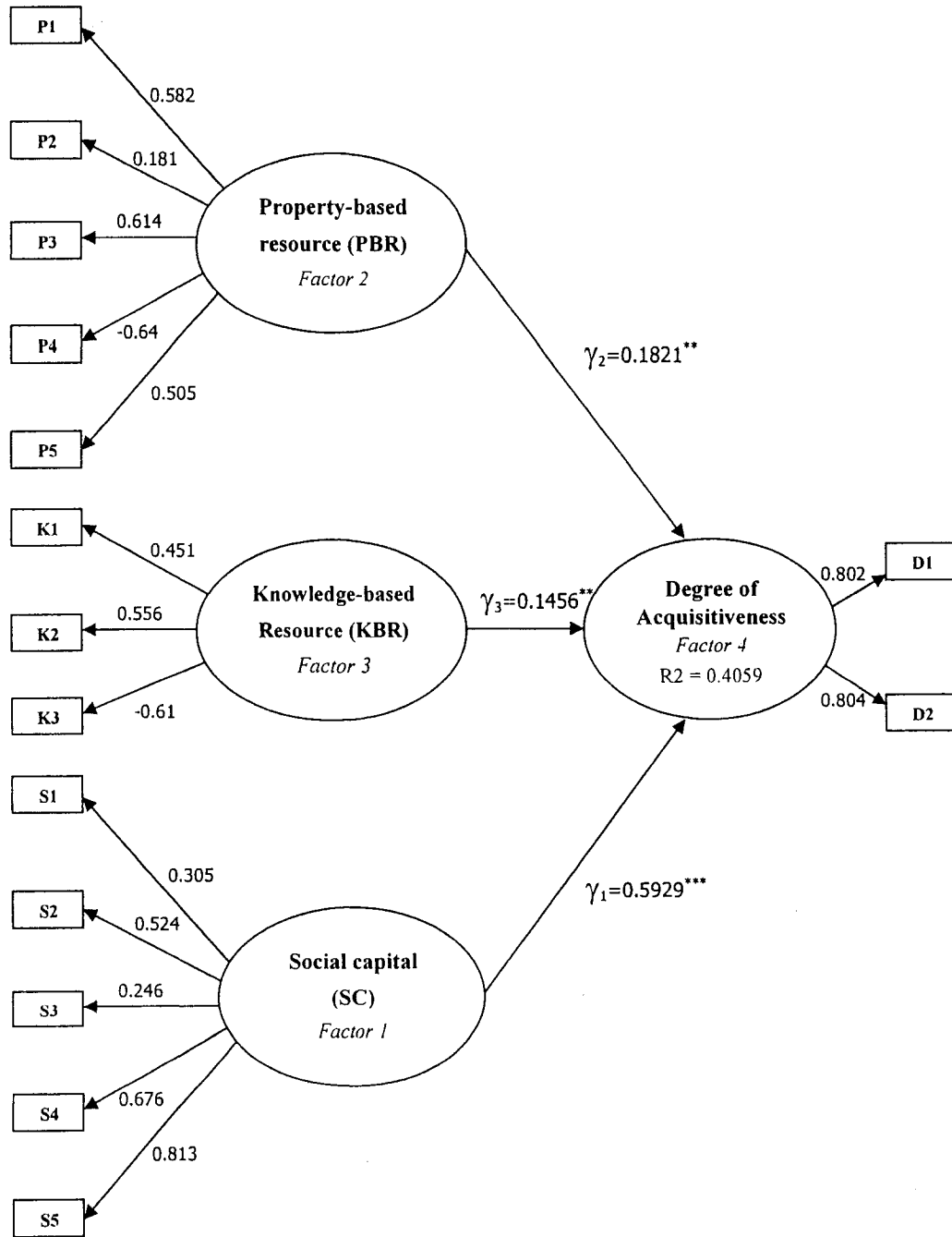
5.4.2.3 Goodness of fit

Given the fact that PLS does not offer a proper overall goodness-of-fit measure, alternative measures such as R^2 of all endogenous constructs (dependent variables) and the significance of relationships among constructs are recommended to be taken into consideration (Hulland, 1999; Cool and Jemison, 1989). The basic model explained 52.69 percent of the variance in the degree of acquisitiveness. Moreover, almost all individual relationships pass the 0.05 significance hurdle, with some even lower than 0.01. All these indicate a satisfactory degree of model fit.

5.5 Results and Discussion

5.5.1 Summary of results from Model 1

Figure 4: Summary of results from Model 1



** , *** indicate significance at 0.05; 0.01 levels

As demonstrated by Figure 4 and Table 10, the results from model 1 supported the first group of hypotheses from H1-1 to H1-3, indicating the degree of acquisitiveness is positively related to all three dimensions of SOE resource endowment. All three of the relationships examined were statistically significant ($p < 0.05$). As predicted, at an aggregate level, PBR, KBR, and SC have positive and additive impacts on DA, with path coefficients of $\gamma_2 = 0.1821$, $\gamma_3 = 0.1456$, and $\gamma_1 = 0.5929$ respectively. Among the three factors, SC exerts the strongest influence, being more than three times as important as PBR ($0.5929 / 0.1821 = 3.26$), and four times as important as KBR ($0.5929 / 0.1456 = 4.07$).

Table 10: Summary of PLS results from Model 1

Model 1	Hypothesized relationship	PLS estimate
H1-1	PBR → DA (+)	$\gamma_2 = 0.1821^{**}$
H1-2	KBR → DA (+)	$\gamma_3 = 0.1456^{**}$
H1-3	SC → DA (+)	$\gamma_1 = 0.5929^{***}$
note	(+) refers to the hypothesized effect between the two constructs **, *** indicate significance at 0.05; 0.01 levels	

CALIS Results -- Latent Variable Equations with Standardized Estimates

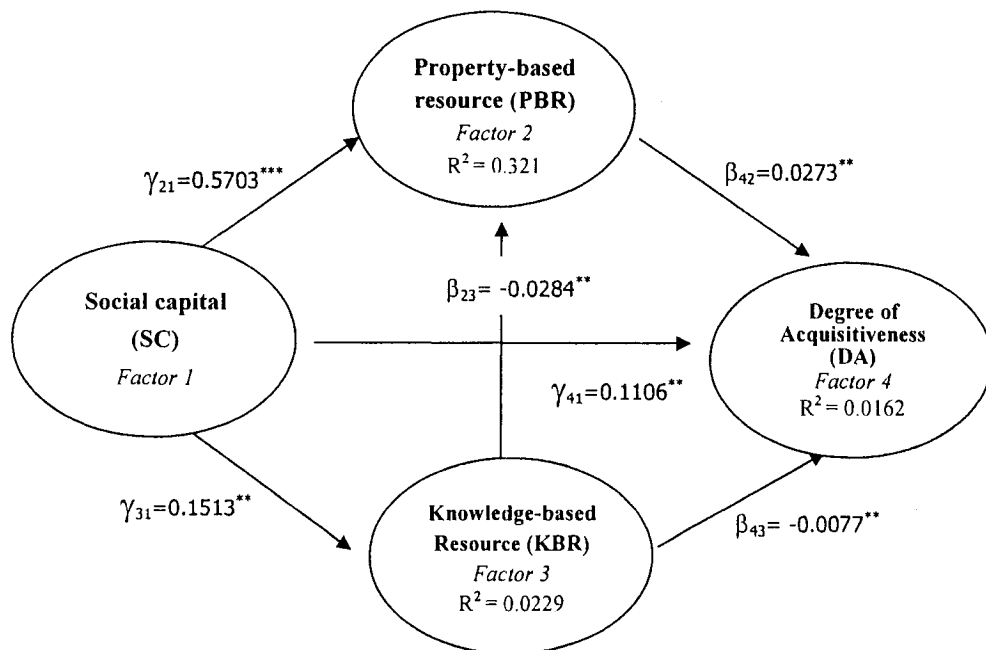
$$F4 \text{ (Factor 4)} = \underset{\text{Gam2}}{0.1821 * F2} + \underset{\text{Gam3}}{0.1456 * F3} + \underset{\text{Gam1}}{0.5929 * F1} + 0.7708 D4$$

5.5.2 Summary of results from model 2

As previously described, Model 1 is a basic, single level model examining only the direct impacts of the exogenous variables (PBR, KBR, and SC) on endogenous variable (DA). However, Model 2 serves as a more informative, two level model by revealing both the direct and indirect relationships among all the variables. In model

2, as shown in Figure 5, DA remains ultimate endogenous variable for all the other three factors; while PBR, KBR becomes first level endogenous variables for SC. In the mean while, PBR becomes first level endogenous variable to KBR, and second level endogenous variable to SC through KBR.

Figure 5: Summary of results from model 2



******, ******* indicate significance at 0.05; 0.01 levels

In terms of direct effect on DA, the order of the influencing power of the three factors' remained the same as in Model 1, while the magnitude of effects decreased dramatically. SC still exerts the strongest direct impact (SC → DA, $\gamma_{41} = 0.1106$) on DA. , however, PBR and KBR barely have any impacts, with path coefficients close to zero (PBR → DA, $\beta_{42} = 0.0273$; KBR → DA, $\beta_{43} = -0.0077$). Although the KBR → DA relationship is negative, given the very small magnitude of the effect, it can be

regarded as no effect. Therefore, the results of direct effects confirmed hypothesis H2-1 that SC is positively related to DA, but rejected hypothesis H2-2b and H2-3b that DA is not associated with either PBR or KBR.

Table 11: Summary of PLS results from Model 2

Model 2	Hypothesized relationship	PLS estimate	Total effect on Degree of Acquisitiveness
H2-1	SC → DA (+)	$\gamma_{41=}$ 0.1106**	$0.125 = \gamma_{41} + (\gamma_{21} * \beta_{42}) + (\gamma_{31} * \beta_{43}) + (\gamma_{31} * \beta_{23} * \beta_{42})$
H2-2a	SC → PBR (+/-)	$\gamma_{21=}$ 0.5703***	
H2-2b	PBR → DA (+)	$\beta_{42=}$ 0.0273**	0.0273
H2-3a	SC → KBR (-)	$\gamma_{31=}$ 0.1513**	
H2-3b	KBR → DA (+)	$\beta_{43=}$ -0.0077	$-0.009 = \beta_{43} + (\beta_{23} * \beta_{42})$
H2-4	KBR → PBR (+)	$\beta_{23=}$ -0.0284	
note	(+/-) refers to the hypothesized direct effect between the two constructs **, *** indicate significance at 0.05; 0.01 levels		

CALIS Results--Latent Variable Equations with Standardized Estimates

$$F2 \text{ (Factor 2)} = -0.0284 * F3_{\text{Beta23}} + 0.5703 * F1_{\text{Gam21}} + 0.8240 D2$$

$$F3 \text{ (Factor 3)} = 0.1513 * F1_{\text{Gam31}} + 0.9885 D3$$

$$F4 \text{ (Factor 4)} = 0.0273 * F2_{\text{Beta42}} + -0.0077 * F3_{\text{Beta43}} + 0.1106 * F1_{\text{Gam41}} + 0.9919 D4$$

The total effect of SC on DA (0.125), as shown in Table 11, is the sum of four path linkages: the direct impact (SC → DA, γ_{41}), the indirect impact through PBR (SC → PBR → DA, $\gamma_{21} * \beta_{42}$), the indirect impact through KBR (SC → KBR → DA, $\gamma_{31} * \beta_{43}$), and finally the indirect impact through KBR-PBR relations (SC → KBR → PBR → DA, $\gamma_{31} * \beta_{23} * \beta_{42}$). The total effect (0.125) is slightly bigger than the direct effect ($\gamma_{41} = 0.1106$), indicating an amplified effect of SC through other resources. As hypothesized by H2-2a and H2-3a, sc amplifies the value of PBR ($\gamma_{21} = 0.5703$) and

KBR ($\gamma_{31} = 0.1513$). However, the hypothesized positive relationship between KBR and PBR was not confirmed. The path coefficient from KBR to PBR ($\beta_{23} = -0.0284$) is close to zero, implying that KBR did not have any influence on PBR.

Table 12: Summary of hypotheses and confirmation

	Hypothesized relationship	Empirical results	Confirmation of hypotheses
Model 1			
H1-1	PBR → DA (+)	(+)	yes
H1-2	KBR → DA (+)	(+)	yes
H1-3	SC → DA (+)	(+)	yes
Model 2			
H2-1	SC → DA (+)	(+)	yes
H2-2a	SC → PBR (+/-)	(+)	yes
H2-2b	PBR → DA (+)	(0)	no
H2-3a	SC → KBR (-)	(+)	no
H2-3b	KBR → DA (+)	(0)	no
H2-4	KBR → PBR (+)	(0)	no

Notes: (+/-): positive or negative effect between the two constructs ;
(0) : no effect.

The results, as summarized in Table 12, confirmed the prior theory that resources do not necessarily have additive effects, and that certain types of resources may amplify the value of others (Autio and Parhakangas 1999). More specifically, social capital amplifies other resources.

In summary, both models supported the absolute importance of social capital. In effect, the low correlations between PBR and DA echo the fact that ill endowed SOEs were usually the acquiring targets because acquisitions were not driven by pure economic logics.

5.5.3 Additional analyses— re-estimation on split samples

5.5.3.1 Groups at different development stage

Since this study takes the perspective of organizational growth to analyze private groups' acquisition motives, it is important to question that whether at the different stages of the group development, the motives for acquisitive growth and the direction of growth in terms of firm resources are different. That is, whether groups at different stage of development place emphasis on different type of resources being acquired.

In a theoretical framework proposed for analyzing acquisitions by entrepreneurial firms⁵⁵, Piirainen (2002) pointed out that the motives for acquisitive growth and the direction of growth in terms of firm resources are different in different stages of entrepreneurial process. In the initial stage, acquisitions are a way to tap entrepreneurial opportunities. KBR such as proprietary technology or ownership of a novel business idea would usually be the acquiring targets. In the ramp up phase, acquisitions mainly focus on the PBR needed to exploit an opportunity. At the expansion stage, acquisitions are used to achieve operational efficiencies, so new PBR and KBR are to be brought into the company and to reinvigorate its existing knowledge base.

⁵⁵ Entrepreneurial firms refer to SME founded by entrepreneurs.

This framework has special implication for the groups under study because all the sample private business groups were evolved from entrepreneurial firms. To retest the hypotheses controlled for stage of group development will better our understanding of their acquisition motives.

According to the five surveys conducted by ACFIC, the majority of Chinese private enterprises have operation history ranging from 6 to 20 years. The average life cycle of Chinese private enterprises is 7.04 years, and that of PBG is 8 years. Among 3258 private firms, only 15% of enterprises survived less than 5 years. The statistics of the sample groups' operation status were consistent with the survey findings. The operation history of the sample ranges from three months to 27 years, with the average of 7.23 years⁵⁶. Five years was observed as a cutoff edge that 26 groups had been operated less than 5 years, while 23 more than 5 years. As all of the sample groups are still in operation at present, it is rational to infer that groups with operation history less than 5 years are at the startup stage of development, while groups with operation history more than 5 years are at the expansion stage. Thus, the models were re-estimated on two sub samples, representing the different stages of group development. Accordingly, 26 groups were at their startup stage and 23 groups at expansion stage.

⁵⁶ It is worth noting that the operation history refers to that of the group's parent companies. Quite a number of enterprises became registered as a "group" after years of operation, so it is appropriate to count their previous operation history in.

Table 13: Model re-estimations on split samples of startup groups and expansion groups

Hypothesized relationship		PLS estimates					
		Full sample (N=49)		Split Sample			
				startup stage (N=26)		Expansion stage (N=23)	
Model 1							
H1-1	PBR → DA (+)	0.1821**		-0.2643**		-0.0586**	
H1-2	KBR → DA (+)	0.1456**		-0.0123**		-0.5044**	
H1-3	SC → DA (+)	0.5929***		0.0133***		0.7315***	
Model 2		Total effect		Total effect		Total effect	
H2-1	SC → DA (+)	0.1106**	0.125	0.5004**	-0.0642	0.6493**	0.5852
H2-2a	SC → PBR (+/-)	0.5703***		0.6749***		0.1088***	
H2-2b	PBR → DA (+)	0.0273**	0.0273	-0.8323**	-0.8323	-0.0935**	-0.0935
H2-3a	SC → KBR (-)	0.1513**		0.1788**		0.0919**	
H2-3b	KBR → DA (+)	-0.0077**	-0.009	-0.0519**	-0.0162	-0.5952**	-0.5876
H2-4	KBR → PBR (+)	-0.0284**		-0.0429**		-0.0822**	
<i>note</i>		<i>(+/-) refers to the hypothesized positive or negative effect between the two constructs</i>					
		<i>** , *** indicate significance at 0.05; 0.01 levels</i>					

The model re-estimations on the split samples, as presented in the last two columns of Table 13, offered worth noting different results from findings on full sample. In the sub sample of groups at start-up stage, PBR was consistently negatively related to DA in both models (-0.2643 in model 1, -0.8323 in model 2), while neither SC nor KBR had any influencing power on DA. On the contrary, in the sub sample of groups at expansion stage, PBR barely had any impact on DA (-0.0586 in model 1, -0.0935 in model 2), while both SC and KBR had significant influence on DA. SC is consistently in positive relation to DA (0.7315 in model 1, 0.5852 in model 2). KBR, on the other hand, is negatively associated with DA (-0.5044 in model 1, -0.5876 in model 2). The salient divergence confirmed the prior theory on growth oriented acquisition that firms tend to acquire different resources at different stage of growth.

The negative relationship between PBR and DA at the start up stage can plausibly be interpreted as the value capturing, short-term orientation of the acquirers. As the priority of startup groups is resource, especially capital, accumulation, given capital constraints, the ideal targets for them are SOEs requiring minimum investment, however can be capitalized in the short run. Usually, the value of an SOE is evaluated by the value of its PBR (represented by its financial performance) rather than KBR or SC, owing to the visibility and comparability featured by PBR. Better PBR endowment represents higher share price, therefore, higher acquiring costs. Start up groups are not willing to pay premium for such better PBR because of their tight budget on one hand, and their avoidance of unpredictable risks associated with higher investment on the other hand. As a result, the SOEs with low quality of PBR are more popular because first, they are most likely to be undervalued, and there is much room of bargaining for further discount; second, local government usually offered various kinds of preferential policies to encourage private enterprise helping restructure these worst performers to relief local government's financial burden; and finally, the bad financial conditions of the SOEs could be an excuse for later assets stripping behavior—the private acquirers can easily attribute the failure of restructure to the extremely weak foundation of the SOEs. When further looking at the post acquisition behavior of start up groups, it is not surprising to find that, six among the 26 start up groups sold out all the shares they bought, and four groups sold more than one third of the shares within two years after acquisition. 2/3 of the groups had frequently (more than twice) used the SOE assets as collateral for bank loans to finance their own

projects or other affiliates within the group. Ten acquirers had viciously release false information and manipulated to raise the stock price. Twelve CEOs or directors of the acquirers were involved in lawsuits because of that. Nevertheless, it is important to note that groups at expansion stage were not free from such value capturing behavior. However, the percentage of asset strippers in start up sample groups is almost as three times higher as that in expansion sample groups. This finding offers a context specific justification for the popular state-asset-striper accusation that private acquirers at their start up stage would more likely to engage in value capturing behavior.

On the contrary to the trend that start up groups prefer worse PBR endowed SOEs and turn a blind eye to KBR or SC, groups at expansion stage are in effect attracted by the high SC endowed SOEs, while avoiding better KBR endowed ones, and being indifferent to the level of PBR endowment. This is probably because those groups with expansion orientation have already passed through initial resource accumulation phase and look forward sustainability. According to RBV, KBR and SC, rather than PBR, can provide sustainable competitive advantage because they are very difficult to imitate by competitors. The question, then, is why expanding groups opt for SC but deny KBR.

This can plausibly be explained by the ownership heritage of private enterprises. As previously mentioned, coupled ownership and control is the key feature of Chinese private enterprises. As the survey shows, till 2001, 96.5% of the 3258 private

enterprises were owned and controlled by the same person(s), the percentage was even higher before, with 97.2% in 1996 and 96.8% in 1999. According to the private entrepreneurs, there are two major reasons for the coupled ownership and control—distrust between owner and manager, and organization stability. The majority (61.5%) of the entrepreneurs claimed that they are not able to find trustworthy top managerial personnel, and some (37.6%) claimed that coupled ownership and control help to maintain stability (However, the survey did not debrief what “stability” meant. My understanding is that consistent management style is attainable if top management does not change frequently).

The trust crisis between the principles and agents has its tradition root (Outsiders are usually excluded from top management team in traditional family businesses.), but can also be attributed to the weak contract enforcement system and the lack of professional moral or credibility featured by developing markets. Taking the advantage of information asymmetry, professional managers are often found stripping organizational assets, trading confidential information such as know-how's, secretly working for competitors, etc. Even though in practice dominant majority of entrepreneurs coupled ownership and control, owners with different level of education held different attitudes towards the issue. The higher the degree of education, the more owners disagreed on coupled ownership and control. According the ACFIC survey (2003), more than 70% of owners with university and above degree of education did not believe in coupled ownership and control, while more than 50% of

those with middle school and below degree of education supported the idea. It is worth noting that the entrepreneurs or founders have an important role in strategic decision. This issue will be elaborated in the next section.

5.5.3.2 Group founders with different social characteristics

In addition to the stage of development, another eye catching feature of the sample groups is the identity of the entrepreneurs or founders of the PBGs. The founders of the groups can be clearly divided in two groups according to their social characteristics. The first group is composed of 22 entrepreneurs who had been or still are cadres. The majority of them quitted their decent and secure jobs to start a business. They had various professional backgrounds (such as middle school teacher, university professor, financial analyst, government employee, writer, engineer, scholar, etc) at different rank of positions (i.e. the higher ranks included the academician in the Chinese Academy of sciences, director of the School of Life Sciences of Fudan university, vice chairman of Fujian Federation of Industry and Commerce, and Department director of Construction Bank). Also, all of them have university and above level education. The second group, on the contrary, consists of entrepreneurs from relatively lower social stratum. They were peasants, prentices, craftsman, successor of small family business, laid-offs, veteran, etc. The majority of them had only middle-high school level of education.

The observation is aligned with the general social economic characteristics of the private owners during the transition stage (Appendix 9). The owners or founders of Chinese private enterprises can be classified, in terms of social economic status, into two main groups. The first group includes people at the lower stratum of the society (i.e. peasants, unemployed, families having business tradition, etc). They usually started from individual business or small size private enterprises before reform, and gradually increase their business scale and scope during the reform. This type of private enterprises is usually concentrated in agriculture, the retail sector, and catering services, or in low tech, labor intensive light industries. The second group consists of cadres or previous managers and engineers in SOEs and collective enterprises. They are featured by possessing high degree of education, rich vocational experience or expertise, and entrepreneurialship⁵⁷. They usually establish a private firm by either quitting their prior jobs, or through management or employee buy out⁵⁸ when their prior SOEs transferred to shareholding companies during reform.

The distinctive homogeneity between these two groups of entrepreneurs called for model re-estimation to see whether different types of founders have different

²¹ In the in-depth interview on 60 Chinese private entrepreneurs conducted by Dolles (2003) during 98—2000, 41.7% of the respondents attributed their motive for setting their own companies as to use their own capabilities.

⁵⁸ According to the survey, 25.7% of the 3256 private enterprises were transferred from SOE (6.5%) , and urban and rural collectives (10.8% and 8.4% perceptively). Among the owners of these enterprises, 60.6% used to be the original managers of the firms before restructure; 9.8% used to be the former employees; only 29.6 % are outsiders.

acquisitive preference in terms of resources. The re-estimation is conducted on two split samples— one consisting 22 groups whose founders were cadres, and the other consisting 27 groups whose founders were non cadres.

Table 14: Model re-estimations on split samples of cadre founders and non-cadre founders

Hypothesized relationship		PLS estimates					
		Full sample (N=49)		Sub Sample			
				cadre (N=22)		others (N=27)	
Model 1							
H1-1	PBR → DA (+)	0.1821**		0.00697**		0.6914**	
H1-2	KBR → DA (+)	0.1456**		0.0264**		-0.1219**	
H1-3	SC → DA (+)	0.5929***		0.9805***		-0.5208***	
Model 2			Total effect		Total effect		Total effect
H2-1	SC → DA (+)	0.1106**	0.125	0.7812**	0.7494	-0.6048**	-0.5932
H2-2a	SC → PBR (+/-)	0.5703***		0.4066***		0.0841***	
H2-2b	PBR → DA (+)	0.0273**	0.0273	-0.0537**	-0.0537	0.0704**	0.0704
H2-3a	SC → KBR (-)	0.1513**		0.1389**		0.0099**	
H2-3b	KBR → DA (+)	-0.0077**	-0.009	-0.0724**	-0.0719	0.5745**	0.5689
H2-4	KBR → PBR (+)	-0.0284**		-0.00928**		-0.0797**	
<i>note</i>		<i>(+/-) refers to the hypothesized positive or negative effect between the two constructs</i>					
		<i>** , *** indicate significance at 0.05; 0.01 levels</i>					

The results, as presented in Table14, suggested that cadre founders were exclusively attracted by SC (0.9805 in model 1, 0.7494 in model 2), being indifferent with PBR or KBR (all close to 0 in both models). The magnitude of both direct and total effects of SC on DA was significantly greater than the model effects on full sample, indicating that cadre founders much preferred SC than the others did. However, the re-estimation on non cadre sum sample did not produce meaningful results. Even though SC was consistently in negative relation to DA in both models, the effects of KBR and PBR on DA in model 1 contradicted with those in model 2, suggesting a failed estimation.

This is probably caused by the more heterogeneous social backgrounds of the non cadre founder sample.

The strong positive relation between SC and DA in the cadre founders sample can be explained by initial founding condition effects. Previous literature has suggested the administrative heritage effect (Carney & Gedajlovic, 2003) of initial founding condition on organizational outcomes such as strategic choices and performance level. Administrative heritage, referring to an organization's way of doing things, is shaped by its founders and leaders, organizational history, and norms, values and behaviors of managers. Therefore, the characteristics of the founder or founding top management team can leave an indelible influence on a firm's corporate governance by imprinting an initial strategic direction and setting constraints on subsequent strategic changes. This is especially true for entrepreneurial firms, which can be viewed as an extension and reflection of the values and cognitive bases of the founder (Van de Ven et al., 1984; Eisenhardt and Schoonhoven, 1990; Chandler and Jansen, 1992).

For the cadre founders in this study, the past experience of being years of cadres-- the former positional power holders, would definitely lead to deeper understanding of the criticality of the social capital. Being the insiders, they knew the rule of the game much better than those non cadre entrepreneurs. Therefore, they would not refrain from SC acquisition because of information asymmetry. Also, the accumulated personal social capital can sufficiently reduce negotiation costs. The experience of

working in an SOE-alike entity would make their managerial capabilities quite compatible at the integration stage of acquisition, thus managerial synergy could be achieved at lower costs. This also helps explain why cadre founders did not care too much about the target's KBR endowment.

6 Conclusion

During China's gradual transition from a centrally planned economy to a market-based economy, the acquisition of State Owned Enterprises (SOE) by private enterprises has been an eye catching phenomenon, yet the motives for the acquisition has not been under systemic analysis. The objective of this thesis was to gain insight into the multifaceted determinants of SOE acquisition at the business group level.

The results from the two models, as summarized in Table 15, suggest that, in general, SOE's social capital endowment has significant positive impacts on PBG's degree of acquisitiveness, while property-based and knowledge-based resources were barely influential. However, PBG demonstrated different acquisitive preference at different stage of group development. Groups at the start up stage preferred to acquire SOEs with worse property-based resources because of the value capturing, short-term orientation of the acquirers. However, groups at expansion stage focus exclusively on social capital endowed in the target SOEs. Also worth noting is that acquisitive preference differed when the founders of PBG demonstrate different social characteristics. Founders who had been cadres were exclusively attracted by social capital owing to initial founding condition effects.

Table 15: Summary of hypotheses and confirmation on full and split samples

Hypothesized relationship			Confirmation of hypotheses				
Model 1			Full sample	Split samples			
				Start-up groups	Expansion groups	Cadre Founders	Non Cadre Founders
H1-1	PBR → DA	(+)	(+) yes	(-) no	(0) no	(0) no	Failed
H1-2	KBR → DA	(+)	(+) yes	(0) no	(-) no	(0) no	re-
H1-3	SC → DA	(+)	(+) yes	(0) no	(+) yes	(+) yes	estimation
Model 2							
H2-1	SC → DA	(+)	(+) yes	(0) no	(+) yes	(+) yes	
H2-2a	SC → PBR	(+/-)	(+) yes	(+) yes	(+) yes	(+) yes	
H2-2b	PBR → DA	(+)	(0) no	(-) no	(0) no	(0) no	
H2-3a	SC → KBR	(-)	(+) no	(+) no	(0) no	(+) no	
H2-3b	KBR → DA	(+)	(0) no	(0) no	(-) no	(0) no	
H2-4	KBR → PBR	(+)	(0) no	(0) no	(0) no	(0) no	

Notes: (+/-): positive or negative effect between the two constructs ; (0) : no effect.

Building on prior theories, this study provides a valuable extension in several ways. First, the proposed structural models integrate the prior well established theoretical relationships between firm level resources and acquisition motives, while placing special attention on social capital's impacts. Being well established, the resource based view has been substantiated by evidence from business groups in emerging markets and has provided solid theoretical ground for acquisitions in developed and developing economies. Therefore, testing RBV with particular acquisition behaviour in transitional economy settings can extend its generalizability. In a more practical sense, by taking a neutral standpoint, this study tries to give an objective evaluation of the motives for private firms' SOE acquisition behaviour, and hopefully can contribute to the better understanding of the new wave of SOE acquisition after 2002.

However, there are two major limitations associated with the methodology. First, a future study should include surveys on the enterprises' self evaluation of the acquisition motives to remedy the exclusion of first-order constructs in this study. This will better our understanding of the nature of the construct and examine the correspondence between the same constructs investigated from an inductive perspective and deductive paradigms. Second, the failure of the re-estimation on the sub sample of non-cadre founder calls for further analysis on the initial founding condition effects.

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Appendices

Appendix 1: Definition and description of Private Sector Enterprises

Individual-employed or self-employed (*geti gongshang hu*)

These are household/individual businesses hiring no more than 7 employees. An individual business has been allowed to operate since 1978. It was defined as the first new business category in “private sector” by the People’s Republic of China (PRC) State Council in 1981. These individual businesses were the pioneer members of the private sector, following the completion of collectivization in the 1950s (ADB 2000a).

Private enterprises (*siying qiye*) were officially introduced as a new business category in 1988 under the “Tentative Stipulations on Private Enterprises.” They were defined as “for profit” organizations that are owned by individuals and employ more than eight people. *Siyang qiye* can be privately owned by 2–50 shareholders, with a minimum registered capital requirement at only \$1 in 2000. They can be registered as sole proprietorships, partnerships, shareholding companies or limited liability corporations. During the past decade or so, however, their status as private enterprises kept them at a disadvantage compared with state-owned enterprises (SOEs) and collectives, owing to heavy restrictions on their freedom to operate and limited access to finance.

Private urban collectives and TVEs (rural) Collective enterprises are defined as firms with assets owned collectively by workers and other economic entities, often including private investors and local government in urban area (urban collective) or rural area (TVE). Although they cannot be considered as part of the private sector in a legal sense, in practice around 50% of them are de facto privately owned companies, controlled or owned by individuals. Often called as “red hat firms,” many privately owned companies with the collusion of local officials adopt the form of a

collectively owned enterprise to secure a protective umbrella for themselves, obtaining the security and privileges extended by local governments that would not have been available if they were defined as individual business or private enterprises (Asia Law and Practice 1999). This phenomenon is still prevalent as seen in recent surveys conducted by the International Finance Corporation and Asian Development Bank (Box 5: Voices of Domestic Entrepreneurs and Foreign Investors).

Joint stock company or shareholding cooperative enterprises are defined as firms that are employee-owned, with equal voting rights independent of asset ownership. This form was introduced in 1994 for large firms. Thousands of SOEs have converted into shareholding enterprises. These enterprises are considered to be an intermediate stage for former collectives being transformed into privately held firms. Also, another variation of companies in transition is joint-ownership (*lian ying*), although this class of firms was larger in the 1950s when many private firms were gradually transformed into state owned or collectively owned enterprises after the Chinese Communist Party took power. Currently, both categories are considered when describing enterprises going through transition toward private ownership.

Wholly owned foreign enterprises and joint ventures with FDI--- Wholly owned foreign enterprises are owned by foreign parties with 100% equity stakes, and are thus considered “private sector enterprises.” Foreign-funded enterprises (PRC-foreign joint equity ventures), on the other hand, can be considered either private enterprises or SOEs, depending on their ownership structure. PRC-foreign equity joint ventures (JVs) can take two forms, equity JVs or contractual JVs. Equity JVs have three characteristics. First, profits are shared depending on each party’s equity shares. Second, JV contract periods can range from 20 years up to 70 years. Third, exit or withdrawal from JVs requires consent from all board members, which makes exit far more difficult for equity JVs than for contractual JVs. Thus, long-term commitment is expected. Profit allocation for contractual JVs is predetermined by contract and can thus be flexible (typically, for the first 5 years 60% of profits for

foreigners and 40% for PRC parties, with a gradually increased profit allocation to PRC parties). Also, the PRC partners are expected to provide land and buildings, while foreign partners provide equipment and technology. The biggest difference between these two forms of JVs is the fact that upon the expiration of contractual JVs, the PRC parties are entitled to receive the assets. Contractual JVs are often undertaken by investors in service industries such as hotels.

Appendix 2: Policy Milestones of Private Sector Development

Source: ADB, 2000. *Technical Assistance to the PRC for Private Sector Development*

Item	Phase I (1978–1985)	Phase II (1986–1991)	Phase III (1992–2000)	Phase IV (2001–Present)
Features	<ul style="list-style-type: none"> • Official revival of private business 	<ul style="list-style-type: none"> • Rise of privately run enterprises 	<ul style="list-style-type: none"> • Rapid private firm development 	<ul style="list-style-type: none"> • Stable development of private sector
Government perception of the private sector	<ul style="list-style-type: none"> • “Supplement to the state and collective Sectors • “Filling the gap” in the economy 	<ul style="list-style-type: none"> • “Necessary supplement” to the socialist public economy • Inconsistent administrative treatment 	<ul style="list-style-type: none"> • Important changes in the PRC’s overall approach to reforms and its official attitude to the role of private Sector • A market system based on the rule of law, in which the private sector is an important component 	<ul style="list-style-type: none"> • The private sector as an integral part of the economy and society
Political events, laws, and circulars relevant to private sector development	<ul style="list-style-type: none"> • 1978. Third Plenary of CCP’s 11th Central Committee marked the beginning of market-oriented reforms. 	<ul style="list-style-type: none"> • 1987. The 13th Communist Party Congress officially recognized the “private economy” and regarded it as a necessary supplement. 	<ul style="list-style-type: none"> • 1992. The 14th Communist Party Congress endorsed the socialist market economy as the PRC’s goal of reform. 	<ul style="list-style-type: none"> • 2001. Streamlined registration of private firms. • 2001. President Jiang Zemin announced that private entrepreneurs are qualified to become CCP members.

Item	Phase I (1978–1985)	Phase II (1986–1991)	Phase III (1992–2000)	Phase IV (2001–Present)
Political events, laws, and circulars relevant to private sector development	<p>1979. State Administration for Industry and Commerce National Conference decided to encourage self-employment.</p> <ul style="list-style-type: none"> 1981. State Council defined a new business category-- single industrial and commercial proprietor. 1982. The 12th Communist Party Congress designated the individual economy as a “necessary supplement” to the public sector. 1983. A series of central and local regulations for licensing and control of individual businesses, taxes, product quality, hygiene, and free markets. 	<ul style="list-style-type: none"> 1988. The 9th National People’s Congress amendment to Article 11 of the Constitution to add that the State “permits” the existence and development of the private economy and protects legitimate rights and interests. 1988. Private enterprises (<i>siying qiye</i>) is under an official categorization. 1988. State Council issued the Tentative Stipulations on Private Enterprises, defining a private firm as “a for-profit organization that is owned by individuals and employs more than eight people,” and identified three types of private firms: <ul style="list-style-type: none"> (i) sole ownership, (ii) partnerships, and (iii) limited liability companies. 	<p>1993. A “grand strategy” of transition to a market economy, a rule-based system with an emphasis on and on building market-supporting Institutions</p> <ul style="list-style-type: none"> 1997. The 15th Communist Party Congress recognizes private enterprise as an important component of the economy. 1999. Private ownership and the rule of law are incorporated into the Constitution. 2000. A new law on sole proprietorship becomes effective. 	<p>2001. The PRC’s official entry into WTO</p>

Appendix 3: Financing Sources

Table 1

Budgetary Subsidies To Loss-Making SOEs							
based on data from <i>China Statistical Year-book</i> (various years), <i>2000 Statistical Communique: China Statistical Information Network</i> (December 2000)							
In billion RMB	1993	1994	1995	1996	1997	1998	1999
Losses	45.3	48.3	64.0	79.1	83.1	85.1	76.9
As a Share of GDP	1.3%	1.0%	1.1%	1.1%	1.1%	1.1%	0.9%
Subsidies	41.1	36.6	32.8	33.7	36.9	33.4	29.0
As a Share of GDP	1.2%	0.8%	0.6%	0.5%	0.5%	0.4%	0.4%
As a Share of Government Expenditures	8.9%	6.3%	4.8%	4.2%	4.0%	3.1%	2.2%

Table 2

Proportion of total financing provided by banks, bonds & equities (in %)

	2001	2002	2003
Bank loans	75.9	80.2	85.1
Government bonds	15.7	14.4	10.0
Corporate bonds	0.9	1.4	1.0
Shares	7.6	4.0	3.9
Total	100	100	100

Source: People's Bank of China

Appendix 4: Lending to the Non-State Sector in China

(as percentage of total outstanding loans)

	Urban Collectives	Urban Individuals	TVEs	Agriculture	Total
1985	4.93%	0.17%	5.63%	6.85%	17.60%
1986	5.11%	0.13%	6.82%	6.68%	18.74%
1987	5.47%	0.16%	7.25%	7.28%	20.16%
1988	5.58%	0.17%	7.59%	7.19%	20.53%
1989	5.15%	0.11%	7.39%	7.12%	19.77%
1990	4.93%	0.09%	7.42%	7.17%	19.61%
1991	4.74%	0.08%	7.63%	7.39%	19.84%

Source: *Almanac of China's Finance and Banking, 1992.*

Appendix 5: Share Structure of China's Listed Companies

(as percentage of total shares)

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Non-tradable Shares	69.25	72.18	66.98	64.47	64.73	65.44	65.89	65.85	64.28	63.25	63.33	64.73
State Shares (%)	41.38	49.06	43.31	38.74	35.43	31.32	34.25	36.13	38.85	46.20	47.20	47.39
Domestic Legal Person's Shares (%)	22.56	19.61	21.43	21.23	25.95	29.36	26.94	25.27	22.68	17.41	16.41	15.71
Foreign Legal Person's Shares (%)	4.07	1.05	1.10	1.40	1.33	1.34	1.42	1.31	1.22	0.88	0.91	0.92
Employee Shares (%)	1.23	2.40	0.98	0.36	1.20	2.04	2.05	1.19	0.64	0.46	0.37	0.17
Other (%)	0.00	0.05	0.16	0.74	0.95	1.18	1.23	1.15	0.98	0.31	0.54	0.54
Tradable Shares	30.75	27.82	33.02	35.53	35.25	34.56	34.11	34.95	35.72	34.75	34.67	35.27
A Shares (%)	15.87	15.82	21.00	21.21	21.92	22.79	24.06	26.33	28.43	25.26	25.69	26.67
B Shares (%)	14.88	6.37	6.06	6.66	6.45	6.04	5.30	4.59	4.00	3.13	2.85	2.73
H Shares (%)	0.00	5.63	5.96	7.66	6.88	5.74	4.75	4.03	3.18	6.36	6.13	5.87
Total Shares (billion)	6,887	38,773	68,454	84,842	121,954	194,267	252,679	308,895	379,171	521,801	587,544	642,846

Source: China Securities and Futures Statistics (2003) and the official web site of China Securities Regulatory Commission. <http://www.csrc.gov.cn>

Appendix 6: The Development of Chinese Enterprises 1990~1999

year	SOE		Collective		FDI		Private	
	number	Growth Rate (%)	number	Growth rate (%)	number	Growth rate (%)	number	Growth rate (%)
1990	1, 151, 472	0. 40	3381937	-11. 69	25389	59. 49	98141	8. 35
1991	1, 253, 725	8. 88	3479971	2. 90	37215	46. 58	107843	9. 89
1992	1547190	23. 41	4159417	19. 52	84371	126. 71	139633	29. 48
1993	1951659	26. 14	5156519	23. 97	167507	98. 54	237919	70. 39
1994	2166331	11. 00	5456818	5. 82	206096	23. 04	432240	81. 68
1995	2218612	2. 41	5337734	-2. 18	233564	13. 33	654531	51. 43
1996	2163346	-2. 49	5013416	-6. 08	240447	2. 95	819252	25. 17
1997	2078348	-3. 93	4470469	-10. 83	235681	-1. 98	960726	17. 27
1998	1836289	-11. 65	3736365	-16. 42	227807	-3. 34	1200978	25. 01
1999	1649870	-10. 15	3172471	-15. 09	212436	-6. 75	1508857	25. 64
2000							1761800	16. 76
Average growth rate		4. 07		-0. 71		26. 62		35. 50

source: China Statistical Yearbook 2001, data as of 2000

Zhongguo qiye guanli nianjian, 2001 (China's yearbook of enterprise management);

Appendix 7: The State-owned Shares Transaction

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of changes in controlling shareholders at listed firms	1	2	1	9	33	70	84	103	119	168	171*
Total number of listed companies at year end	183	291	323	530	745	851	949	1,088	1,160	1,224	1,287
Number of take-overs as a proportion of total listed companies, %	0.5	0.7	0.3	1.7	4.4	8.2	8.9	9.5	10.3	13.7	13.3**
Average % of State Shares being transferred	n/a	n/a	n/a	n/a	21.21	27.14	31.06	40.17	35.29	n/a	n/a

Sources: Nie and Tian (2001: 304); Chen (2003: 5); SHGSE (2003: 186); www.sdcqjy.com; and assorted press reports.

* Figure based on annualising the 128 for Jan-Sept. 2003. ** Estimates based on the 2003 annualized figure.

Appendix 8: Summary of Sample Data

Table 1: Industrial distribution of target SOEs

Industry	# of SOE
Building Materials	3
Chemicals	7
Agriculture	2
Food Processing	3
Textiles	3
Machinery	5
Urban Utilities	3
Construction	2
Transportation / Storage	2
Commerce	3
Retail	2
Petroleum	2
Printing	2
High Tech	3
Real Estate	4
Electronics	3
Total	49

Appendix 8 - Table 2: Descriptive statistics of sample data

		Minimum	Maximum	Average
	Property based resources (PBR)			
PBR1	Liquidity: Acid Test=(TCA - Inventory) / TCL	.17	6.96	1.1671
PBR2	Asset Utilization: (Annual Sales / Total Assets)	.02	.99	.4040
PBR3	Profitability: Operating Margin= EBIT / Op Rev	-76.95	63.37	8.9829
PBR4	Solvency: Debt/ Asset Ratio=Total Debt / Total Assets	5.09	153.82	52.4172
PBR5	Attractiveness of investment: (3 yr average RONA)	-145.00	23.00	-4.5673
	Knowledge based resources (KBR)			
KBR1	TMT expertise / Total TMT	.29	1.00	.7846
KBR2	TMT expertise retained / Total TMT expertise	.00	1.00	.5196
KBR3	Different person assumes the role of CEO and board director	.00	1.00	.6939
KBR4	Business relatedness	1.00	5.00	2.7347
	Social capital (SC)			
SC1	# of state share holders among top 10 share holders	.00	9.00	2.7755
SC2	% state-owned share retained after acquisition	.00	52.19	18.2678
SC3	% of cadre TMT	.00	1.00	.6015
SC4	% of cadre TMT retained	.00	1.00	.4702
SC5	% of cadre BOD retained	.00	1.00	.5072
	Degree of acquisitiveness			
DA1	asset acquired / total assets of the acquire	.03	1.43	.4126
DA2	% of share transferred	8.76	52.50	26.0214

Appendix 9: Social Characteristics of Chinese Private Entrepreneurs

	Sample size	Gender (% of female)	Age (average)	Years of operation average	Education %	
					High school and college	University and above
1993	1394	8.92	39.96	5.91	35.9	17.2
1995	1461	12.95	n/a	n/a	38.1	18.4
1997	1918	9.01	40.05	4.54	41.7	20.2
2000	3041	12.45	43.38	6.5	39.2	38.4
2002	3256	12.35	43.93	7.04	41.9	38.4

Source: Compiled from the results from the Fifth National Sample Survey on Private Enterprises conducted by the China Private Enterprise Study Group and the China Federation on the Private Economy (Beijing Review 2003).