

Understanding China

Xianzhi Zhang

Enterprise Management Control Systems in China

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Enterprise Management Control Systems in China

 Springer

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ISSN 2196-3134 ISSN 2196-3142 (electronic)
ISBN 978-3-642-54714-0 ISBN 978-3-642-54715-7 (eBook)
DOI 10.1007/978-3-642-54715-7
Springer Heidelberg New York Dordrecht London

Library of Congress Control Number: 2014939012

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Preface

Along with the process of China's 30-year economic system reform and opening to the outside world, Chinese traditional enterprise system which was generated under the traditional planned economic structure has developed and transformed into the modern enterprise system under the socialist market economic structure. The modern enterprise system has clearly established ownership, well-defined power and responsibility, separation of enterprise from administration and scientific management. With such a system, China's enterprise management control is getting more and more attention and development. In this process, the advanced control theory and methods of western developed countries have a very good reference and promoting effect on the system construction and the academic research of China's enterprise management control. However, the external and internal environments of China's enterprise management control are different from those of western developed countries. Therefore, China's scholars and practitioners, working on enterprise management control theory, have long been exploring to adapt to the enterprise environment management control system in China. An enterprise management control system with Chinese characteristics is under continuous development and improvement.

In order to introduce the status of China's enterprise management control for foreign scholars and entrepreneurs who are focusing on China's economic development and the development of enterprise management, we write this book *Enterprise Management Control Systems in China* and publish its English version oversea, so as to help scholars with the international comparative study on enterprise management and help foreign entrepreneurs with managing Chinese invested enterprises.

Compared with similar foreign works, this book has distinctive Chinese features. Especially the four major modes of management control system, which are based on China's specific environment, have significant value both in theory and application.

First of all, based on China's own control environment, this book summarizes the developing process of Chinese economic structure reform and the enterprise management control, and establishes the systems of management control theory and method adaptive for Chinese characteristic.

Secondly, the book not only classifies management control scientifically, but also defines the relationship among management control, accounting control and audit control. It puts forward the idea of how to coordinate management control, accounting control and audit control, and establishes the position of the management control in the internal control.

Thirdly, it scientifically defines the 10 key elements of management control, which is a further innovation and improvement of three-element, four-element and five-element view of internal control. This is really important for comprehending the connotation of the management control accurately and developing the management control theory.

Finally, the viewpoint that different management control modes and methods should be taken according to different circumstances is put forward in this book. It establishes four kinds of management control system modes: the rule-based control system, budgetary control system, evaluation control system and incentive control system; it also scientifically and systematically demonstrates the characteristics, targets, advantages, disadvantages and application scopes of each mode.

Meanwhile, the publishing of *Enterprise Management Control Systems in China* in English is conducive to make the world come to know the development process and achievement of China's enterprise management control since China's reform and opening up; it is beneficial to the international academic community to learn Chinese scholars' theoretical achievements on enterprise management control; it is also helpful to introduce the theory and practice of enterprise management control with Chinese characteristics.

Dalian, China

Prof. Dr. Xianzhi Zhang

Acknowledgments

Enterprise Management Control Systems in China is the achievement of my long-term efforts and all my members of “Development Innovation Team” working on innovation and application of management control theory with Chinese characteristics and “Research Office of Corporate Finance and Management Control”. At this very moment of the book publication, I would like to gratefully acknowledge the following relevant institutions and individuals that have made great contributions to the composition, translation and publication of this book.

I would like to extend my gratitudes to:

Prof. Guohua Chi, Prof. Yan Chen, Dr. Wengang Sun, Dr. Xiuye Zhang and Dr. Xiaodong Zhang for their writing and revision of Chinese original;

Dr. Yuanyuan Liu, Prof. Yan Chen, Prof. Yanli Chen, Dr. Lingbing Liu, Dr. Yunjiang Geng, Dr. Yuan Qi, Dr. Xiaodong Zhang, Prof. Guohua Chi and Dr. Shuibin Gu for their contributions as leading translators in charge of different parts of the book;

Dr. Yanqiu Cheng, Dr. Fajing Cui, Ph.D. candidates Yanhong Hu, Ling Yan, Ying Cui, Xingfei Jia, Jia Hao, Fang Zhou and Chao Yan, and master candidates Jiayu Zhang, Rui Wang, Mingxing Dong, Zhuo Sun, Yao Yao, Wei Zou and Jingjing Guo for their contributions as first draft translators;

Prof. Yan Chen, Prof. Liyan Chen, Dr. Lingbing Liu, Dr. Yunjiang Geng, Dr. Yuan Qi and Dr. Xiaodong Zhang for their contributions as translation subeditors;

Foreign Ph.D. candidates, including but not limited to Erasmus Fabian Kipesha, Gwahula Raphael, Jameel Ahmad Mulani, Sultan Skinder Mirza, Ansar Majeed and Amjad Iqbal for their proofreading;

Associate Professor Yuanyuan Liu for her contribution to the translation and publication as a coordinator.

My special appreciation also goes to:

Professor Utz Schäffer from German WHU–Otto Beisheim School of Management, who supported and provided help for publication of the book in Springer-Verlag;

Professor Chia-Ying Ma from Soochow University and Professor Yuanlue Fu from Xiamen University for their comments and appraisals;

Springer-Verlag and Mrs. Emmie Yang for their supports and contributions to publication;

The Dalian Evaluation committee for publishing Academic Works Sponsored. The published book is sponsored by the Dalian Evaluation Committee for Publishing Academic Works Financed.

I would like to express my appreciation to Accounting Department of the Ministry of Finance, Accounting Society of China, Education Department of Liaoning Province, Finance Department of Liaoning Province, and The Science and Research Office, School of Accounting and Sino-German Management Control Research Center of Dongbei University of Finance and Economics. I am grateful to all business groups and their principals for their warm help on research and case studies; and I am thankful to all the writers of my references.

Dalian
31 Nov 2013

Prof. Dr. Xianzhi Zhang

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Part I
Study on Development of Enterprise
Management Control in China

Chapter 1

Reform of Chinese Economy and Management Control in Enterprises

1.1 Planned Economy and Enterprises¹

When the Communist Party of China came to power in 1949, the fundamental long-range goals of its leaders were to transform China into a modern and powerful socialist nation. In economic terms these objectives meant industrialization, improvement of living standards, narrowing of income differences, and production of modern military equipment. As the years passed, the leaders were still stick to these goals. But the economic policies formulated to achieve them were dramatically altered on several occasions in response to major changes in the economy, internal politics and international political and economic developments.

An important distinction emerged between leaders who felt that the socialist goals of income equalization and heightened political consciousness should take priority over material progress and those who believed that industrialization and general economic modernization were prerequisites for the attainment of a successful socialist order. Both the economic policies and their underlying economic models remained relatively stable, which might differ from the predecessors. Thus the form of the economic model and the policies that were expressed at any given point in Chinese history reflected both the current policy emphasis and a structural foundation built up during the earlier periods.

1.1.1 *Recovery from War, 1949–1952*

The main objective of the government for the 1949–1952 periods was simply to restore the economy to normal working order. The administration moved quickly to repair transportation and communication links and revive the flow of economic activity. The banking system was nationalized and centralized under the People's

¹Economic history of China [1].

Bank of China. To bring inflation under control by 1951, the government unified the monetary system; tightened credit, restricted government budgets at all levels and put them under central control, and guaranteed the value of the currency. Commerce was stimulated and partially regulated by the establishment of state trading companies (commercial departments), which competed with private traders in purchasing goods from producers and selling them to consumers or enterprises. Transformation of ownership in industry proceeded slowly. About a third of the country's enterprises had been under state control when the Guomindang government was in power (1927–1949), as was much of the modernized transportation sector. The Communist Party of China immediately made these units state-owned enterprises upon taking power in 1949. The remaining privately owned enterprises were gradually brought under government control except 17 % of industrial units were still completely outside the state system in 1952.

1.1.2 First Five-Year Plan, 1953–1957

Having restored a viable economic base, the leadership was prepared to embark on an intensive program of industrial growth and socialization. For this purpose the administration adopted the Soviet economic model, based on state ownership in the modern sector, large collective units in agriculture, and centralized economic planning. The Soviet approach to economic development was manifested in the First Five-Year Plan (1953–1957). As in the Soviet economy, the main objective was a high rate of economic growth, with primary emphasis on industrial development at the expense of agriculture and particular concentration on heavy industry and capital-intensive technology. Soviet planners helped their Chinese counterparts formulate the plan. Large numbers of Soviet engineers, technicians, and scientists assisted in developing and installation of new heavy industrial facilities, including many entire plants and pieces of equipment purchased from the Soviet Union. Government control over industry was increased during this period by applying financial pressure and inducements to convince owners of private, modern firms to sell them to the state or convert them into joint public-private enterprises under state control. By 1956 approximately 67.5 % of all modern industrial enterprises were state owned and 32.5 % were under joint public-private ownership. No privately owned firms remained. During the same period, the handicraft industries were organized into cooperatives, which accounted for 91.7 % of all handicraft workers by 1956.

In terms of economic growth the First Five-Year Plan was quite successful, especially in those areas emphasized by the Soviet-style development strategy. A solid foundation was created in heavy industry. Key industries, including iron and steel manufacturing, coal mining, cement production, electricity generation, and machine building were greatly expanded and were put on a firm, modern technological footing. Thousands of industrial and mining enterprises were constructed, including 156 major facilities. Industrial production increased at an average annual rate of 19 % between 1952 and 1957, and national income grew at a rate of 9 % a year.

1.1.3 Great Leap Forward, 1958–1960

Before the end of the First Five-Year Plan, the growing imbalance between industrial and agricultural growth, dissatisfaction with inefficiency, and lack of flexibility in the decision-making process convinced the nation's leaders that the highly centralized, industry-based Soviet model was not appropriate for China. In 1957 the government adopted measures to shift a great deal of the authority for economic decision making to the provincial-level, county, and local administrations. In 1958 the Second Five-Year Plan (1958–1962), which was intended to continue the policies of the first plan, was abandoned. In its place the leadership adopted an approach that relied on spontaneous heroic efforts of the entire population to produce a dramatic “great leap” in production for all sectors of the economy at once. Further reorganization of agriculture was regarded as the key to the endeavor to leap suddenly to a higher stage of productivity. A fundamental problem was the lack of sufficient capital to invest heavily in both industry and agriculture at the same time. To overcome this problem, the leadership decided to attempt to create capital in the agricultural sector by building vast irrigation and water control works employing huge teams of farmers whose labor was not being fully utilized. Surplus rural labor was also employed to support the industrial sector by setting up thousands of small-scale, low-technology, “backyard” industrial projects in farm units, which would produce machinery required for agricultural development and components for urban industries. Mobilization of surplus rural labor and further improvements in agricultural efficiency were to be accomplished by a “leap” to the final stage of agricultural collectivization and the formation of people's communes.

During the Great Leap Forward, the industrial sector also was expected to discover and use slack labor and productive capacity to increase output beyond the levels previously considered feasible. Political zeal was to be the motivating force and to “put politics in command” enterprising party branches took over the direction of many factories. In addition, central planning was relegated to a minor role in favor of spontaneous, politically inspired production decisions from individual units.

The result of the Great Leap Forward was a severe economic crisis. In 1958 industrial output did in fact “leap” by 55 %. Mines and factories continued to expand output through 1960, partly by overworking personnel and machines but largely because many new plants constructed during the First Five-Year Plan went into full production in these years. Thereafter, however, the excessive strain on equipment and workers, the effects of the agricultural crisis, the lack of economic coordination, and, in the 1960s, the withdrawal of Soviet assistance caused industrial output to plummet by 38 % in 1961 and by a further 16 % in 1962.

1.1.4 Readjustment and Recovery: “Agriculture First,” 1961–1965

Faced with economic collapse in the early 1960s, the government sharply revised the immediate goals of the economy and devised a new set of economic policies to replace those of the Great Leap Forward. Top priority was given to restoring

agricultural output and expanding it at a rate that would meet the needs of the growing population. Planning and economic coordination were to be revived in a less centralized form than before the Great Leap Forward, so as to restore order and efficient allocation of resources to the economy. The rate of investment was to be reduced and investment priorities reversed, with agriculture receiving first consideration, light industry second, and heavy industry third.

In a further departure from the emphasis on heavy industrial development that persisted during the Great Leap Forward, the government undertook to mobilize the nation's resources to bring about technological advancement in agriculture. Organizational changes in agriculture mainly involved decentralization of production decision making and income distribution within the commune structure. The role of the central commune administration was greatly reduced, although it remained the link between local government and agricultural producers and was important in carrying out activities that were too large in scale for the production brigades. Production teams were designated the basic accounting units and were responsible for making nearly all decisions concerning production and the distribution of income to their members. Private plots, which had disappeared on some communes during the Great Leap Forward, were officially restored to farm families.

In industry, a few key enterprises were returned to central state control, but control over most enterprises remained in the hands of provincial-level and local governments. This decentralization had taken place in 1957 and 1958 and was reaffirmed and strengthened in the 1961–1965 period. Planning rather than politics once again guided production decisions and material rewards rather than revolutionary enthusiasm became the leading incentive for production. Major imports of advanced foreign machinery which had come to an abrupt halt with the withdrawal of Soviet assistance starting in 1960, were initiated with Japan and Western Europe countries.

During the 1961–1965 readjustment and recovery period, economic stability was restored, and by 1966 production in both agriculture and industry surpassed the peak levels of the Great Leap Forward period. Between 1961 and 1966, industrial output was increased at an average annual rate of 10.6 %, largely by reviving plants that had operated below capacity after the economic collapse in 1961. Another important source of growth in this period was the spread of rural, small-scale industries, particularly coal mines, hydroelectric plants, chemical fertilizer plants, and agricultural machinery plants. The economic model that emerged in this period combined elements of the highly centralized, industrially oriented, Soviet-style system of the First Five-Year Plan with aspects of the decentralization of ownership and decision making that characterized the Great Leap Forward and with the strong emphasis on agricultural development and balanced growth of the “agriculture first” policy. Important changes in economic policy occurred in later years, but the basic system of ownership, decision-making structure, and development strategy that was forged in the early 1960s was not significantly altered until the reform period of the 1980s.

1.1.5 Cultural Revolution Decade, 1966–1978

The Cultural Revolution, unlike the Great Leap Forward, was primarily a political upheaval and did not produce major changes in official economic policies or the basic economic model.

The effect was a 14-percent decline in industrial production in 1967. A degree of order was restored by the army in late 1967 and 1968, and the industrial sector returned to a fairly high rate of growth in 1969. To revive efficiency in industry, Communist Party of China committees were returned to positions of leadership over the revolutionary committees, and a campaign was carried out to return skilled and highly educated personnel to the jobs from which they had been displaced during the Cultural Revolution.

After the fall of the Gang of Four, the leadership reaffirmed the modernization program. They also set forth a battery of new policies for the purpose of accomplishing the Four Modernizations.

The new policies strengthened the authority of managers and economic decision makers at the expense of party officials, stressed material incentives for workers, and called for expansion of the research and education systems.

This new policy initiative was capped at the Fifth National People's Congress in February and March 1978, when the leadership presented the draft of an ambitious 10-year plan for the 1976–1985 periods. The plan called for high rates of growth in both industry and agriculture and included 120 construction projects that would require massive and expensive imports of foreign technology.

Between 1976 and 1978, the economy quickly recovered from the stagnation of the Cultural Revolution. Industrial output jumped by 14 % in 1977 and by 13 % in 1978.

1.1.6 Period of Readjustment, 1979–1981

The first few years of the reform program were designated the “period of readjustment,” during which key imbalances in the economy were to be corrected and a foundation was to be laid for a well-planned modernization drive.

The major goals of the readjustment process were to expand exports rapidly; overcome key deficiencies in transportation, communications, coal, iron, steel, building materials, and electric power; and redress the imbalance between light and heavy industry by increasing the growth rate of light industry and reducing investment in heavy industry.

The central policies of the reform program were introduced experimentally during the readjustment period. The most successful reform policy, the contract responsibility system of production in agriculture, was suggested by the government in 1979 as a way for poor rural units in mountainous or arid areas to increase their incomes. The responsibility system allowed individual farm families to work a piece of land for profit in return for delivering a set amount of produce to the

collective at a given price. This arrangement created strong incentives for farmers to reduce production costs and increase productivity. Soon after its introduction the responsibility system it was adopted by numerous farm units in all sorts of areas.

In the industry, the main policy innovations increased the autonomy of enterprise managers, reduced emphasis on planned quotas, allowed enterprises to produce goods outside the plan for sale on the market and permitted enterprises to experiment with the use of bonuses to reward higher productivity. The government also tested a fundamental change in financial procedures with a limited number of state-owned units: rather than remitting all of their profits to the state, as was normally done. These enterprises were allowed to pay a tax on their profits and retain the balance for reinvestment and distribution to workers as bonuses.

The government also actively encouraged the establishment of collectively owned and operated industrial and service enterprises as a means of soaking up some of the unemployment among young people and at the same time helping to increase supplies of light industrial products. Individual enterprise (true capitalism) was also allowed, after having virtually disappeared during the Cultural Revolution, and independent cobblers, tailors, tinkers, and vendors once again became common sights in the cities. Foreign-trade procedures were greatly eased, allowing individual enterprises and administrative departments outside the Ministry of Foreign Trade (which became the Ministry of Foreign Economic Relations and Trade in 1984) to engage in direct negotiations with foreign firms. A wide range of cooperation, trading, and credit arrangements with foreign firms were legalized so that China could enter the mainstream of international trade.

1.2 Courses of Economic Reform in China²

Economic reforms began after Deng Xiaoping and his reformist allies ousted the Gang of Four Maoist faction. By the time Deng took power, there was widespread support among the elite for economic reforms. As the defector leader, Deng's policies faced opposition from party conservatives but were extremely successful in increasing the country's wealth.

1.2.1 *From Planned Economy to Planned Commodity Economy*

1.2.1.1 From 1978 to 1984

Reforms were implemented in urban industry to increase productivity. A dual price system was introduced, in which state-owned industries were allowed to sell any production above the plan quota, and commodities were sold at both plan and

²Chinese economic reform [2].