

# State-owned Enterprise Reforms in the New Era: The Recentralization Reform of Chinese High-speed Railway Industry

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# State-owned Enterprise Reforms in the New Era: The Recentralization Reform of Chinese High-Speed Railway Industry

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## ABSTRACT

Chinese economic development has undergone significant changes in the past several decades. When China first joined the WTO and announced its “Going out” policy in the early 2000s, increasing the role of the market was Beijing’s major goal. In line with this objective, Chinese State-owned Enterprise (SOE) reforms focused on how to improve domestic market competition as well as company profitability. After a decade of double-digit GDP growth and the ramping up of export-oriented economic policies and projects, China entered a “New Era of the Chinese Economy,” which emphasized the importance of Chinese overseas investment and presence. With support from industrial policies and government subsidies, Chinese SOEs dramatically increased their overseas commercial activities. The result of these trends is that SOEs paid less attention to their political duties and focused more on revenues. Malicious overseas competition among Chinese SOEs appeared more frequently and raised questions about the Chinese government’s ability to control SOEs. In order to avoid cutthroat competition and better manage resources, the Chinese government launched a series of recentralization reforms, aimed at the leading SOEs in several strategically important industries. The 2015 merger of two large high-speed rail SOEs demonstrated the Chinese government’s effort to centralize large SOEs and strengthen industry’s global competitiveness, while capital markets played a more influential role in the process. The paper will enrich the current discussion about Chinese SOE reforms and provide practical evidence to explain the role of government in the reforms.

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## LIST OF ACRONYMS

CCP: Chinese Communist Party

CNR: China CNR Corporation

CSR: China South Locomotive & Rolling Stock Corporation

CRRC: CRRC Corporation

EMU: Electrical Multiple Units

HSR: High-speed Railway

LORIC: China National Railway Locomotive & Rolling Stock Industry Corporation

MOR: Ministry of Railways

OFDI: Outward Foreign Direct Investments

SASAC: The State-owned Assets Supervision and Administration Commission of the State Council

SOE: State-owned Enterprise

## Introduction

As an essential part of the government-directed development model, an exported-oriented economic development plan has been implemented in China, marked by China's join of the WTO. The core of this economic strategy was to promote domestic market competition, with a view to enhancing Chinese firms' international competitiveness. The policy has been very successful to date. In recent years, the dramatic increase in Chinese outbound foreign investment and goods export attracts people's attention Chinese Outward Foreign Direct Investments (OFDI) flows have greatly increased, from US \$2.5 billion in 2002 to \$56.5 billion in 2009, an increase of more than 2000%.<sup>1</sup> Notably, more than 80% of the OFDI has been funded by Chinese SOEs, among which SOEs financed and owned by the Chinese central government contributed almost 90% of the investment.<sup>2</sup> This growth is largely the result of a series of market-oriented State-owned enterprise reforms initiated by the Chinese government.

Marketization has not only changed their business behaviors but also their business goals. Before the reforms, the heavy reliance on orders and subsidies from the Chinese government lowered SOEs' motives and capacity to adjust to a fast changing business environment and compete with private firms or foreign peers. The reformed SOEs liberated themselves from traditional planned economic mentality and even ignored their political tasks to maximize profits under certain circumstances. SOEs with similar products went so far as to launch

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<sup>1</sup> [http://www.cifor.org/publications/pdf\\_files/WPapers/WP-79CIFOR.pdf](http://www.cifor.org/publications/pdf_files/WPapers/WP-79CIFOR.pdf), pp1

<sup>2</sup> [file:///C:/Users/ysp30/AppData/Local/Packages/Microsoft.MicrosoftEdge\\_8wekyb3d8bbwe/TempState/Downloads/When%20China%20National%20Champions%20Go%20Global\\_stamped%20\(1\).pdf](file:///C:/Users/ysp30/AppData/Local/Packages/Microsoft.MicrosoftEdge_8wekyb3d8bbwe/TempState/Downloads/When%20China%20National%20Champions%20Go%20Global_stamped%20(1).pdf) (Journal of World Trade, Michael M Du, University of Surrey)

malicious price wars in overseas competition. The competition became even more intense after China announced the Belt and Road Initiative in 2013. The losses of overseas “National interests” and the growing autonomy of SOEs raised the Chinese government’s concern about its overall ability to use State-owned economic players to fulfill political goals. As a result, the Chinese government initiated series of SOE recentralization reforms, deviating from the old decentralization and marketization path and emphasizing the coherence and consistency of business activities. Although it is in some ways a reiteration of the Chinese government's intervention in economic development, recentralization movement should not be misinterpreted as a simple move back to the planned economy. The integration into world markets forced the Chinese government to play under the market rules, choosing more market-based instruments such as the stock market to achieve its goals, instead of relying solely on political instruments.

This article will first explain how the recent shifts in Chinese economic development goals have reshaped Chinese SOEs reforms. Then the article will dive into a more detailed analysis of SOE reforms in the Chinese high-speed rail industry. By using the merger of two Chinese large railway construction companies in 2015 as a case study, the article will examine the nature of recentralizing reforms, as well as the instruments the state used. By analyzing the causes and effects of the merger process, we can have a better understanding of the recentralization reform model, which may be applied to other strategically important industries and even forecast the outcome of the new round of SOE reorganization.

## Literature Review

There is a large literature on the government's changing role in economic reforms. The majority of it takes a macrolevel approach and explains how governments use economic reforms to fulfill their political and security goals (e.g., Baldwin 1985; Furman, J., Porter, M. and Stern, S. 1999; Miller and Rose 1990). Several scholars, noting that the mainstream view only captures one dimension of the complex relations between the state and SOE, have tried to include commercial actors and focus more on the microeconomic level. (e.g. Eugen 1973; Glipin 1975; Erica 2014). Also, some scholars have managed to grasp the dynamic balance and interaction between the government and the private sector (Norris 2016; Margaret M. 2005). However, economic trends have always been treated as the cause or the outcome of government' actions and its effects on the government has generally been ignored. Recently, some scholars have started to examine whether the influences of globalization have reshaped domestic regulatory politics (e.g. Vogel, D. and Kagan, R. 2004; Ipek, 2007; Matti, W. and Woods, N 2009). This paper is going to provide new empirical evidence to enrich this discussion.

Chinese SOEs have been developing rapidly since the Reform and Opening Up policy was initiated in 1978. Most research on Chinese SOE reform has focused on the reform of property rights regulations (e.g. Wu 1993; Shleifer, A. and Vishny, R.W. 1997), the internal governance of companies (e.g., North D.C.1990; Scott W.R. 1995), and the external business environment (e.g. Lin 2004; Bai 2006; Liao 2014). Discussing the impact of the existing export-oriented economy on the reform of State-owned enterprises presents an opportunity to add to the theories about Chinese SOE reform.

As for the railway industry, past research on this sector is mainly based on evidence from developed countries such as Japan and France, where technology and industry advantages were the major driver of development. (e.g. Podestà C. 1993; Anthony and Calimante 2011). Since 2010, the globalization of Chinese High-speed Railway (HSR) has attracted some people's attention. Previous studies have discussed China's strategy behind the promotion of HSR and its spillover benefits. Most research by Chinese scholars has concentrated on two topics: The first one being HSR's role in bolstering Chinese domestic economic growth and promoting regional integration and communication (e.g. Gao 2012; Chen 2015; Zhang and Chen 2015); and the second topic being HSR's empirical development plans. Technology improvement (e.g. Zhang and Chen 2015), increasing national support (e.g. Xu 2015) and improve intercultural communication (e.g. Chen and Wang 2009) identified as key strategies to enhance the high-speed rail industry future growth. However, none of these studies mention the current recentralization reforms. A more comprehensive and updated understanding of the railway industry reforms could help to make a better projection about the industry's future.

## **Theory and Method**

Market-liberalization reform is always used in developing countries as a strategy to boom their economy. According to the new institutional economics perspective, institutions regulate economic activities through formal and informal constraints by setting the rules of the game as a basis of economic activities (Davis and North 1971; Scott 1995). Formal constraints are mainly policies, regulatory rules and contracts, etc. The planning regime is the

most important formal constraint in a transition economy, and it has an overwhelming effect on economic performance (North 1990; Lawrence and Valachoutsicos 1990). The rise of the Western world can be traced to the evolution of property rights that provided the necessary incentives for economic players (North and Thomas 1973). The recent market reforms in former communist countries have renewed debates on the effect of property rights and other institutional factors (e.g. Nee 1992; Walder 1995; Boisot and Child 1996; North 2005).

Scholars have also been interested in whether the state can serve as a positive factor during institutional changes and which kind of state is preferable (e.g. Williamson 1975; North 1990). Structural reforms led by governments highlight the need to help firms modernize their production processes, develop new markets and enhance competitiveness (e.g. Porter 1990; Hall and Soskice 2001; Steil, Victor, and Nelson 2002). Based on this theory, this paper examines how the state actively asserts its influence during the economic transition period to achieve its main goals, and it analyzes how the Chinese government uses SOE reforms to build up favored industries and achieve its economic and political objectives.

This article is a qualitative social science paper. The major methods used in this article are text analysis and case study. The sources can be divided into three categories. The first is government documents, most of which are from the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), Ministry of Railways (MOR) and the State Council. The article also extensively uses guidance documents issued by the Chinese Communist Party (CCP) on issues related to the reform of State-owned enterprises. The second set of sources is company information disclosures, which contain annual business reports and reports on major business decisions. The third primary resource is news about the reform process and the memories of the people involved in the reform. Through these

documents, we can decipher the Chinese government's and the enterprises' expectations, as well as the impacts of the reforms.

## **Chinese Economic Opening and State-owned Enterprise Reforms**

China has actively participated in the world market since it successfully joined the WTO in 2001. In order to make better use of the cheap labor and large market, the Chinese government began to reform Chinese economic structures, especially the State-owned economy in which State-owned enterprises played a central role. Increasing market competition and enhancing companies' own profitability became the guiding principle of reform. In 2003, the SASAC and Central Huijin Investment Ltd. were set up as investors on behalf of the state and ownership of many SOEs was transferred from administrative ministries to them.<sup>3</sup> In October 2003, "The Decision of the Central Committee of the Communist Party of China on Several Issues Concerning the Perfection of the Socialist Market Economic System"<sup>4</sup> pointed out that "China needs to establish and improve the market-based property rights system. The purpose of establishing a property rights protection system was to stimulate innovation, enhance companies' own strength and form a good credit foundation and market competition order." The need to increase the use of capital markets was reiterated in the China Securities Regulatory Commission's promotion of the split share

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<sup>3</sup> Central Huijin Investment Ltd. operates as a subsidiary of China Investment Corporation. Central Huijin Investment Ltd. is a principal investing firm specializing in investments in major State-owned financial enterprises. <https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=22758326>

<sup>4</sup> Xinhua News Agency. Decision of the Central Committee of the CPC on Several Issues Concerning the Improvement of the Socialist Market Economic System (zhonggong zhongyang guanyu wanshan shehui zhuyi shichang jingji tizhi ruogan wenti de jue ding). [http://www.gov.cn/test/2008-08/13/content\\_1071062.htm](http://www.gov.cn/test/2008-08/13/content_1071062.htm)

reforms.<sup>5</sup> By 2012, more than 80% of central SOEs, including their subsidiaries, had implemented shareholding reforms and the function of the capital markets was gradually recovered.<sup>6</sup> The revival of capital markets attracted large amount of private investment flow into SOEs and facilitated large-scale convertible mergers and acquisitions between SOEs. This series of administrative reforms accelerated the transformation of SOE business models and motivated SOEs to open up new markets.

The implementation of the “Going Out” policy provided further policy and fiscal support to SOEs venturing overseas. According to the 2010 China Foreign Direct Investment Statistics Report, by 2010, more than 13,000 Chinese investing entities had established about 16,000 overseas enterprises over 178 countries and regions. The State-owned enterprises accounted for 66.2% of all China’s non-financial foreign direct investment and the top 20 non-financial Chinese enterprises involved in foreign markets were all State-owned.<sup>7</sup> State-owned enterprises became the main driving force of China’s export economy.

This development goal had considerable influence on SOE reforms. The accumulated foreign market profits and the growing importance of China’s overseas economic influences made competition not as favorable as in the past, and foreign companies were seen as rivals rather than partners. Increasing global competitiveness turned out to be more and more essential. In the “Guiding Opinions on Promoting Central Enterprises to Integrate Subordinate Enterprises

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<sup>5</sup> The split share structure refers to the existence of a large volume of non-tradable State-owned and legal person shares. Related reforms concerned the essential management transformation of State-owned assets in China. According to the reform proposal, the SOE companies or major shareholders should compensate about three shares per 10 shares to tradable shareholders so as to make all their shares tradable.

<sup>6</sup> World Trade Organization. 2012. “Trade Policy Review: Report by China.”

<sup>7</sup>The data comes from Ministry of Commerce of the People’s Republic of China [www.mofcom.gov.cn/article/tongjiziliao/dgzz/201109/20110907741156.shtml](http://www.mofcom.gov.cn/article/tongjiziliao/dgzz/201109/20110907741156.shtml)

to Reduce Management Problems”<sup>8</sup>, issued by the SASAC, the central-government-owned enterprises needed to restructure themselves to improve internal control. The Third and Fifth Plenary Sessions of the 16th CPC Central Committee and related government reports all mentioned the need to reform the telecommunications, electricity, and other strategically important industries. This period of organizational restructuring and market integration aimed at combining poorly-operated State-owned enterprises with better performing firms, in order to improve the overall competency of the companies and the industries. In the economic reform blueprint approved at the end of 2013, the top leadership of the Chinese Communist Party required State-owned enterprises to “take social responsibility” and proposed to “accelerate the development of new advantages in order to participate in and lead international economic cooperation and competition” (*jiakuai peiyu canyu he yinlin guoji jingji hezuo jingzheng xin youshi*)<sup>9</sup>.

However, the extensive marketization reforms raised several questions. SOEs with special functions were initially set up to strengthen the socialist economic system and ensure the country’s economic security. Chinese SOEs were not only enterprises chasing profits but more importantly the government’s macroeconomic tools for carrying social responsibilities. Post-reform SOEs’ increased focus on profits deviated from the traditional state-oriented mentality and lowered their incentives to their political duties. The phenomenon was more apparent in overseas markets, where the state asserted less influence. SOEs from the oil,

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<sup>8</sup> SASAC Bureau of Enterprise Reform. 2004. Guidelines on Promoting Central Enterprises to Clean up and Integrate Subordinate Enterprises to Reduce Related Problems in Enterprise Management Level (*guanyu tuidong zhongyang qiye qingli zhenghe suoshu qiye jianshao qiye guanli cengi youguan wenti de zhidao yijian*). <http://www.sasac.gov.cn/n103/n85881/n85921/c968669/content.html>

<sup>9</sup> Decision of the Central Committee of the Communist Party of China on Several Major Issues of Comprehensively Deepening Reform (*zhonggong zhongyang guanyu quanmian shenhua gaige ruogan zhongda wenti de jueding*) was passed by the Third Plenary Session of the 18th Central Committee of the Communist Party of China on November 12, 2013,

minerals, telecommunications and high-end manufacturing industries competed against each other for projects. The result of this fierce competition among domestic “brother” firms was the lowering of anticipated revenues and, effectively, the diminishing of the state’s economic assets. Chu Xuping, the director of the SASAC Research Center, said at the 4th International Investment Forum: “In the past, when we met fellow villagers in a foreign country, people’s eyes were full of tears because of happiness. Now, when people meet fellow villagers, their eyes are full of hostility. The competition between SOEs leads to a lot of loss in the interests of the country.”<sup>10</sup>

In order to minimize overseas competition, the Chinese government came up with a straightforward solution — reducing the number of players. In the 2015 “Government Work Report,” the supervision of State-owned assets was said to be strengthened, avoiding the loss of assets as much as possible. The need to merge similar SOEs was reclarified in September 2015 with the “Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening State-owned Enterprise Reform,” a framework text that was to be followed by a series of detailed policy documents.<sup>11</sup> Numerous actors participated in drafting the Guiding Opinions, including the Central Leading Group for Deepening Overall Reform, the Leading Group for State-owned Enterprises Reform under the State Council and the SASAC. The final text reflected the political compromises and intense negotiations that preceded its publication. Rather than using mergers as the primary instrument for overhauling the State-owned economy, the Guiding Opinions referred to

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<sup>10</sup> SASAC. 2015 “Overseas foreign investment has exceeded RMB 12 trillion. Corruption in the management of State-owned enterprises leads to huge losses.” [http://finance.ifeng.com/a/20150616/13779144\\_0.shtml](http://finance.ifeng.com/a/20150616/13779144_0.shtml)

<sup>11</sup> Xinhua News Agency. 2015. “Guiding Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening State-owned Enterprise Reform (zhonggong zhongyang, guowuyuan guanyu shenhua guoyouqiye gaige de zhidao yijian).” [http://news.xinhuanet.com/politics/2015-09/13/c\\_1116547305.htm](http://news.xinhuanet.com/politics/2015-09/13/c_1116547305.htm).

mergers as one method among others in a broader reform strategy, to rebuild State-owned “aircraft-carriers”. Although the direction of reforms tended to be conservative or even retrogressive, the rising role of stock markets to improve the transparency of mergers was more in line with the global market’s standard corporate restructuring practices.

## **Case Study of the Chinese High-speed Rail Industry’s State-owned Enterprise Reforms**

### **From Decentralization to Recentralization**

Railway not only has a direct impact on people's daily life, but also plays an essential role in promoting regional economic communication and development. A railway project usually requires vast preconstruction investments, long-term maintenance and a long interest cycle, which private investors could hardly afford. As one of the most controlled and nationalized industries, the industry has long been the test ground for State-owned enterprise reforms.

China’s railway industry had been completely State-owned for over 64 years. The efficiency of China’s railway system was extremely poor before the 1990s reforms. There were more than 2 million employees and over 600 different railway offices. The Chinese railway lines had recruited 37.2 people per business kilometers on average, while the U.S. had only 1.36 people, Japan had 8.84 people and India had 22.16 people. It was not until the 1980s and 1990s, facing increased pressure from massive population movements, that the central government started reorganizing the railway industry. To improve the competitiveness of railway service and accelerate technology innovations, a massive SOE reform took place in

the industry. China National Railway Locomotive & Rolling Stock Industry Corporation (LORIC) was detached from the Ministry of Railways and began its business. In 2000, The LORIC split into China South Locomotive & Rolling Stock Corporation (CSR) and China CNR Corporation (CNR), in accordance with the spirit of “building the main body of competition and avoiding redundant construction” (*goujian jingzheng zhuti, bimian chongfu jianshe*). The split was more like an instructed allocation instead of a corporate restructuring. A former railway employee recalled, "At that time, the plan was rushed and there was almost no room for discussion. From the first hearing of the idea, to the publishing of the plan, to the actual allocation of separation, it was no more than half a year."<sup>12</sup> To facilitate this separation, the railway market was divided according to geographic division, using the Yangtze River as a segregation line. All other resources such as research centers and subsidies were also divided equally among the two companies.

Giving the fact that the strength and market share of the two companies are almost the same, this separation greatly improved market competition in the railway industry. In 2002, the former minister of MOR Zhijun Liu proposed a new plan called “the Railway Leapfrog Development,” which focused on infrastructure improvement. The goal for this plan was to import new technology and experience from developed countries and then apply these to the Chinese railway industry. The period between 2009 and 2011 was seen as the start-up period of China’s high-speed rail industry. The Ministry of Railways of China had established coordination groups for 16 overseas railway cooperation projects, including projects in Russia, Brazil and the United States. The main task of the project coordination groups was to

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<sup>12</sup> China Economic Net. 2014. “The industry said that the integration of CNR and CSR is only a matter of time. Chinese Railway Administration always strongly opposed.”  
<http://finance.china.com.cn/industry/company/20141015/2726754.shtml>

assist Chinese enterprises in launching bids for high-speed rail overseas projects and to help the companies to further open up overseas railway construction and equipment export markets. The Chinese government signed several preliminary HSR cooperative initiatives with many countries, especially China's neighboring countries. This favorable marketization movement reached its peak in 2013, when the Ministry of Railway was broken up into the China Railway Corporation, which undertook the corporate responsibility of the ministry, and a regulatory body, the State Railway Bureau. The booming of China's HSR exports was also the product of a benevolent international environment at that time. In June 2009, the "Government Agreement for the Trans-Asian Railway Network,"<sup>13</sup> signed by 18 members of the Economic and Social Commission for Asia and the Pacific countries, including China, was formally implemented. This agreement provided many opportunities for China to export its technology. All of these policies gave CSR and CNR opportunities to enjoy the benefits of policy support and industrial protection, while maintaining a certain degree of autonomy.

The development of CNR and CSR lived up to the state's expectations. According to the firm's 2013 annual report, as of the end of 2013, CNR achieved an operating income of 97.24 billion yuan, and CSR's was 97.89 billion. These amounts were close to 10 times the revenue the two companies had when they were formed. Their influence in overseas markets also grew rapidly. When the two companies were established, there were almost no overseas orders. In 2013, CSR signed overseas orders worth US\$2.23 billion. Company statistics

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<sup>13</sup> The Trans-Asian Railway Network refers to the regional railway network formed by connecting 28 Asian and European countries' railway networks. It is built on the basis of existing railway networks in various countries. In order to connect with each other, the membership countries will build 8,300 kilometers of railways and invest about 25 billion U.S. dollars. After completion, the Trans-Asian Railway Network will have a total length of 114,000 kilometers. The agreement aims to further promote commercial exchanges between Europe and Asia. The eight countries that currently ratify the agreement are: Myanmar, India, Mongolia, South Korea, Russia, Tajikistan, Thailand, and China. <http://www.mofcom.gov.cn/aarticle/i/jyjl/m/200906/20090606336977.html>

showed that CSR's in-hand orders reached 93.38 billion yuan, of which overseas orders accounted for 26%. CNR overseas market revenue also reached 7.6 billion yuan in 2013.<sup>14</sup>

The development of high-speed railways was later designated as an important national development strategy. The new generation of Chinese leaders, represented by President Xi Jinping and Prime Minister Li Keqiang, began to vigorously promote high-speed rail diplomacy in the 2010s. The merger of CNR and CSR, as the first complete merger of two large listed central SOEs, marked the prelude to a series similar mergers in the nuclear power industry, the mineral industry, the maritime transportation industry and the construction industry.

### **The Cause of the Merger**

There are two potential reasons why CNR and CSR were selected. The first is that the export-oriented growth strategy represented by the Belt and Road Initiative, needs the support of the transportation industry. China could rely on high-speed rail to connect markets in Central Asia, South Asia, the Middle East, Eastern Europe, Russia, and finally to Western Europe. A major land traffic artery linking Eurasian counties is forming. These railways could accelerate the free flow of raw materials and goods in the countries along the lines, create new demand, attract new investment and lay the foundation for regional economic integration. Considering its strategic importance, promoting the global competitiveness of the high-speed rail industry is one of the Chinese government's priorities.

The second cause for this merger is that the state wanted to solve the destructive overseas competition between CNR and CSR. The two companies were China's leading high-speed

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<sup>14</sup> Corporate annual report 2013

railway vehicle exporters and had been competing against each other since the day they were established. Domestically, in 2010 CNR took the first action to break the “North-South divide” market share balance and successively entered Shanghai, Fujian, Kunming and other regions which were traditionally seen as CSR’s “territories”. The two companies then experienced fierce competition across the country. However, it is important to point out that the purpose of the merger was not to downgrade the competition in the Chinese high-speed rail industry. Local governments benefited from this market equilibrium. The lower price reduced the cost of local construction projects and could greatly reduce the local governments’ fiscal pressure. The central government was also willing to promote urban infrastructure and raise the level of urbanization by constructing more urban railways. As a result, the administration strived to ensure the vitality of the domestic high-speed rail industry. The railway regulatory authorities tactically controlled the bidding results to maintain the balance of market shares between CSR and CNR. For example, in 2013, CSR won a 40.97 billion-yuan high-speed Electrical Multiple Units (EMU) project, which accounted for 51.2% of the domestic market share of the high-speed rail sector in that year. CNR won 39.08 billion-yuan worth projects, equal to 48.8% of the 2013 domestic market. The same equilibrium was preserved in 2014. CSR won the bid for 150 high-speed EMUs project, accounting for 48.9% of the annual market of high-speed EMUs. CNR won the bid for 157 high-speed EMUs, which accounted for approximately 51.1% of 2014 EMU annual sales. The market was deliberately separate between these two companies. After the merger of CSR and CNR, the Qingdao Sifang BST joint venture company was introduced into the Chinese tendering market. In 2015, BST, for the first time, beat its major competitor CRRC Corporation (CRRC) and won high-speed EMU order of 350 km/h in the tender hosted by the Railway Corporation.

The overseas competition was more destructive. CSR had a long history of conducting business in Turkey since 2009. In 2011, when the Turkish government invited open bidding of its locomotives project, CNR joined the bid without notifying either CSR or railway regulatory bodies. CNR offered a quote of \$1.2 million per car, compared to CSR's original \$2 million per-car quote. This ambush forced CSR to lower its price drastically. The Turkish government became suspicious of the integrity of Chinese companies because of the huge discrepancy in bidding prices. The uncooperative actions downgraded Chinese SOEs' bidding capacity, and the order was eventually given to a South Korean company. The same story happened again when CSR and CNR bid for a subway contract in Argentina in 2012. Argentina's market belonged to CNR for a longtime, and CNR initially submitted an offer of US\$2.4 million per carriage for the market. This time it was CSR that entered the competition abruptly and quoted a price of US\$1.27 million. The gap in price shocked the Argentinian government, as a result, the government raised questions about the authenticity of China's bids and decided to suspend the cooperation projects signed with Chinese companies. The Argentinian government then asked for a new round of quote from CSR and CNR. CNR submitted a quote of US\$1.26 million in the second round, but CSR won with a bid of US\$1.21 million, roughly half of the initial offer made by CNR and almost equal to the production cost. All other companies offered an average price of 2 million US dollars per vehicle. The extreme price wars hurt both companies seriously and created a huge crisis for China's high-speed rail exports.

After CNR and CSR merger, the number of leading companies in the high-speed rail industry in China has decreased, and the corresponding competition has also decreased significantly. Chen Dayong, the manager of the CRRC International Division (*guoji shiye bu*), said that

after the merger, the HSR market returned to normal, and product prices gradually returned to a reasonable level. The data show that in 2015 China CRRC achieved an operating revenue of RMB243.7 billion, an increase of 8.31% year-on-year; total profits amounted to RMB 16.3 billion, an increase of 17.44% year-on-year. Since the beginning of this year, CRRC's overseas orders have increased significantly. This will not only safeguard the company's economic interests, but also enhance the country's image.<sup>15</sup>

## **Policy versus Market**

- **Top Level Design**

The merger of CNR and CSR is a reflection of the Chinese government's will, rather than a business decision made by the company itself. However, the merging instruments are market-based stock market and fully comply with the requirements which listed companies should follow. This mismatch of content and form has become one of the most significant features of China's current SOE reform.

Both CNR and CSR have experienced rapid growth in recent years and actively sought to expand their market share. It is hard to explain why this complete merger happened between two well-run unattached competitors from a business development perspective. Neither of them had the ability to fully acquire the other. Leading up to the merger, the two companies had no official public negotiations. Many employees in these two companies were shocked by the sudden occurrence of this merger. In one interview with a former employee of CSR, it was revealed that there was no discussion in any internal public event and no one anticipated

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<sup>15</sup> China Securities Journal. 2016. "CRRC Integration Effect Shows Recently: Newly Signed Overseas Orders in the First Half of the Year Increase 126%." <http://money.163.com/16/1121/06/C6CJON7N002580S6.html>

the merger. On the evening of September 4, 2014, the two companies made an announcement that their controlling shareholders did not receive any merger related documents or any relevant information regarding the integration. However, two months later, both CNR's and CSR's stocks were suddenly suspended from trading because of major reorganizations. Chinese media, during the suspension, argued that a merger was highly possible, and that this might be promoted by the Chinese State Council and supervised by State Councilor Wang Yong, whose role was to supervise the implementation of mergers. Many employees could not confirm the merger until they read the news from Xinhua News Agency. This non-commercial opaque decision-making process indicated the role played by the country's top leaders in this merger.

The Chinese government's role was also directly reflected in the company's mission statement. The newly established CRRC's interpretation of its role was "the forerunner, pathfinder and practitioner of deepening the reform of State-owned enterprise" (*shenhua guoyou qiye gaige de xianxingzhe, tanluzhe he shijianzhe*).<sup>16</sup> The chairman of the CRRC said in his speech to the shareholders that the merger of CNR and CSR was to explore a model that could be replicated and promoted to deepen the reform and development of central enterprises.<sup>17</sup> In the expression of the future development goal of the CRRC, there are also indications of the country's export-oriented economic strategy. In the consolidation report released by CNR and CSR in 2015, the words related to "international" appeared 97 times, and the word "overseas" appeared 31 times. Increasing internationalization (*zengqiang guojihua*) became the company's top priority. The report asserted that, by integrating overseas sales teams, formulating a unified overseas market expansion strategy and

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<sup>16</sup> CRRC. 2016. "Message from the Chairman."

<sup>17</sup> *ibid.*

concentrating on the advantages of both parties in participating in international competition, CRRC could gain a more favorable position in international competition.<sup>18</sup> Although CSR and CNR showed strong growth potential in foreign markets, the company's annual report showed that CSR's overseas operating income in 2014 was only 8.5% of its revenue in China. CNR's overseas revenue accounted for only 5.79% of its total revenue. The companies' key interests still laid in domestic markets. The overestimating of global markets was not in line with the current development situation of the companies and more likely to be the government's choice.

The non-market features of the merger could further be found in the new organizational structure of the reformed company. There was no change in the absolute controlling shareholders of the companies after the merger. Before the merger, the actual controllers of CSR and CNR were SASAC which held 57.15% of CSR's total stock and 54.65% of CNR's.

<sup>1920</sup> After the merger, the actual controller of the new CRRC was still the SASAC. The personnel changes were also very limited. In the published merger plan, the labor contracts for all employees of CSR and CNR continued by the CRRC and there were no massive layoffs. The efforts to retain the original personnel management system could also be seen in the formation of the company leadership team. The chairman of the board of directors was formerly chairman of CNR, and the positions of vice chairman were assigned to two former vice presidents of CSR. The two positions of the executive director were equally assigned to the CSR and CNR former directors. The management team consisted of three former CSR vice directors and three former CNR leaders. The personnel arrangement maintained a

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<sup>18</sup> CRRC Annual Report: 52

<sup>19</sup> *ibid.*: 70

<sup>20</sup> *ibid.*: 88

balance of influence of former leaders from CSR and CNR in CRRC. Rather than forming a completely new company, it is more appropriate to describe the CRRC as a formal consortium of CNR and CSR.

- **Standard Practices**

Different from the previous nonstandard government-led merger practice, the CNR and CSR merger completely complied with securities law and financial industry regulations. The CNR and CSR fully disclosed related business information and conducted required company audits. On October 27, 2014, CSR and CNR announced that their stocks were officially suspended and there would be major events happening. On December 31, 2014, when the stocks resumed trading, a detailed merger plan was announced. Under the leadership of the SASAC, CSR and CNR followed the principle of “consistent merging, focusing on the future, seeking common development, and adhering to meticulous planning, steadily advancing, and standardizing operations”. In operation, CSR officially absorbed CNR, which meant that CSR would give CSR’s stocks to all CNR shareholders, through the Shanghai Stock Exchange and the Hong Kong Stock Exchange. CNR's stocks were withdrawn from circulation. The entire merger had been reviewed by the China Securities Regulatory Commission and the Hong Kong Securities Regulatory Commission and had also been reviewed by both Chinese and foreign antitrust agencies.

This open and transparent merger process is different from the previous partial merger of State-owned enterprises. In the past, the merger between subsidiary companies and non-listed State-owned enterprises was not required to follow a strict information disclosure process. People often learned or speculated about the changes through vague news report or

government announcements. In this merger, all corporate assets and personnel changes were publicly published and the impact of the merger on the market is easy to find.

## **Conclusion**

"It is inevitable that there will be more M&A among centrally-administered SOEs, which is the focus of SOE reform. During a period in which China is hastening economic restructuring and industrial upgrading, the central government needs SOEs to play a leading role in some industries," Liu Yuhui, an economist at the Chinese Academy of Social Sciences, said in an interview.<sup>21</sup> It is not difficult to see the impact of national development policies in the SOE reforms of Chinese high-speed rail industry. When the country started to build a domestic market system, the reforms of the high-speed rail industry were focused on how to better promote the marketization of high-speed rail products and introduce foreign products to strengthen competition and improve product quality. When the state tried to start promoting an export-oriented economy, high-speed rail SOEs joined forces to counter foreign competitors and ensure the implementation of the national strategic plan. SOE reform is a tool which the government can use to achieve its influence and control. The nature of SOE reforms in China remains unchanged. However, this does not mean that the government can design the reforms as it wishes. The formulation of economic policies is influenced by the status of economic development and the global economic environment. With the increasing

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<sup>21</sup>China denied massive SOE merger reports. Liu Tian Source:Global Times Published: 2015-4-28  
<http://www.globaltimes.cn/content/919048.shtml>

globalization of the Chinese economy, the Chinese government becomes more accustomed to market rules.

This high-speed rail industry merger shows a replicable reform model — the government holds the control while the market decided the instruments. In fact, the alliance between powerful SOEs is widely promoted by the Chinese government in the strategic export-related industries. In 2015, the former China Power Investment Corporation and the State Nuclear Power Technology Corporation reorganized to form the State Power Investment Group; and the China Ocean Shipping(Group) Company and the China Shipping Group Implement were reorganized to the China COSCO Shipping Group. In 2016, China Textile Group, was incorporated into COFCO Group; China National Building Materials Corporation and Sinoma Group implemented restructuring. In 2017, China National Electricity Group and Shenhua Group merged and were restructured into National Energy Investment Group Co., Ltd. The logic after these mergers is the same: enhancing international competitiveness through mergers. It is reasonable to anticipate more monopolies in strategically important industries.

By decreasing competition and creating larger and more complex companies, mergers will facilitate potential rent-seeking behavior and negatively impact efficiency, competition, and the quality of goods and services. Others note that by increasing the size and complexity of state firms, mergers can exacerbate the existing organizational problems, such as low efficiency, weak oversight, and communication gaps. How to promote economic reforms while achieving international competitiveness will continue to test the leadership wisdom of China's new generation of leaders.

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