

UNDERSTANDING THE STRATEGY OF THE CHINESE GOVERNMENT
REGARDING ITS BUSINESS STAKEHOLDERS:
A STRATEGIC MANAGEMENT APPROACH

by

Anestis Keremis

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Anestis Keremis

Abstract

This thesis critically analyzes the relationship between the Chinese government and its business related stakeholders namely, the State Owned Enterprises, the Private Sector, and the foreign Multinational Enterprises. Since the start of the reform of the Chinese economy in late 70's, debates regarding the orientation of the Chinese government have been holding in the academic and political fields. Two of the most debated approaches namely State Capitalism and Developmental State, commonly acknowledge the influence of the Chinese leadership to the Chinese business environment, but emphasize on different ends. The State Capitalism approach argues for the prioritization of the state sector which allows the Chinese government to control the rest of the economy and subsequently the country. Conversely, the Developmental State line of thought maintains that the priority of the Chinese government is the development of the economy through the private sector and thereby to secure the legitimization of its authority.

One of the breaking points in the reform of the Chinese economy was the establishment of Special Economic Zones and the intensification towards incoming foreign investments which offered new technology, employment, and experience. Therefore, any analysis regarding the Chinese government's strategy in developing its economic capabilities should include not only a dominating state sector and the development of private entrepreneurship, but also the unique inputs foreign companies add to the Chinese economic scene.

The study argues that the Chinese government utilizes a strategy which includes all the productive forces of the Chinese economy and in particular it highlights the role of foreign Multinational Enterprises. In order to extract such a strategy, a set of Strategic Management tools are utilized because of their political and not due to their ideological nature. A Stakeholder analysis allows for the identification of the importance of each business stakeholder of the Chinese government. Finally, the results are applied on the Obel-Gurkov model of strategic orientation for extracting the strategy of the Chinese government.

The findings reveal the role of each stakeholder and confirm the special role of the Multinational Enterprises in the Chinese economy. In particular, the study proposes that

the Chinese government uses an “analyzer” strategy in which some stakeholders are being utilized in order to maintain a basic but crucial share, while others are tasked to provide for innovation. In the Chinese government’s strategy, the former role has been carried out by the State Owned Enterprises while foreign Multinational Enterprises are expected to fulfil the latter. The Private Sector has dramatically developed from a non-existent and supplementary sector between late 70’s and early 00’s, to the main drive of the Chinese economy. However, it lacks the quality and experience foreign Multinational Enterprises bring into the Chinese economy, which are considered as crucial elements of the strategic orientation of the Chinese government.

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List of abbreviations.

ACFTU	All-China Federation of Trade Unions
AMCHAM	American Chamber of Commerce
CCP	Chinese Communist Party
COE	Collective Owned Enterprise
DS	Developmental State
EUCCC	EU Chamber of Commerce in China
FDI	Foreign Direct Investment
GMCG	General Motors China Group
MNE	Multinational Enterprise
NEG	National Enterprise Groups
PPCC	People's Political Consultative Conference
SASAC	State-Owned Assets Supervision and Administration Commission
SC	State Capitalism
SEZ	Special Economic Zones
SOE	State Owned Enterprise
ST	Stakeholder Theory

1. Introduction.

The rise of China as the second biggest economy of the world brought forth discussions with regard to its political-economic system. Many scholars argue that the preference of the Chinese government on the State Owned Enterprises (SOEs) defines the system as State Capitalism; a market-based system under socialist rule.¹ In contrast, the East Asian experience of state development maintains that China is a state in transition towards democratization and liberal capitalism because of the rising private sector.² Due to their ideological background, both approaches favor state intervention to exclusive ends, but elude to consider the overall interest and plan of the Chinese government to maintain high rates of growth and consequently political control. The question to be answered in this Thesis is: How the Chinese government manages its business stakeholders in the context of its broader strategic orientation?

The objective of this Master Thesis therefore is twofold. First, it seeks to offer a comprehensive and balanced depiction of the Chinese business environment as it has been shaped under the heavy influence of the Chinese government. Second, to argue that not only the Chinese leadership has an overall and holistic plan when managing its business stakeholders, but also that foreign Multinational Enterprises (MNEs) play a vital role in it.

As organizational forms, states, do have (or they should have) a strategic orientation which in this case refers to the strategy a government pursues so as to accomplish its goals. To deal with the task of identifying the Chinese government's strategy regarding its business environment, a set of theories and concepts based on Management studies will be utilized in two consecutively steps. First, Stakeholder Theory (ST) and analysis will provide for a non-ideological but heavily political tool so as to point out the relationships

¹ Christopher A. McNally, "Sino-Capitalism: China's Reemergence and the International Political Economy," *World Politics* 64, (2012); Ian Bremmer, "State Capitalism Comes of Age: The End of the Free Market?," *Foreign Affairs* 88, (2009); Jane Duckett, "The emergence of the entrepreneurial state in contemporary China," *The Pacific Review* 9, (1996).

² Wonik Kim, "Rethinking Colonialism and the Origins of the Developmental State in East Asia," *Journal of Contemporary Asia* 39, (2009); Mark Beeson, "Developmental States in East Asia: A Comparison of the Japanese and Chinese Experiences," *Asian Perspective* 33, (2009); Alvin Y. So, "The Chinese developmental miracle: Origins, Characteristics, and Challenges," *Asian Perspective* 25, Special Issue on Economic Reforms and Social change in Contemporary China, (2001).

between the Chinese government and its business environment/stakeholders, namely SOEs, the private sector, and foreign MNEs. Stakeholder theory is about the management of a firm's environment. However, it avoids the ideological constraints usually found in discussions with regard to states. That is to say, a business type is not by definition prioritized as it happens with SOEs in state capitalism or with the private sector in the Developmental State approaches. Instead, stakeholder analysis offers an unbiased view of the Chinese business environment by focusing on the actual interaction between the Chinese government and each one of its particular for this case stakeholders according to their relative power and interest.

Second, the findings of the aforementioned analysis will be applied in the model of strategic orientation developed by Professors Børge Obel and Igor Gurkov³ in order to discern the strategy of the Chinese government in managing its business environment. Interestingly, it is revealed that away from political ideologies, the Chinese government's strategic orientation favors MNEs due to the prospects they create, while it uses the private sector and SOEs for economic and political gains respectively. Such an approach resembles to what Miles and Snow described as an "analyzer" strategy as opposed to strategies such as "prospecter", "defender", and reactor".⁴

The variety of goals and tasks of the Chinese government, requires an equally multi-dimensional and ideology-free strategy. The analyzer strategy realistically encompasses what the Chinese government pursues and aims to accomplish because it offers a balanced management of the organizational environment. In particular, despite of the unprecedented development of the country, China is still developing compared with the western world and therefore it requires foreign investment, technology and experience. Thus, the country needs to be desirable to investors from abroad. In addition, it needs to maintain a domestic level of development able to support its huge population which is also seen as the means to legitimize the authoritarian one-party government of China.

³ Børge Obel and Igor B. Gurkov, "Revisiting Miles-Snow Typology of Strategic Orientation using Stakeholder Theory," *ICOA Working Papers Series*, (2013), http://pure.au.dk/portal/files/55713699/2013_02.pdf.

⁴ Raymond E. Miles and Charles C. Snow, "Organizational Strategy, Structure, and Process. (Stanford: University Press: 2003).

Finally, the control of the country's economy can be achieved through the close management of the state owned assets.

The study offers a new view of the Chinese political-economic system in that it emphasizes in the practical rather than ideological goals of the Chinese government. That is not to say ideologies do not matter. On the contrary, ideologies do matter and shape state policies, but considering the fact that the Chinese government is authoritarian, it seeks to accommodate multiple and often controversial goals such as a dominating state sector and a thriving private one. Thus, it cannot afford to be monolithic and pursue ideological domination, superiority, or objectives. Instead, the Chinese government seeks to address practical issues that will secure its legitimacy through the continuation of the country's unprecedented developmental pace. Under such a perspective, the study contributes also in the discussion on the rather unique economic-political development of China.

The rest of the study consists of five sections. In part two, the theoretical background of the study is reviewed in order 1) to present the current status of the Chinese business environment through the concepts of state capitalism and developmental state, 2) to present the management/organization theories and models upon which the study will approach the topic. In part three, each one of the sectors of the Chinese business environment will be analyzed in relation with the governmental influence and under a power-interest framework. In the fourth chapter, the findings of part three will be utilized in a stakeholder analysis so as to reveal the relative importance of each business sector to the government. Subsequently, the application of the new findings to the Obel-Gurkov model of strategic orientation will highlight the strategy of the Chinese government. The study closes with a discussion of the findings with regard to the strategy of the Chinese government as well as a conclusion including suggestions for future research.

1.1 Methods, methodology, and limitations.

The inductive approach has been selected for the undertaking of this project. Since its purpose is to analyze a well-studied issue from a different perspective, the study starts

from a specific problem such as the relationship of the Chinese government with its business environment, and aims to use induction in order to produce general conclusions on the topic. In doing so, literature from the fields of Chinese, Political, and Organizational/Managerial studies constitute the main source of data and theoretical tools upon which the study will unfold.

Although this is a qualitative and interpretive study, numerical data are also being utilized mostly in describing the Chinese business environment such as in depicting the share of each sector in the local economy. Despite the fact that this is enough so as to “calculate” the power and influence of each sector in the Chinese business environment and government, it fails to perform as an indicator of their interest. As a result, the estimation of interest is left to the author’s own interpretation which is backed up by the aforementioned extended literature review.

Furthermore, the stakeholder analysis is supported by a power/interest grid in order to evaluate the importance of stakeholders when dealing with the government. In doing so, power and interest are counted only in a low/high scale which was deemed adequate for the purposes of this study. It allows however room for interpretation. Similarly, diagrams are also utilized so as to depict the relationship between business stakeholders and the Chinese government. Yet, no quantified data or any kind of quantification are being used in the application of the theoretical models, which are based on qualitative and theoretical conclusions drawn from the literature review.

This lack of quantification constituted also the first limitation of this Thesis. Without quantified data, the interpretation of behaviors might be to a certain extent influenced by the author’s subjective view. To treat such a limitation, an extensive literature has been used in order to strengthen the validity of the arguments and leave the subjective interpretation to take place only in the final argumentation. A further limitation derived from the complexity of the Chinese governmental system. It is not a secret that several top politicians in China hold several positions in the CCP and the government, thereby making impossible to identify whose interests are being served each time; the government’s, the party’s, or the individual’s own ambitions? Finally, the exclusion of Collective Owned Enterprises (COEs) constitutes by itself a limitation for this thesis.

Although the significance as well as the amount of people employed in COEs has dramatically decreased between 1985 and 2004, they still stand as an important part of the Chinese economy which has not been taken into consideration in this thesis (the reasons for this exclusion are elaborated later.⁵ See page 12).

2. Background and Theories.

2.1 Chinese State Capitalism and Developmental State.

In understanding the post-reform Chinese economic system, two approaches have been prominently utilized. Capitalism with Chinese characteristics or else State Capitalism (SC) symbolizes the departure of the Chinese government from its previous rhetoric and practice of socialism, but at the same time underlines that this turn does not belong to the western based liberal tradition due to the political domination of the Chinese State Sector.⁶ On the other hand, the Developmental State (DS) approach maintains that China's development resembles the transition of other East Asian states towards more liberal regimes and emphasizes the role of the Private Sector in such cases.⁷

Under the perspective of SC, the state undertakes the most important role in an economy for its own benefits and perpetuation.⁸ "It is the state which should lead economic development and the state should shape the market, particularly in strategic industries".⁹ SC can take various forms always according to the intentions of the government. For instance and as it was described by a scholar, in just thirty years we witnessed two models of Chinese state capitalism from which the latter is active nowadays: "One China model emphasized financial liberalization, support for private entrepreneurship, and some

⁵ Barry Naughton, *The Chinese Economy: Transitions and Growth*, (Massachusetts: MIT Press, 2007):286; James Kai-sing Kung and Yi-min Lin, "The Decline of Township-and-Village Enterprises in China's Economic Transition," *World Development* 35 (2007).

⁶ Li Xing and Timothy M. Shaw, "The Political Economy of Chinese State Capitalism," *Journal of China and International Relations* 01, (2013).

⁷ John B. Knight, "China as Developmental State," *The World Economy* 37, (2014).

⁸ Ian Bremmer, *The end of the free market: who wins the war between states and corporations?* (New York: Portfolio/Penguin, 2010): 5; John Osburg, "Global Capitalisms in Asia: Beyond State and Market in China," *The Journal of Asian Studies* 72, (2013); Nan Lin, "Capitalism in China: A Centrally Managed Capitalism (CMC) and Its Future," *Management and Organization Review* 7, (2010).

⁹ Xing and Shaw, *op. cit.*:91.

political liberalism. The other China model is more statist in orientation, putting the emphasis on financial and political controls and favoring the SOEs at the expense of private entrepreneurship.”¹⁰

When discussing SC in China, it is commonly stressed that the primacy of SOE’s constitutes the pillar by which the government monitors, regulates and eventually controls the rest of the economy. For instance, Nan Lin offers a depiction of state capitalism where “the ‘free’ market is asymmetric in favor of state-owned and affiliated enterprises in accessing loans and resources”.¹¹ Therefore, SOE’s constitute not only a significant part of the economy but also a valuable tool for the political elites and the perpetuation of the system. Indeed, despite the privatization surge the Chinese economy witnessed during the 90’s, the state maintains control of the “strategic” sectors of the economy via the control of SOE’s.¹²

However, more recent works argue that even though the power and commitment of the state to the public sector stands firm, it is the private sector which increases its significance and constitutes the driving power of the economy.¹³ Moreover, according to World Bank’s report “China 2030”, in order for the continuation of the development of the Chinese economy, more liberalization and privatizations will be required while the role of the state must be re-examined.¹⁴ A question therefore could be raised about the future of China as a SC model; what would be the relationship of a rising private sector with its government when state intervention will oppose or attempt to manipulate private interests?

In contrast with the political domination of the state over the economy, the concept of DS implies that there is an overall national plan for economic growth behind state intervention. A DS sets as its primary goal the development of the economy and its

¹⁰ Yasheng Huang, “Debating China’s Economic Growth: The Beijing Consensus or the Washington Consensus,” *Academy of Management Perspectives* 24, (2010), p. 33.

¹¹ Lin, *op. cit.*:71.

¹² World Bank and Development Research Center of the State Council, P. R. China, *China 2030: Building a Modern, Harmonious, and Creative Society*, (Washington, DC: World Bank, 2013) DOI: 10.1596/978-0-8213-9545-5. License: Creative Commons Attribution CC BY 3.0.

¹³ Nicholas Lardy, *Markets Over Mao: The Rise of Private Business in China*, (Washington D.C.: Peterson Institute for International Economics, 2014)

¹⁴ China 2030: Building a Modern, Harmonious, and Creative Society, *op. cit.*

intervention serves only this very cause by benefiting and supporting those elements of the society which can carry out such a task.¹⁵ Knight maintains that China can be seen as a DS since its government pursued economic growth by establishing the necessary institutions which consequently ensured its legitimization.¹⁶

Nevertheless, in a DS, “there is an underlying commitment to private property and market, and state intervention is firmly circumscribed by this commitment.”¹⁷ Although, state intervention in China was directed towards the recovery and revitalization of the private sector, the concessions of the Party to the private sector in China can hardly be understood as commitments. Instead of a dedication to the country’s development, state intervention in China prioritized the perpetuation and legitimization of the Party’s authority.¹⁸ In the same line of thought, a scholar points out that although the private sector is booming in China, the “clientelistic relation with the state” separates China from the rest of East Asian cases which have been characterized as developmental states.¹⁹ Furthermore, Breslin rejected China as a DS and stated seven reasons which can be summarized as the divergence within the elites over the time and ultimate goal of reform, as well as the fact that the underlying scope of reforms was the maintenance of most of the benefits privileged classes of the Chinese society had been enjoyed until then.²⁰

Each approach seems to cover just a part of the Chinese reality. SC, as the main doctrine behind the Chinese leadership provides adequate basis in explaining the political domination of the state sector on the rest of the economy but fails to understand the rise of the private sector and what it represents or where it will lead. On the other hand, the DS concept captures the overall theme of intervention of the Chinese state in the private economy but it does not provide any clue on why the Chinese state maintains the control

¹⁵ Amiya Kumar Bagchi, “The Past and the Future of the Developmental State,” *Journal of World-Systems Research* 6, (2000); Alexius A. Pereira and Chee Kiong Tong, “Power and Developmental Regimes in Singapore, China and Malaysia,” *Global Economic Review: Perspectives on East Asian Economies and Industries* 34, (2005).

¹⁶ Knight, *op.cit.*

¹⁷ Ziya Öniş, “The Logic of the Developmental State,” *Comparative Politics* 24, (1991): 111.

¹⁸ Shaun G. Breslin, “China: Developmental State or Dysfunctional Development?,” *Third World Quarterly* 17, (1999).

¹⁹ Pranab Bardhan, “The Paradigm of Capitalism Under a Developmental State: Does it Fit China and India?,” *The Singapore Economic Review* 55, (2010), p. 250.

²⁰ Breslin, *op. cit.*

and preference on SOE's, when it is the private sector which clearly contributes the most in the economy.

2.2 Stakeholder Theory.

The utilization of Stakeholder Theory (ST) aims to bridge the gap between the aforementioned approaches. Not only it does not exclude any sector of the economy for ideological reasons but it considers each part as important actor in China's business environment. Due to its political but not ideological character, ST will contribute to the "mapping" of the business environment with regard to the preferences of the Chinese government.

ST incarnated in Freeman's classic book *Strategic Management: A Stakeholder Approach*, where he argued that a firm's management should take into consideration a whole set of stakeholders besides those who directly engage in the intrinsic operations of the corporation.²¹ Such stakeholders can be governmental agencies, competitors, environmentalists and any social group which has an interest on the firm's operation.²² In contrast with the simple *input-output* model where the corporation satisfies the interests of specific groups including its owners, suppliers, customers and employees, the stakeholder model introduces a broader perception of what the organizational environment stands for and how it can be treated from a managerial perspective.

According to Clarkson, ST is about the nature of the relations between an organization and the actors in its environment.²³ In other words, ST's core aim is to understand and analyze the interaction between an organization and its environment or to put it in simpler words, the strategic management of an organization's environment. What is more, some scholars maintained that the nature of the relations of a firm and its stakeholders can be seen in three different aspects.²⁴ According to their argument, a first aspect of the ST is

²¹ R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Cambridge: University Press, 1984).

²² *Ibid.*

²³ Max B. E. Clarkson, "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance," *Academy of Management Review* 20, (1995).

²⁴ Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications," *Academy of Management Review* 20, (1995).

to *describe* and try to explain such relations. On the other hand, a *normative* view of ST would advise or provide guidance according to how these relations ought to be and finally the *instrumental* aspect would offer for a roadmap on how certain objectives can be actually achieved.²⁵

For the purpose of this study, only the descriptive aspect of ST will be utilized. There is no intention to criticize, advice or propose certain policies but rather to neutrally analyze the relations of the Chinese government and its business environment. There is a need however (1) to define who and what a stakeholder is and (2) to justify why SOE's, the private sector and the foreign MNE's are key stakeholders of the Chinese government. Defining who or what a stakeholder actually is, can be a challenge since there is not a single and commonly accepted definition.²⁶As it was implied above, a stakeholder is any individual or social group "who can affect or get affected" by the organization.²⁷ However, the purpose of this thesis is to analyze the Chinese business environment in relation with the strategic orientation of the Chinese government. Therefore, the stakeholders under examination are limited to the main productive sectors of the Chinese economy namely, the SOEs, private sector, and foreign MNEs.

- SOEs are legal persons which are owned by the government, including those where the state owns the majority of shares. They are important stakeholders since they are considered as the means for the maintaining of authority on behalf of the Chinese state (See Chapter about SOEs).²⁸
- The private sector is regulated by the "Provisional Regulations on Private Enterprises" established in 1988. Three types of private ownership are included; individual, partnership, and limited liability companies. Nowadays, the Chinese private sector has turned into an important stakeholder of the Chinese government

²⁵ Niklas Egels-Zanden and Joakim Sandberg, "Distinctions in descriptive and instrumental stakeholder theory: a challenge for empirical research," *Business Ethics: A European Review* 19, (2010).

²⁶ Ronald K. Mitchell, Bradley R. Agle and Donna J. Wood, "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts," *Academy of Management Review* 22, (1997): 858.

²⁷ Freeman, *op. cit.*:46.

²⁸ Bret H. McDonnell, "Lessons from the Rise and (Possible) Fall of Chinese Township-Village Enterprises", *William & Mary Law Review* 45, (2004).

since it constitutes the main drive of the Chinese economy and it affects the lives of millions of Chinese people (See respective chapter).²⁹

- Foreign enterprises are either wholly foreign owned, or Sino-foreign cooperation companies and are subject to laws according to their special characteristics. MNEs add to the Chinese economy not only investments but also experience, know-how and advanced technology. The very fact that some of them have the support of their home countries in dealing with the Chinese government, incurs to their significance as a stakeholder.³⁰
- Collective Owned Enterprises (COEs) finally, are subjects to “Law on Collectively-Owned Enterprises” (1991) and are “legal persons owned by workers or other economic entities”.³¹ COEs still constitute a big part of the Chinese economy. COEs usually seen as a by-product of the reform period and played a huge role in the development of the Chinese economy during the 1980’s due to the deregulation of the market. However, they seem to shrink under the rise of the private sector.³² Their main characteristic lies to the ambiguity of their property rights. In many cases, COEs were used as a mask of private enterprises in order to gain access to resources which were controlled by the state. Furthermore, COEs usually are controlled by party-members and are more affiliated to the local governments than the central.³³ Since a clear connection between COEs and the central government cannot be directly established, then they cannot be seen as a stakeholder of the Chinese government and thus are excluded from this project.

Finally, the identification of stakeholders would be incomplete without specifying the unit of analysis, namely the Chinese government. The two most prominent institutions in the Chinese political system are the Chinese Communist Party (CCP) and the Chinese government. Regardless of the efforts in the late 80’s to separate CCP from governmental

²⁹ Cyril Lin, “Corporatization and Corporate Governance in China’s Economic Transition,” *Economics of Planning* 34, (2001).

³⁰ *Ibid*

³¹ *Ibid*: 30.

³² *Ibid*

³³ Chenggang Xu and Xiaobo Zhang, “The Evolution of Chinese Entrepreneurial Firms: Township-Village Enterprises Revisited”, *IFPRI Discussion Paper* 00854, (2009).

duties, their relationship still remains at least complex and interlocking.³⁴ As Martin expressed it, “The diffusion of political power between the Party and government...can make it a difficult and complex proposition to determine who has authority to set and/or implement specific policies”.³⁵ For reasons of convenience in this study, terms such as, Chinese government, Party-state, Chinese leadership or any term regarding the highest level of authority, refers to the Chinese complex system of governance regardless the source of power. It would offer no assistance to this study to examine whether the government or the CCP has the ultimate command in each case. However, in few cases where the competition (and not the source of power) of the two institutions has an impact on the specific topic under discussion, they will be considered and referred as distinct institutions.

2.2.1 Stakeholder analysis.

In practice, stakeholder theory has resulted in many variants of stakeholder analysis. “The purpose of stakeholder analysis is to indicate whose interests should be taken into account when making a decision.”³⁶ Subsequently, scholars have argued for the variables which should be taken into account when analyzing a stakeholder. Nevertheless, for the purpose of this Thesis the *power/interest* grid by Aden and Ackermann will be utilized.³⁷ Since the goal of this study is to understand the interplay of the government with its stakeholders, then to categorize them according to their power and interest on the governmental policy and goals seems to suit that cause. Power as a variable was chosen because in an authoritarian regime, the power of any stakeholder is the definitive attribute which the government will take into consideration. As it will be shown later, what distinguishes MNEs from domestic enterprises is that the former have multiple sources

³⁴ Tony Saich, *Governance and Politics of China*, (New York: Palgrave McMillan: 2011).

³⁵ Michael F. Martin, “Understanding China’s Political System,” *CRS Report for Congress* R41007, (2010): 3.

³⁶ Benjamin L. Crosby, “Stakeholder Analysis: A Vital Tool for Strategic Managers,” *U.S. Agency for International Development No 2*, (1991): 1.

³⁷ Dragan Z. Milosevic, *Project Management ToolBox: Tools and Techniques for the Practicing Project Manager (Industrial Engineering)*, John Wiley & Sons (2003); Paul C. Nutt, *Why Decisions Fail: Avoiding the Blunders and Traps That Lead to Debacles*, Berrett-Koehler (2002); Colin Eden, Frank Ackermann, *Making Strategy, The Journey of Strategic Management*, SAGE Publications, London, UK (1998).

of power. Additionally, interest stands as a adequate indicator of the willingness to make use of power. Power is conceived as Dahl expressed the ability to make others do what they would not otherwise do, while interest is defined as the concern on something or someone.³⁸

The power/interest grid consists of a quadrant which is further separated into four quadrants, each one representing a different combination of power and interest (Figure 1, p.19). The ranking of these two variables is based in a simple low/high scale and it shows relative, rather than absolute, capabilities. That is, different approaches and perspectives might result to various outcomes regarding the estimation of power and interest. In any case:

- The upper right quadrant depicts the stakeholders which possess high power and interest. In this case, stakeholders engage actively in decision making and their demands should be taken into consideration. As we shall see in later chapters, General Motors China Group has managed to be taken into consideration in terms of the development of the Chinese automobile industry (Figure 1, position B).
- The upper left quadrant represents stakeholders with high power but low interest. Such a stakeholder should be kept satisfied regarding its area of interest in order not to mobilize its power against the interest of the unit of analysis; the Chinese government. Ideally, measures should be taken in order for its interest to be increased and become a key stakeholder (Figure 1, position A).
- The lower right quadrant refers to stakeholders with low power but high interest. Since they lack on power, it is on the hand of the government to take advantage of their interest by including and consulting them in low risk matters. They can be good advertisers and supporters. For example, a happy Chinese state sector mirrors a healthy economy (Figure 1, position D).
- The lower left quadrant is the place where stakeholders with low power and interest are positioned. They receive regular communication in order to increase their interest and subsequently move to the right box (Figure 1, position C).

³⁸ Robert Dahl, "The Concept of Power," *Behavioral Science* 2 (1956); Merriam Webster Online Dictionary, <http://www.merriam-webster.com/dictionary/interest>.

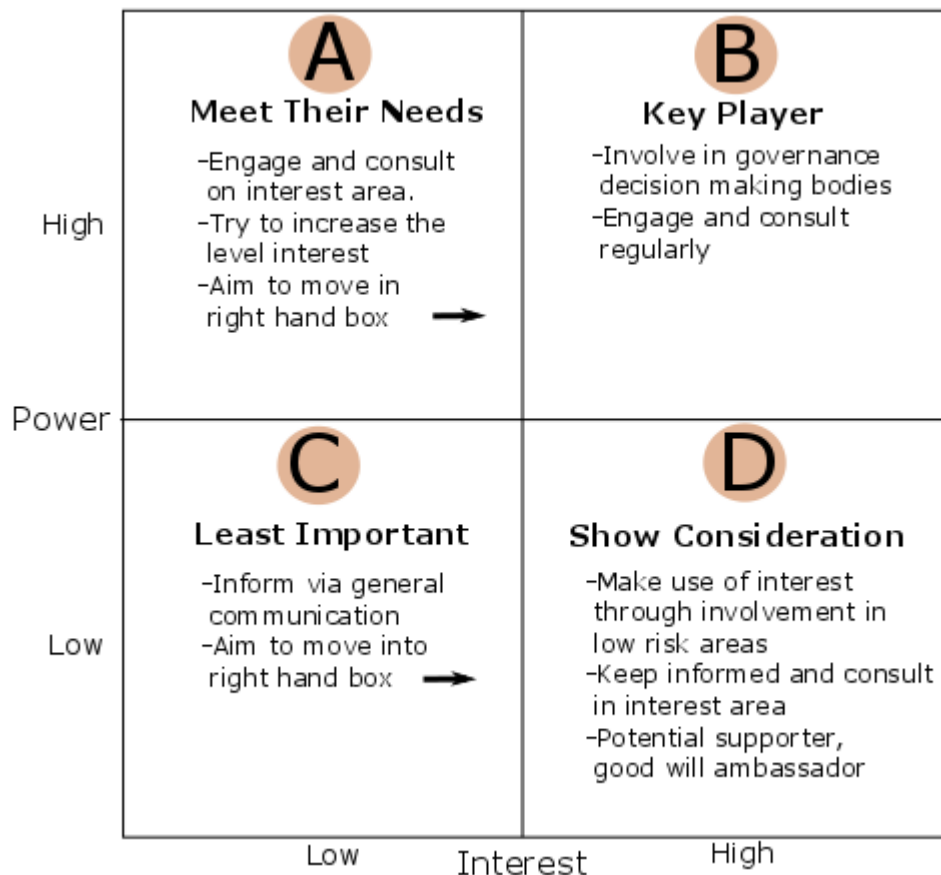


Figure 1: The Aden and Ackerman power and interest grid for Stakeholder Analysis.

Source: <http://www.stakeholdermap.com/stakeholder-analysis.html>.

The use of stakeholder analysis in a power and interest grid serves the purpose of this project, in that it turns a general discussion on the relationship of the government with its stakeholders into workable data, by categorizing them according to their importance. The ranking of the stakeholders is the first step in pursuing the extraction of the strategy of the Chinese government and it sets the base for the application of the model exactly for that cause.

2.3 Model of Strategic Orientation (Obel-Gurkov).

Although the Chinese business stakeholders has been a well-studied topic, their analysis constitutes a means to an end.³⁹ The aim of this study is not only to neutrally describe the Chinese business environment and the government's role in that, but also to argue that there is a strategy behind its behavior and management of its business stakeholders. The tool upon which the findings of the stakeholder analysis could be utilized so as to depict the correlations between the engaged actors, is a model of strategic orientation by Professors Børge Obel and Igor Gurkov.⁴⁰ The recently developed model utilizes a diagram in order to depict the relationship between a stakeholder and a firm based on the respective inputs and outputs (Figure 2, p.21). Its advantage lies to the fact that it is a natural extension of a stakeholder analysis because it utilizes the resulted categorization of the stakeholders from the stakeholder analysis, in order to discern a general plan under which particular strategies are in effect. For example and in contrast with the state capitalism arguments, the preference of the Chinese government to SOEs is not an end by itself but rather a means towards the accomplishment of a broader strategy.

Besides the vertical and horizontal axes where *outputs to* a stakeholder, and *inputs of* a stakeholder are depicted respectively, the line which stresses from the bottom left corner of the diagram to the upper right corner reflects the *line of equivalent exchange*. Stakeholders which are placed on this line are in a state of equal and fair exchange with the firm, meaning that the value of the inputs by a stakeholder equals the value of the outputs it receives in return from the firm.

The two black dashed lines above and below the equilibrium line constitute the boundaries inside which transactions and exchanges between a firm and its stakeholders

³⁹ Mariko Hayashibara, "New Hope for China's Entrepreneurs." *Asian Business* 34 (1998). <http://search.proquest.com/docview/199814875?accountid=14468>; Shu-Yun Ma, "The state, foreign capital and privatization in China," *Journal of Communist Studies and Transition Politics* 15, (1999); Zhi-Xue Zhang, *Understanding Chinese Firms from Multiple Perspectives* (Heidelberg :Springer, 2014); Organization for Economic Co-operation and Development, *Foreign Direct Investment in China: Challenges and Prospects for Regional Development*, Full text available from OECD iLibrary (Paris : OECD Publishing, 2002).

⁴⁰ Obel and Gurkov, *op. cit.*

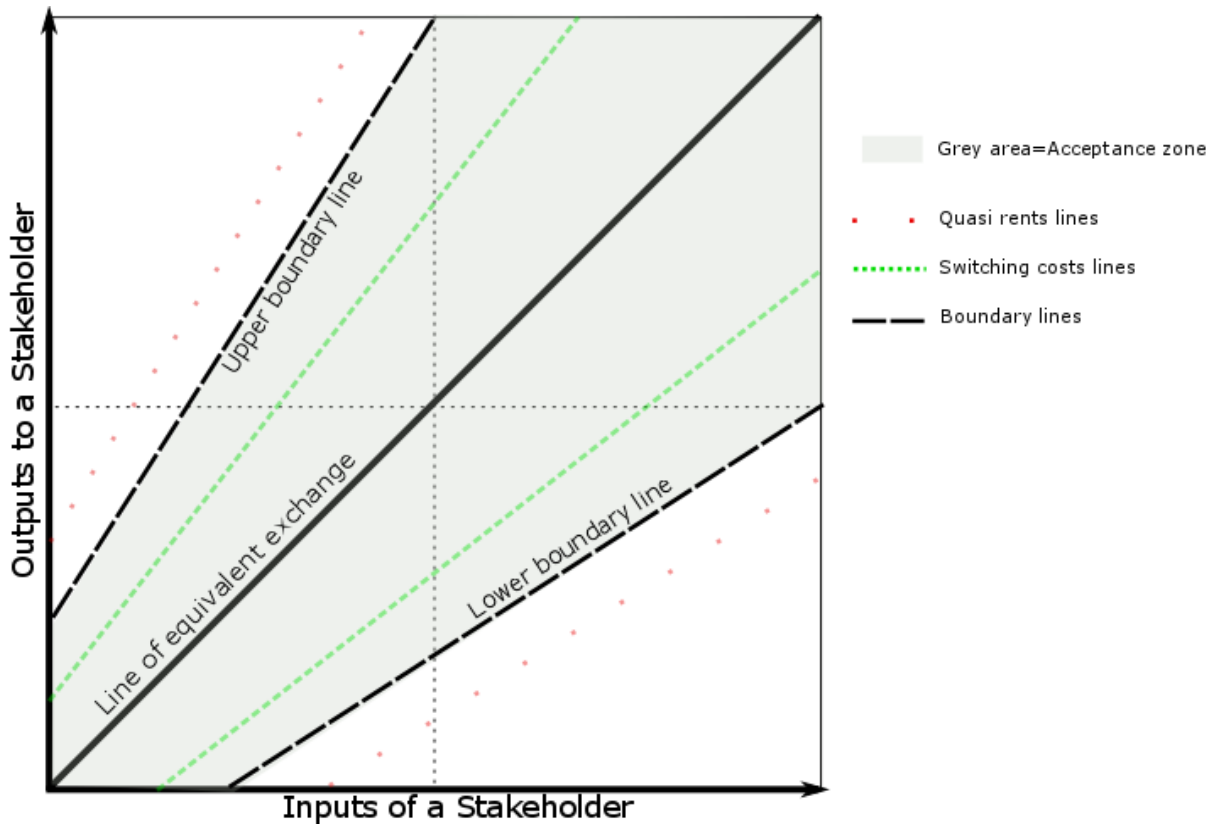


Figure 2: Based on Børge Obel's and Igor B. Gurkov's, *Revisiting Miles and Snow Typology of Strategic Orientation using Stakeholder Theory*," ICOA Working Papers 2013, pp:6.

are considered as acceptable or reasonable by both sides.⁴¹ Both boundary lines formed as an average of the quasi-rents and switching costs of the firm and the stakeholder (red and green dashed lines). Quasi-rents resemble to rents, but differ in that they have a temporary nature. They are created by factors which appear for a short or limited amount of time. For instance, the experience Chinese workers gain in being employed in multinational corporations creates a quasi-rent for the Chinese economy. However, as more and more workers will be trained in other countries, the rent will vanish. Switching costs refer to the losses an actor suffers when it decides to change its collaborator. In other words, it is the negative cost of finding new market, brand, supplier etc. which will satisfy its needs. Additionally, it should be noted that both terms usually refer to monetary values. However, for the purpose of this study, rents and switching costs will refer also to

⁴¹ Obel and Gurkov, *op. cit.*

profits or losses not immediately quantified. That is to say, benefits or losses in non-monetary form such as time, psychology, experience, technology etc. which usually end up in monetary values in the future, will be also considered.⁴²

The two boundary lines delimit the space where the relationship between a stakeholder and a firm is considered acceptable by both. However, a stakeholder placed above the equilibrium line is in *exploration* mode meaning that it provides for benefits to the firm.⁴³ Exploration is achieved when the outputs of a relationship exceed the value of the inputs of a stakeholder, providing thus new opportunities. In contrast, stakeholders positioned below the equilibrium line but above the lower boundary are considered to be in *exploitation* mode providing thus low returns to the stakeholder.⁴⁴ Keep in mind that exploitation is considered acceptable by both parts as long as the relationship remains inside the abovementioned boundaries. Once again, it should be noted that the forthcoming placement of the Chinese business stakeholders in the diagram will be based on relative estimations of their power and interest. Their positioning aims to depict their relative relationship with the government while their exact position would require further quantification of their characteristics.

The positioning of the stakeholders in the diagram will be based on Scholes' discrimination of stakeholders according to their *interest* and *power*, which was also used by Obel and Gurkov in their presentation of their model.⁴⁵ According to their example, power is the defining variable for placing a stakeholder above or below the equilibrium line (Figure 3, p.23).⁴⁶ In particular, a stakeholder with high power and high interest is placed high and close to the upper boundary line, while a stakeholder with high power but low interest is positioned closer the line of equivalent exchange. Furthermore,

⁴² Switching Costs in Investopedia, accessed in May, 1st 2015, <http://www.investopedia.com/terms/s/switchingcosts.asp>; The wealth and huge workforce of the Chinese economy allow for such opportunities. China can devote money as well as human resources in developing technologies and gain an advantage in the short run.

⁴³ Obel and Gurkov, *op. cit.*: 7-13.

⁴⁴ Obel and Gurkov, *op. cit.*: 7-13; the penetrability of the boundary lines goes beyond the purpose of this study. For information see Obel and Gurkov, 2013: 7.

⁴⁵ Kevan Scholes, "Stakeholder mapping: a practical tool for managers," in *Exploring Techniques of Analysis and Evaluation in Strategic Management* edited by Veronique Ambrosini, Gerry Johnson and Kevan Scholes (Essex: Prentice Hall Europe, 1998): 152-169; Obel and Gurkov, *op. cit.*: 16.

⁴⁶ Obel and Gurkov, *op. cit.*: 16.

stakeholders with low power but high interest are placed below and close the line of equivalent exchange. Finally, stakeholders with low power and interest approach the lower boundary line.

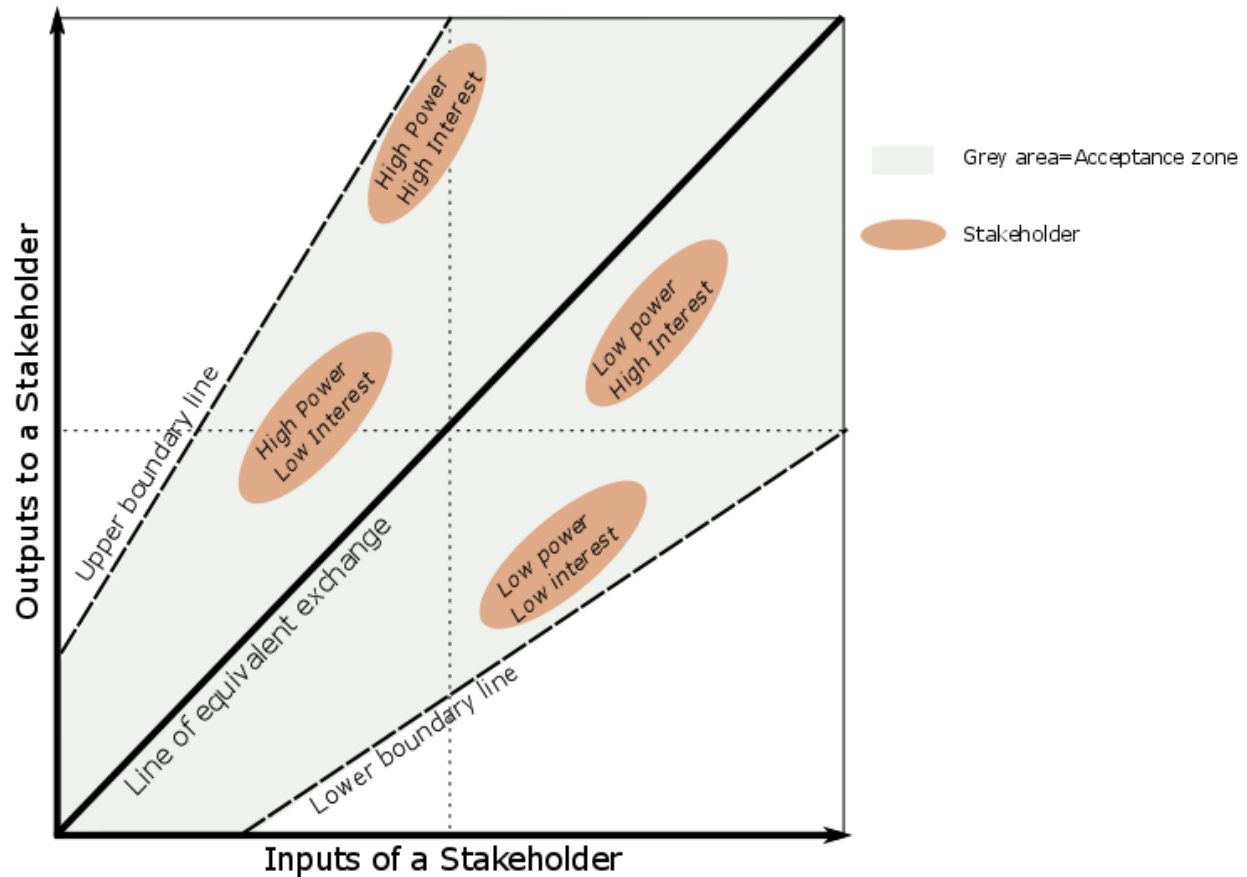


Figure 3: Depiction of the relationship between a firm and its stakeholders according to their power and interest based on Børge Obel's and Igor B. Gurkov's, "Revisiting Miles-Snow Typology of Strategic Orientation using Stakeholder Theory", ICOA Working Papers 2013.

Figure 3 presents a random mapping of a firm's stakeholders. Stakeholders with power are expected to explore. Not only a stakeholder with high power can request a privileged relationship with the main organization but the organization itself would prefer a powerful stakeholder satisfied. Accordingly, the level of interest defines whether the stakeholder will be closer to the line of equivalent exchange or to their respective upper or lower boundaries. That is, the level of interest is responsible for the adjustment of the levels of

exploration or exploitation. A highly interested stakeholder has more chances in having more room to explore or it is more likely to be less exploited. Practically, the more interest a stakeholder possess, and after taking into consideration its power, the higher in the diagram it will be positioned. Furthermore, it is also visible how the positioning of the stakeholders in the diagram could lead to patterns which derive from a firm's strategic objective. A firm which places most or all the stakeholders above the equilibrium line, pursues new opportunities through innovation. On the contrary, by placing all stakeholders below the line, a firm might be in search of maintaining their share in the market and take not unnecessary risks.

2.3.1 Miles and Snow typology of Strategic Orientation.

One of the feats the model of strategic orientation by Obel and Gurkov highlights, is the extraction of the strategy a firm is undertaking based on the Miles and Snow typology of strategic orientation.⁴⁷ Miles and Snow categorized businesses according to the changes they implement in their products or markets in order to align themselves with the environment.⁴⁸ They argued that the adaptive cycle firms have to face, “can be broken apart into three major problems...: entrepreneurial, engineering and administrative” and the ways by which companies deal with these three fundamental problems give birth to four different strategies⁴⁹:

- 1) *Defenders* have a relatively stable structure because their priority is to maintain and strengthen their position in the market. They use long term planning and they achieve cost reduction by further specialization (exploitation) (Figure 4, p.25).
- 2) In contrast with Defenders, *Prospectors* seek constantly to innovate and create new markets in which their competitors must adapt. Stakeholders are positioned above the line of equivalent exchange (exploration) (Figure 4).

⁴⁷ Miles and Snow, *op. cit.*

⁴⁸ C. Anthony Di Benedetto and Michael Song, “The relationship between strategic type and firm capabilities in Chinese firms,” *International Marketing Review* 20, (2003).

⁴⁹ Miles and Snow, *op. cit.*: 21.

3) *Reactors*, finally, are unable to make any adjustment unless their survival is threatened. They maintain a passive strategy and therefore their stakeholders are positioned close to the line of equivalent exchange (Figure 4).

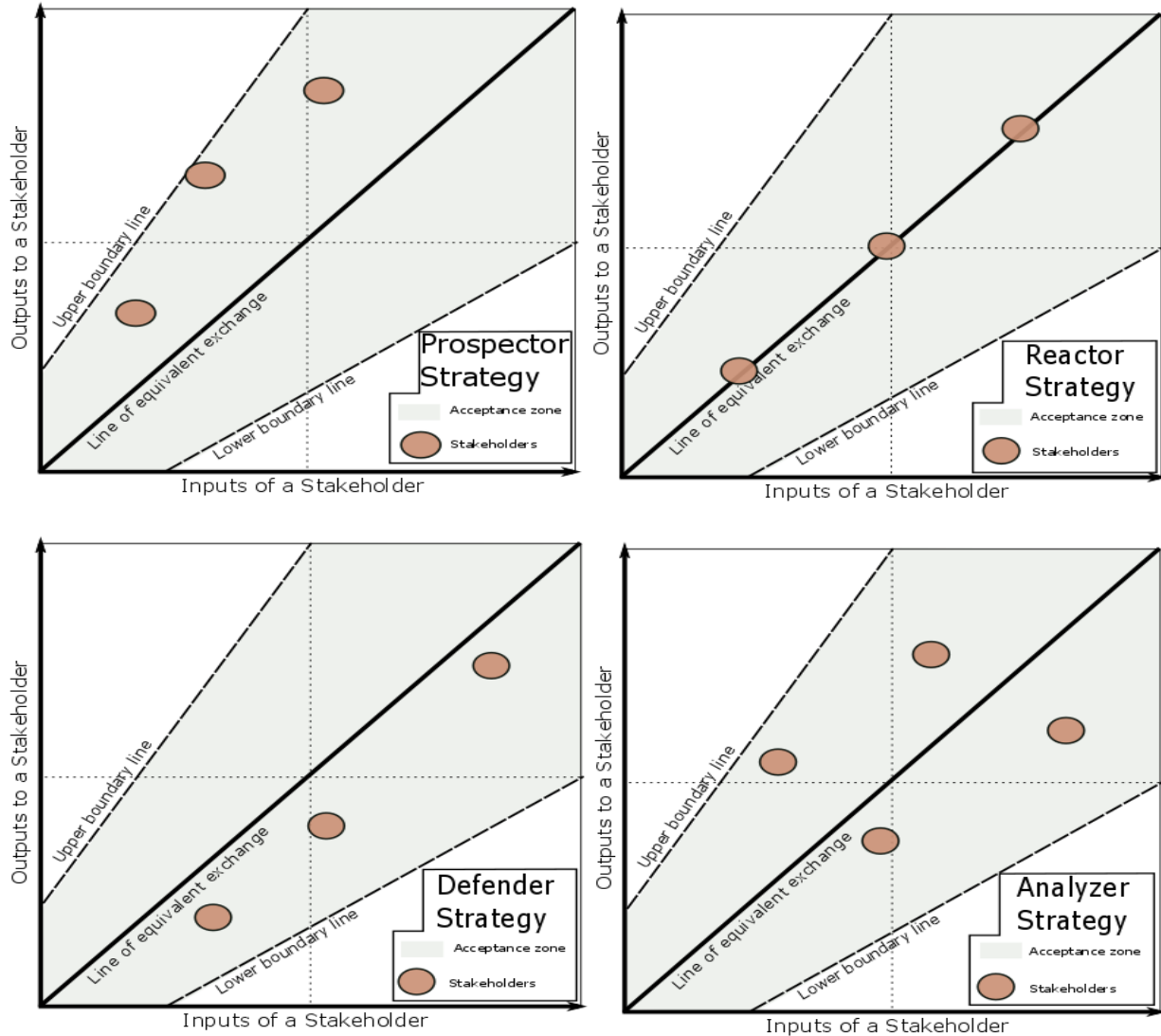


Figure 4: The Miles and Snow four strategies depicted in Børge Obel's and Igor B. Gurkov's model, "Revisiting Miles-Snow Typology of Strategic Orientation using Stakeholder Theory", ICOA Working Papers 2013.

4) *Analyzers* stand between Defenders and Prospectors. While they maintain the existing base and market share of the company, they devote some of its resources

in examining the environment for new opportunities. In the diagram, this relationship will be depicted by positioning some stakeholders above the line of equivalent exchange (exploration) while others will be placed below (exploitation) (Figure 4). For the purposes of this study, only the example of “analyzers” will be utilized. In fact, it will be argued that the Chinese government utilizes such a strategy in order to accomplish its goals. It is logical to assume that the Chinese government desires on the one hand to maintain political control by preserving a strong state sector and on the other to legitimize its authority by invigorating the development of the private sector. Therefore, this double and according to the concepts of state capitalism and developmental state controversial objective, outlines the framework under which the relationships between the unit of analysis (Chinese government) and stakeholders (SOEs, private sector, and foreign MNEs) must be examined and understood.

Although Miles and Snows’ concept refers to businesses, there is no obvious reason so as to exclude governments and states. In fact, it would be elusive to consider that the unique development of China achieved under random choices and not under a comprehensive strategy. After all, states are also organizations and they face entrepreneurial, engineering and administrative as well. In the following chapters the relationship of the Chinese government with each one of the business types will be analyzed according to the power and interest they project in relation with the governmental objectives.

3. The Chinese Government and its Business Stakeholders.

3.1 The Chinese Private Sector and Government.

Normally, and following the western experience, the discussion for the private sector on a socialist state would be rather a short story. Having in mind that the means of production under socialist rule belong to the state, private sector would seem not only as irrelevant but also as something which should be avoided for the wellbeing of society. Indeed, this

is the story of the Chinese private sector under Mao's rule. Private entrepreneurship and initiative were condemned as a curse for the Chinese society while those who were part of such activities experienced disrespect as well as persecutions at times of ideological campaigns.

Things have changed though. After thirty years of reforms and unprecedented growth, the private sector in China has recovered its significance by powering the economy through employment, innovation and, as some would argue, the rise of a new entrepreneurial class which might seek to transform its economic wealth into political power.⁵⁰ Therefore, a new landscape has emerged in Chinese reality. The private sector is no more the source of "evil" but rather the source of wealth and power of Chinese society. This chapter seeks to investigate the relations between the private sector and the Chinese government. What both parts expect from each other? What are their interests in working together? Do they have the power to impose those interests? In order for these questions to be answered, a brief review of China's private sector course over time would pave the way for the identification of elements which highlight the state of affairs of the Chinese state and the Chinese private sector.

As mentioned, the rise of the private sector of the Chinese economy initiated only after Mao Zedong's death and goes with Deng Xiaoping's reform plans in 1978. In absolute contrast with Maoist ideology, Deng sought to experiment with market based policies in carefully selected areas and sectors of the economy. For instance, the reforms began in the rural areas where the once collective system was replaced by "a system based on household responsibility".⁵¹ Eventually, its success led to further reforms in other areas and sectors of the Chinese economy. Moreover, the establishment of Special Economic Zones (SEZ) played a particular role in this process. Although their main goal was to attract foreign investments and technology, SEZ's created an environment where private

⁵⁰ Eva Bellin, "Contingent democrats: industrialists, labor, and democratization in late-developing countries," *World Politics* 52, No. 2 (2000); Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World* (Boston: Beacon Press, 1996); Gordon White, "Democratization and economic reform in China," *Australian Journal of Chinese Affairs* 31 (1994).

⁵¹ Wei Zhang & Xiaohui Liu, "Introduction: Success and challenges: an overview of China's economic growth and reform since 1978," *Journal of Chinese Economic and Business Studies* 7, No. 2 (2009): 129.

initiative thrived because state intervention and political control where to a certain extent reduced.

That is not to say however that to own and run a private enterprise in China during the 80's and 90's was an easy endeavor. Not only, the average Chinese enterprise (*getihu*) could not exceed the limit of eight employees but also it continued to be considered as a pariah sector of the economy and society.⁵² Getihus were the only legal private (individual) enterprises in 1981, while larger units had to wait for such acknowledgement until 1988 when all private enterprises were recognized as legal, regardless of their size.

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No matter however the difficulties, data shows that the Chinese private sector witnessed a noteworthy growth during that era which not only improved the lives of millions of people but most importantly paved the way for the continuation of the Chinese rise in the following decades. Private sector's share in industrial output as well as in total employment rose by 5% and 8% respectively between 1980 and 1990, providing thus strong incentives to the Chinese government to maintain its reforming plans.⁵⁴

Subsequently, the private sector continued to grow under governmental guidance in the 90's, even after the tragedy in Tiananmen Square when entrepreneurs were accused of supporting the demonstrators. More specifically, in his southern tour in 1992, Deng clearly supported private entrepreneurship in his effort to revitalize the economy by releasing the dynamic forces of the Chinese economy. Indeed, sales revenue in the private sector increased with a rate of almost 60% annually between 1990 and 2002, while it accounted for almost 40% of the national economy in 1997.⁵⁵ In the very same year, Deng Xiaoping announced his theory of the *three benefits* which was supplemented a few years later by Jiang Zemin's proposition for the *requirements of the three representations* and by which

⁵² Bruce J. Dickson, "Integrating Wealth and Power in China: The Communist Party's Embrace of the Private Sector," *The China Quarterly* 192 (2007).

⁵³ Jørge Delman, "China's party-state and the private business sector: Dog wags tail' or 'tail wags dog'?" *Norwegian Journal of Geography* 59 (2005).

⁵⁴ Gregory, Neil F, Stoyan Tenev, and Dileep M. Wagle, *China's Emerging Private Enterprises: Prospects for the New Century*, (Washington, D.C: International Finance Corp, 2000).

⁵⁵ Shiyong Zhao, "Government Policies and Private Enterprise Development in China: 2003-2006", *China and World Economy* 17, No. 4 (2009); An Chen, "Capitalist Development, Entrepreneurial Class and Democratization in China," *Political Science Quarterly* 117, No. 3 (2002).

they recognized the value and contribution of the Chinese private sector and attempted to incorporate it in the party's ideology.⁵⁶ Subsequently, the official and legal acknowledgement of the significance and protection of the private sector in China was completed when in the early 2000's "the Constitution was again revised to say that the state protects the rights, interests and legality of individual and private enterprises".⁵⁷

Similarly, private entrepreneurs needed to wait patiently in order for them to secure equal status and rights with the rest of the Chinese society and economy. During the 80's, private entrepreneurs could join the party only in a disguised manner and it was up to the hands of local authorities and party cadres to decide mostly based on the potential of exploiting entrepreneurs and their profits.⁵⁸ The growing importance however of the private sector during the 90's, and despite the disgrace for capitalists after the Tiananmen incident, forced the party to reconsider the social status of private entrepreneurs. The above mentioned theory of *three represents* by Jiang Zemin made it clear that the doors of CCP were open to exceptional businessman.⁵⁹ As a result, a new stream of entrepreneurs sought the opportunity to either be members of the political life of the Chinese society or to harness the connections and the conveniences a party membership would offer.⁶⁰

Besides those entrepreneurs who once were public employees but decided to turn to the private sector after the 'grasp the big and let go of the small' state policy applied, and those who wanted indeed to join the CCP for reasons of social status or economic profits, not all private entrepreneurs share a wish to join CCP.⁶¹ According to Delman, the reasons for that may vary from the unwillingness to engage in politics, to low levels of faith in the CCP and the search of other ways of influencing.⁶² What is more, the latest generation of China's entrepreneurs, "deliberately kept their distance from power

⁵⁶ Heike Holbig, "The Party and Private Entrepreneurs in the PRC," *Copenhagen Journal of Asian Studies* 16 (2002).

⁵⁷ Dickson, *op. cit.*: 834.

⁵⁸ Jae Cheol Kim, "From the Fridge to the Center: The Political Emergence of Private Entrepreneurs in China," *Issues and Studies* 41, No. 3 (2005).

⁵⁹ *Ibid.*

⁶⁰ Dickson, *op. cit.*

⁶¹ Shahid Yusuf, Kaoru Nabeshima, and Dwight H. Perkins, *Under New Ownership: Privatizing China's State-Owned Enterprises* (Washington DC: World Bank and Stanford University Press:2005).

⁶² Delman, *op. cit.*

establishments” as a sign of the private sector’s partly emancipation both from the party-state as well as the vague and unethical past practices.⁶³

The acquisition of equal legal status with the state sector does not mean however that the private sector was meant to be free from the influence of the government. Legal protection and recognition came along with control. According to the Chinese Constitution, “The State protects the lawful rights and interests of the individual and private sectors of the economy, and exercises guidance, supervision and control over individual and the private sectors of the economy”.⁶⁴ The Chinese state acknowledges the private sector as equal and significant part of the national economy, but only as a sector of private ownership as opposed to state ownership, and not as a sector of separate interest. It is exactly this notion of one and only interest which legitimizes (or excuses) the government to apply control and scrutiny on the private sector.

As a result and regardless of the staggering development of the past decades, the Chinese private sector faces a number of disadvantages closely related to governmental interference. For instance, Wang and Hu found that state intervention favors SOEs in competing with non-state owned enterprises in the tourism sector.⁶⁵ Furthermore, Zhao concluded that between 2003 and 2006, the performance of large Chinese private enterprises declined due to credit reduction from state owned banks.⁶⁶ As a result, a hypothesis here can be made by assuming that more liberalization would benefit the private sector by eliminating the governmental discrimination against them.

Although international institutions indeed propose to the Chinese government to liberalize further its economy, it is unlikely that the Chinese leadership faces such a prospect in good faith.⁶⁷ In effect, the Chinese government means to control the private economy by controlling resources valuable to private enterprises via the control of SOE’s. For instance

⁶³ Zhaohui, Hong, “Mapping the Evolution and Transformation of the New Private Entrepreneurs in China”, *Journal of Chinese Political Science* 9, No. 1 (2004): 31.

⁶⁴ People’s Daily, 2004 in Delman, *op. cit.*: 209.

⁶⁵ Caiping Wang and Honggang Xu, “Government intervention in investment by Chinese listed companies that have diversified into tourism,” *Tourism Management* 32 (2011).

⁶⁶ Shimin Chen, Zheng Sun, Song Tang, and Donghui Wu, “Government intervention and investment efficiency: Evidence from China” *Journal of Corporate Finance* 17 (2011).

⁶⁷ *Ibid*, World Bank and Development Research Center of the State Council.

and as it was shown above, private companies rely on the availability of credit by the bank system which is controlled by the state. What is more, SOE's control not only financial resources but also all sorts of resources, tangible and intangible, such as land, energy, exports etc.⁶⁸ The Chinese government attempts, and to some extent succeeds, to control private companies by allowing its owners to join the CCP or by requiring the establishment of CCP committees in private firms.⁶⁹

Nonetheless, it would be elusive not to mention that the government is also dependent on the private sector's performance, which according to current statistics stands as the main drive of the Chinese economy. The private sector in China accounts for more than 75% of the Chinese economy in sharp contrast with the seedy 1% in 1978, while it creates 90% of new jobs.⁷⁰ Being in fact the representation of the increasing wellbeing of the Chinese society, the private sector maintains great power. As the main driving power of the national economy, the private sector is more than necessary for the further development of China. Not only has it provided intrinsic profits such as taxes, employment and bank savings, but most importantly it is needed because it can support the social order upon which political elites legitimize their authority. Being an authoritarian government and assuming that the lessons of Tiananmen Square were adequately understood, the government uses strong economic development so as to legitimize and justify its authority over the Chinese people.

Therefore, it seems that both sides have significant amount of power at their disposal; the government holds valuable resources necessary for the further development of the private sector while private entrepreneurs represent the interests and wellbeing of a significant percentage of the Chinese population. Although a western-based modernization and democratization model would position these two power establishments as opposing sides, recent evidence from China support the argument that Chinese entrepreneurs are not necessarily interested in opposing let alone in changing

⁶⁸ Keming Yang, "The Dependency of Private Entrepreneurs on the Chinese State", *Strategic Change* 21 (2012).

⁶⁹ *Ibid.*

⁷⁰ Andrew Atherton, "How the Chinese government can boost its private sector", *Business Insider UK*, February 18 2015. <http://uk.businessinsider.com/how-the-chinese-government-can-boost-its-private-sector-2015-2?r=US>

the political system; they seem to prefer to work with the state as long as their interests are satisfied.⁷¹

Even though the magnitude of the private sector reveals its significance and the Chinese new generation of entrepreneurs keep their distance from governmental ties and power, they do not seem to pose a threat to the political system. As Tsai concludes, the majority of entrepreneurs, do not have the capacity or willingness to oppose state interests.⁷² This lack of willingness of the private sector to oppose the state may relate to the fact that it is literally the creation of a powerful state. In contrast with the liberal west where the class of entrepreneurs led to the establishment of nation-states, in China it was the state which resurrected the private sector with the reforms of 1978 and since then it has been gradually offering more and more freedom to private entrepreneurship, under strict state supervision though. Therefore and for almost forty years, the Chinese state stands as an ally and sponsor of the once vanished private sector. Thus, the lack of capacity or willingness of the private sector to oppose the government, should be rather interpreted as a lack in interest than in power. Nevertheless, the very fact that the Chinese government seeks to incorporate private entrepreneurs into the party ideology, constitutes evidence of the nervousness the rise of the private sector causes to the Chinese leadership.⁷³

In summary, the private sector has developed to a thriving and highly profitable part of the Chinese economy. Moreover, the rise of the private sector has been related with the rise of the living standards in the Chinese society. However, the overall objective of the Chinese government to maintain high rates of growth while at the same time to secure political control, neutralizes to a great extent the interest of the private sector to claim more rights. For the time being, private entrepreneurs are more interested in maintaining or increasing their profits than opposing the political system in China.

⁷¹ Jie Chen, Bruce J. Dickson, "Allies of the State: Democratic Support and Regime Support among China's Private Entrepreneurs," *The China Quarterly* 196 (2008).

⁷² Tsai S. Kellee, "Capitalists Without a Class: Political Diversity Among Private Entrepreneurs in China," *Comparative Political Studies* 38, No. 9 (2005).

⁷³ Yang, *Op. cit.*

3.2 State Owned Enterprises and the Chinese Government.

This subchapter's scope is to provide for an analysis of the relationship between SOEs and the Chinese government. Probably more than any other Chinese reform case, the partial detachment of the state sector from its founder and source of guidance signified a huge shift in the Chinese business environment. In contrast with the chapters on the private sector and foreign multinationals, there is no argumentation on where the power lies between the party-state and the state sector. Instead, the subchapter reviews how the Chinese government maintained control and power through the reforms. In doing so, the roles of the State-Owned Assets Supervision and Administration Commission (SASAC) and The All-China Federation of Trade Unions (ACFTU) as the main instruments of control on SOEs on behalf of the Chinese political elites will be presented. Furthermore, an analysis of the interests of SOEs will follow. The chapter will conclude with a summary of the interests and power each side projects.

As the main sector in the pre-reform Chinese socialist economy, the state sector was the target and first to be affected by the reforms the post Mao Chinese government implemented. These reforms resulted in four major changes: "(1) greater autonomy for managers; (2) management contracting; (3) restructuring; and (4) ownership diversification."⁷⁴ As a result, the purpose of SOEs was re-oriented towards effective and profitable entrepreneurship besides being a provider of social services and state policy tool.⁷⁵

In fulfilling these steps, the Chinese government chose to utilize a gradual approach of reforms and liberalization in contrast with the mass privatization programs other ex-communist states had followed.⁷⁶ Gradual approach meant that the whole process occurred under a "trial and error" basis which allowed for corrections but also control and

⁷⁴ Chenxia Shi, "Recent Ownership Reform and Control of Central State-Owned Enterprises in China: Taking One Step At a Time," *UNSW Law Journal* 30 (2007): 1.

⁷⁵ Jonathan G.S. Koppell, "Political Control for China's State Owned Enterprises: Lessons from America's Experience with Hybrid Organizations", *Governance: An International Journal of Policy, Administration, and Institutions* 20 (2007).

⁷⁶ E. Sam Overman, "Privatization in China, Mexico, and Russia: A Comparative Study," *Public Productivity & Management Review* 19 (1995).

avoidance of unexpected social disturbance and disorder.⁷⁷ The efforts of the Chinese government not to lose control over the economy however, slowed down the privatization of the majority of SOEs and their subsequent separation from the state bureaucracy, leading thus to huge financial debts due to the inability and inefficiency of the state sector to function in a competitive environment.

In order to deal with these challenges, the Chinese leadership initiated a second surge of reforms. The major step which allowed for the accommodation of such challenges came with the adoption of the Company Law in 1994.⁷⁸ The Company Law allowed for a number of modifications in the state sector by offering a legal framework upon which SOEs would be reorganized. Firstly, the Chinese government decided to maintain under state control only the large and strategically important SOEs including sectors such as advanced technology, nonrenewable natural resources, public utilities, infrastructure and defense.⁷⁹ Indeed, between 1990 and 1995 the industrial output of SOE's dropped by more than 20% while more than 200.000 small and medium enterprises were left outside from state ownership.⁸⁰ Secondly, the reduced number of SOEs would be corporatized so as to clarify their ownership status. It separated governmental from company actions, but established the "accountability of management to the enterprise's owner (the state)".⁸¹ Third, it was decided that the ownership of these companies could be diversified which meant that SOEs could be owned by several entities. Such a measure would allow for the separation of the interests of the company with those of its owners and the subsequent commercialization of SOEs.⁸² Finally, the internal competition the Chinese state firms were facing by the foreign owned companies led the government to favor the establishment of large enterprise groups which were supposed to be more appropriate

⁷⁷ Jan Svejnar, "China in Light of the Performance of Central and East European Economies," *IZA Discussion Paper* No. 2791 (2007).

⁷⁸ Organisation for Economic Co-operation and Development, "Reforming China's Enterprises," *China in the Global Economy*, (Paris: OECD Publishing, 2000): 310.

⁷⁹ Chun Liao, "The Governance Structures of Chinese Firms: Innovation, Competitiveness, and Growth in a Dual Economy" (Shanghai: Springer, 2009).

⁸⁰ Sarah Y. Tong, "Reforming State Owned Enterprises," in Wang Gungwu and John Wong "Interpreting China's Development," (Singapore: World Scientific Publishing Co, 2007)

⁸¹ China in the Global Economy, *op. cit.*: 53.

⁸² *Ibid.*

for competition. Many enterprises chose to join such groups mainly because of the preferential treatment of the government.

Nevertheless, data shows that the Chinese state was not ready to give up the ownership of SOEs as simple as that. According to OECD, only one third of the total amount of shares was actually available for public trading whereas the majority of shares remained under direct or indirect state control.⁸³ As of 2005, the percentage of state controlled shares slightly dropped to 65% from 67%, giving the impression that a very slow liberalization process might be in effect. However, further liberalization is not to be expected since the great majority of shares under any kind of state control remain in non-tradable form.⁸⁴

The magnitude of the remaining state sector required improved governance and control in order to be effective. For that reason, the State Owned Assets Supervision and Administration Commission (SASAC) officially established in 2003, so as to represent and exercise the government's right as owner of state property. SASAC itself is under the supervision of the State Council having the same authority as ministries do (Figure 5). In many cases however, SASAC does not fully control national enterprises but it shares the ownership of individual state owned companies with the National Enterprise Groups (NEG).⁸⁵ Nonetheless, according to the official website of SASAC, the agency is tasked to supervise and manage the state-owned assets of enterprises, guide and push forward the reform and restructuring of SOEs, appoint, evaluate, reward or remove top executives of the enterprises and, direct and supervise the management of local state-owned assets.⁸⁶ SASAC's role and central positioning at the organizational structure of the Chinese economy serves as to both command, and enhance the reorganization and competitiveness of the most important SOEs, or to act as a hub between state corporations and the Chinese government. As figure 5 shows, SASAC's control extends not only to the board of directors of SOEs, but also to local SASACs which control local

⁸³ *Ibid*: 53.

⁸⁴ Liao, *op. cit.*

⁸⁵ Li-Wen Lin and Curtis J. Milhaupt, "We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China," *Stanford Law Review* 65 (2013).

⁸⁶ SASAC website, URL: <http://en.sasac.gov.cn/index.html>.

SOEs (dotted lines). Moreover, SASAC is connected with NEG's with which it shares authority over special cases of SOEs (dotted lines).

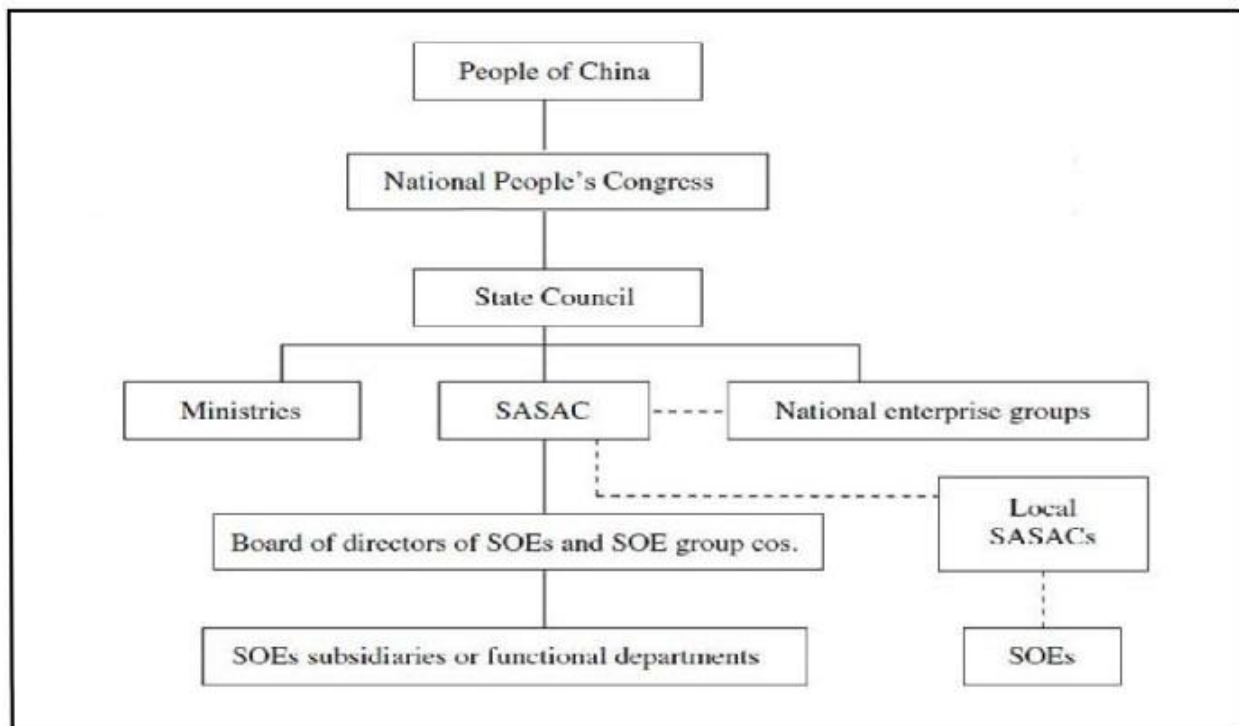


Figure: 5. SASAC in the Chinese Economy. Based on Bechy Chiu, and Mervyn K. Lewis (2006), in Liao Chun (2009).

Although the establishment of an oversight agency such as SASAC seemed promising and in the direction towards the improvement of functionality, competitiveness and effectiveness of SOEs, this study is mainly concerned with the relationship between SASAC and the government. Interestingly, many scholars argue that SASAC's real objective is to serve the political or non-commercial interests of the party-state.⁸⁷ The complicated and close relation of SASAC with the party-state is evident on the problems

⁸⁷ Christopher A. McNally, "Strange Bedfellows: Communist Party Institutions and New Governance Mechanisms in Chinese State Holding Corporations," *Business and Politics* 4 (2002); "The state-owned assets supervision and administration commission" In S. Green & G. S. Liu (Eds.), *Exit the dragon? Privatization and state* (Portland, Blackwell Publishing: 2005); Hon S. Chan, "Politics over markets: Integrating state-owned enterprises into Chinese socialist market," *Public Administration and Development* 29 (2009).

this relationship has produced. Although SASAC is the responsible body for appointing key personnel in SOEs, it is the CCP which influences to a great extent this process. Seen as a way to maintain control over SOEs and as a reward for loyalty, CCP maintains its power to appoint top personnel in public enterprises.⁸⁸ Moreover, the manipulation of SASAC and consequently of SOEs is achieved by the financial dependency of SASAC to the government. SASAC's gets constrained by the fact that it does not have any right on the earnings from exercising its ownership right.⁸⁹ Finally, SASAC falls victim to the super complexity of the Chinese state sector. Many corporations which were supposed to be under SASAC's control, used to be governmental bodies or companies with their own networks and political connections.⁹⁰ It will take time until SASAC will acquire such authority and experience in order to rationalize such a complicated system.⁹¹

The government's power is also enhanced by the lack of any opposing power by the state sector in terms of available means for association and claiming of worker rights. Not only the right to strike is not well clarified in China, but also The All-China Federation of Trade Unions (ACFTU) is the only legitimate union by which all other trade unions must be recognized.⁹² This similarity to the political system of China, where political parties are allowed to operate only under the authority of CCP, symbolizes the intention of the ruling party to maintain control at all levels. To make things even more complicated, it is commonly accepted that ACFTU is a subordinate organ of the CCP and its main role is to serve its interests in maintaining order instead of protecting worker rights.⁹³ Any efforts on behalf of the workers to release themselves from ACFTU by forming independent unions such as the Worker's Autonomous Federation, eventually failed after the Tiananmen crackdown in 1989. What is more, recent governmental attempts to reform

⁸⁸ Li-Wen Lin and Curtis J. Milhaupt, *op. cit.*: 727.

⁸⁹ Li-Wen Lin and Curtis J. Milhaupt, *op. cit.*: 745.

⁹⁰ Li-Wen Lin and Curtis J. Milhaupt, *op. cit.*: 736.

⁹¹ Chun Liao, *op.cit.*

⁹² Jie Shen and Chris Leggett, "Contradictions in Chinese Trade Unionism," *International Journal of Comparative Labour Law and Industrial Relations* 23 (2007).

⁹³ Ruixue Bai, "The Role of the All-China Federation of Trade Unions: Implications for Chinese Workers Today," *Working USA* 14 (2011); "Protecting Workers or Serving the Party? The way forward for China's trade unions" *China Labor Bulletin* (2009).

the ACFTU by implementing elections in some provinces, did not have the expected results due to the involvement and influence of party officials.⁹⁴

However, maintaining a strong state sector offers some advantages and benefits to those who work as public employees. According to reports, the percentage of those who are somehow employed in the state sector reaches almost 50% of the total workforce.⁹⁵ The attractiveness of state employment is also evident to the fact that Chinese students highly regard jobs in the public sector because they offer long-term job security.⁹⁶ Moreover, working in the state sector might offer more career advancements since according to Dickson and Rublee, party membership helps in getting a better job.⁹⁷ What is more, public employees enjoy not only better wages but also a whole set of benefits such as free local transport, cheap housing etc.⁹⁸ It becomes clear then that a significant part of the Chinese workforce has a strong incentive to support the Chinese government and its policy of maintaining the control of SOEs.

Nonetheless, the gradual approach of the Chinese leadership in reorganizing the economy succeeded both in bringing rapid development and maintaining the political control of the country. In this process, the state sector lost a great deal of its economic reach in contrast with the recovered and emerging private sector. However, the importance of the state sector remained intact due to its preservation as a means for maintaining control on behalf of the state-party. Although there are issues with the working conditions and rights of the workers particularly in the industrial sector, the rule of the party-state in SOEs is far from being challenged. As a result, SOEs show a significant interest in the objectives of the Chinese government since they are dependent

⁹⁴ Au Loong Yu, "From "Master" to "Menial:" State-Owned Enterprise Workers in Contemporary China," *Working USA* 14 (2011); Ruixue Bai, *op. cit.*

⁹⁵ Joe Weisenthal, "Guess Which Country Has the Highest Percentage of Workers Employed by the Government," *Business Insider*, November 28, 2011; Barbara Wang and Harold Chee, "China's public sector: a different way of working," *The Guardian*, January 3, 2012.

⁹⁶ Kilkon Ko and Lulu Han, "An empirical Study on Public Service Motivation of the Next Generation Civil Servants in China," *Public Personnel Management* 42 (2013).

⁹⁷ Bruce J. Dickson and Maria Rost Rublee, "Membership has its Privileges: The Socioeconomic Characteristics of Communist Party Members in Urban China," *Comparative Political Studies* 33 (2000); Qingjie Xia et al, "Effect of Public Sector and SOEs on Wage Inequality of Urban China: 1988-2007," *IZA Discussion Papers* No. 7142 (2013).

⁹⁸ Chengcheng Jiang, "The Iron Rice Bowl Is Back: Why Young Chinese Want to Be Civil Servants," *Time Inc.*, March 27, 2013.

on the success of governmental policies. To put it in simpler words, SOEs and the people employed as public servants, rely on the ability of the state to provide them for an income.

3.3 Foreign Multinational Enterprises and the Chinese Government.

In this chapter, the relationship of the Chinese government with the foreign originated capital and enterprises will be reviewed. Keeping in mind that the goal of the Chinese government in choosing a gradual reform of its economic system was to allow for economic development without jeopardizing its political dominance, the interaction with foreign and mostly liberal “forces” adds to the discussion. Therefore, the chapter will include a review of the establishment, role and implications of the Special Economic Zones (SEZ) and MNEs in China as well as the interplay between the Chinese government and MNEs since 1978.

SEZs are particular areas where certain rules (different and more liberal than those which apply in the rest of the country) are established in order to promote economic growth, exports, employment and to attract Foreign Direct Investment (FDI).⁹⁹ Moreover, in the case of China, SEZs played the role of the “test tube” in implementing reforms without risking spreading disorder in the case of failure. The first SEZs the Chinese government announced in 1980, were the cities of Shenzhen, Zhuhai, Shantou, and Xiamen, all of them in safe distance from the political centers.¹⁰⁰ Their success in providing for rapid development and attracting FDI, forced the Chinese government to create more SEZs which resulted in a total number of eighteen by the end of 1984. As of 2012, China hosts more than ten thousand SEZs of various kinds.¹⁰¹

The proliferation of SEZs in China resulted from the most beneficial implications they brought to Chinese economy. China’s annual rate of growth skyrocketed to 10% between 1980 and 1984 while Shenzhen grew at a rate of 58% each year for the same period of

⁹⁹ Douglas Zhihua Zeng, “Building Engines for Growth and Competitiveness in China: Experience with Special Economic Zones and Industrial Clusters,” (Washington DC: The World Bank, 2010).

¹⁰⁰ *Ibid.*

¹⁰¹ Lein-Lein Chen and Melvin Jameson, “Rents, party cadres and the proliferation of Special Economic Zones in China,” *Journal of Economic Policy Reform* 15 (2012); The general term SEZ includes specialized types of zones such as, free trade zones, industrial parks etc. For the purpose of this study, a SEZ refers to any kind of special zone.

time.¹⁰² In the export sector, from the 26th place in the world in 1980, China, climbed up to the 1st place in exports in 2013.¹⁰³ What is more, in terms of inward FDI, China has received more than any other developing country since 1993, while at the same time it has been competing the USA as the most desirable place for foreign investments since 2009.¹⁰⁴

The appeal of the Chinese economy in attracting FDI remains strong despite its diversification and expected evolution after more than three decades of development. Initially it was the cheap and huge labor force that China could provide to foreign investors which meant less production costs and therefore increased profits. For instance, the Tianjin SEZ received the investments of 11.552 multinational corporations between 1979 and 1997 which constitutes evidence of the prospects Chinese SEZs have been offering for foreign funds.¹⁰⁵ Additionally, the subsequent rise of the living standards of the Chinese population formed a new class of consumers turning thus China into one of the biggest markets in the world. Therefore, the opening of the Chinese economy by introducing SEZs where liberalization by experimentation could safely take place, contributed the most in China's rise as the second biggest economy of the world in just three decades.

Despite of the benefits the Chinese economy has been collecting from its opening to foreign capital however, the entrance and operation of multinational companies to the Chinese market has not been left unregulated. Being an authoritarian regime, the Chinese government in all its forms and conceptions, is considered to be the most influential stakeholder in the Chinese economy.¹⁰⁶ In effect, it pressures MNEs to comply and align with the interests of the Chinese state. In order an MNE to operate in China, it needs to

¹⁰² Zeng, *op.cit.*

¹⁰³ Kevin Honglin Zhang, "How does foreign direct investment affect economic growth in China?," *Economic of Transition* 9 (2001); CIA: The World Factbook, url: <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2078rank.html>

¹⁰⁴ Cheryl Long, Jin Yangc, and Jing Zhang, "Institutional Impact of Foreign Direct Investment in China," *World Development* 66, (2015)

¹⁰⁵ Yadong Luo, "Guanxi and Business", (Singapore, World Scientific Publishing Co. Pte. Ltd: 2007): 205.

¹⁰⁶ Dirk Holtbrugge and Nicola Berg, "How Multinational Corporations Deal with their Socio-political Stakeholders: An Empirical Study in Asian, Europe, and the US," *Asian Business and Management* 3 (2004); John Child and David K. Tse, "China's Transition and its Implications for International Business", *Journal of International Business Studies* 32 (2001).

commit that it will transfer advanced technology which will be learned and thereby used by local enterprises.¹⁰⁷ Moreover, the same applies to the transfer of advanced managerial skills in order Chinese executives to be trained.¹⁰⁸ Furthermore, MNEs are under pressure from the Chinese government not only to increase exports and thus increase profits but also to acquire their supplies from domestic sources as well as to channel their products domestically.¹⁰⁹ An indicative example of what happens when an international corporation denies to line up with the local status, is the case of Microsoft's entrance in the Chinese market. As Gao points out, the reluctance of the company to comply or even adapt with the Chinese way of doing business led to an "adverse relationship with Chinese governments".¹¹⁰ In such cases, the obstacles the Chinese government can utilize are embodied in the vastly bureaucratic structure of the state, corruption, as well as in deliberate delays when official approval is required.¹¹¹

Chinese governments are also in position to regulate the accessibility on certain sectors of the Chinese economy which are considered as nationally important. As it is already mentioned, the main objectives of the Chinese governments is twofold; economic growth and development but without risking losing control of the economy. The entrance and operation of many but also very powerful international businesses in China, accompanied by the rise of the living standards of the general population, could lead to an opposition to the regime which the Chinese government would like to avoid. In order to do so and maintain control, the Chinese leadership refuses to privatize industries and corporations of high national importance such as telecommunications, energy, defense industry etc. Therefore, in contrast with wholly-owned foreign investments, subsidiaries in such cases has been allowed only in the form of joint ventures where governmental control can be applied.¹¹²

¹⁰⁷ Yongqiang Gao, "Dealing with Non-Market Stakeholders in the International Market: Case Studies of US-Based Multinational Enterprises in China," *Singapore Management Review* 29 (2007).

¹⁰⁸ Ingmar Bjorkman and Gregory E. Osland, "Multinational Corporations in China: Responding to Government Pressures," *Long Range Planning* 31 (1998).

¹⁰⁹ *Ibid.*

¹¹⁰ Yongqiang Gao, *op.cit.*:86.

¹¹¹ Dirk Holtbrugge and Nicola Berg, *op. cit.*

¹¹² *Ibid.*

A factor which complicates things for foreign enterprises in China, is the fact that it has a decentralized governmental system and quite often the interests of the central government do not fall in line with those of the local governments.¹¹³ That is to say, any corporation which wants to operate in China, needs to develop relationships and tactics in both the local and central levels of administration. For such cases it is important for the corporation to develop its “guanxi”, or in other words the development of personal connections with governmental officials which will help the corporation to maintain a competitive status in China. For example, a strong guanxi with local stakeholders might allow the establishment of a corporation because it will create jobs and wealth and possibly rents for the local actors, despite the fact that some of the conditions the central government had established might not be met.

Therefore, guanxi can be seen as -must- strategy MNEs need to develop in order to counter governmental pressures and deal with the institutional environment in China. However, guanxi is a measure that any organization, business related or not, can utilize in China. Foreign MNEs possess a number of ways by which they can regulate the Chinese government’s heavy presence in the business environment. Gao argues for four strategies MNEs have been using in dealing with governmental pressures in China namely, guanxi, commitment, competitive, and leverage strategy.¹¹⁴

A competitive strategy means that a foreign corporation has decided to oppose the Chinese government in selected issues.¹¹⁵ In order for such strategy to be effective, the bargaining power of the corporation must be economically or technologically significant. In addition, less powerful companies with common interests might form a group in order to pursue a competitive strategy.¹¹⁶ Such examples include the American Chamber of Commerce (AMCHAM) and EU Chamber of Commerce in China (EUCCC) which are

¹¹³ Yongqiang Gao, “Institutional Environment and MNEs’ Strategy in Transitional China,” *Managing Global Transitions* 6 (2008).

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

¹¹⁶ Yi-Ru Regina Chen, “Effective public affairs in China: MNC-government bargaining power and corporate strategies for influencing foreign business policy formulation,” *Journal of Communication and Management* 8 (2004).

tasked to “guard” the interests of European and American enterprises operating in China.¹¹⁷

The establishment of the new *Labour Contract Law* in China in 2008, constitutes an indicative example of competition between the Chinese government and foreign MNEs. The new law was meant to replace the older labour law of 1995 in an effort to regulate the labour market by providing for a more favorable framework for the Chinese workers. However, when the new draft put in public discussion, it received several criticisms on behalf not only of domestic institutions, but also on behalf of American and European business representations in China. As a result, the final draft which actually implemented in 2008, failed to a great extent to deliver the changes it was initially written for.¹¹⁸

Furthermore, foreign MNEs can make use of a leverage strategy in order to strengthen their position.¹¹⁹ A leverage strategy includes actions which take advantage of the decentralization of the Chinese governmental system or the utilization of the international *guanxi* of MNE's. As it was already mentioned, MNEs might find support against the central government by developing their *guanxi* with the local leadership. Additionally, foreign corporations might ask their home countries to assist them by internationalizing an issue. Such a move aims to limit the Chinese government's intervention since the issue turns into a state to state rather than a state to firm dispute.¹²⁰ Another way to downgrade the effect of the Chinese government's involvement on foreign MNEs, is to bring the discussion to international institutions where China is a member.¹²¹ For instance, China joined the World Trade Organization in 2001 and therefore it is bound to certain and rather neo-liberal rules, which in some cases might delimit its ability to regulate the market according to its political interests.

¹¹⁷ For more information see: <https://www.uschamber.com/china> and <http://www.europeanchamber.com.cn/en/home>

¹¹⁸ Peer Møller Christensen, “Transnational Business NGOs and the Chinese Labour Contract Law,” in *Transnational NGOs: Creative Connections of Development and Global Governance*, ed. Abdulkadir Osman Farah (Aalborg: Aalborg University Press, 2014).

¹¹⁹ Yongqiang Gao (2008), *op.cit.*

¹²⁰ Yongqiang Gao (2008), *op. cit.*

¹²¹ Yi-Ru Regina Chen, *op. cit.*

Nevertheless, the aforementioned tactics can be also utilized in order to influence the very decision making process of the Chinese government.¹²² This is exactly the point where the power of foreign MNEs over the Chinese state is better depicted. That is not to say, the Chinese government lacks power but rather that MNEs have also significant amount of power to affect the Chinese leadership. This statement is well projected by another strategy MNEs have in their toolbox in order to influence the Chinese government. According to Hung, commitment strategy is the most effective strategy in order MNEs to gain the support of the Chinese government and therefore to be able to influence the decision process with regard to the Chinese business environment.¹²³ Since the Chinese government's main goal is to maintain high rates of development, then the commitment on such a cause on behalf of an MNE is deemed very important in the eyes of the Chinese leadership. The means by which a corporation can show its commitment to the Chinese interests can be seen in the case of General Motors China Group (GMCG).¹²⁴ GMCG gained access to the decision making process of the Chinese officials by declaring and practicing its intention to remain and invest in the Chinese market, to help the Chinese auto-industry to enter the international market, to share advanced technology, and to hire mostly local people in its factories.¹²⁵

Both the Chinese government and the foreign corporations which operate in China have more than good reasons to maintain the current status and their cooperation which proved to be very beneficial. On the one hand, the willingness of the Chinese leadership to liberalize its economy, and on the other, the careful approach of foreign enterprises not to challenge the authority of the government to rule, result in a unique but rather interesting relationship. In terms of power, MNEs present a different, "western", attitude which balances the domination of the Chinese government in the economy. Not only, they possess wealth, advanced technology and knowledge which are useful to the Chinese economy, but also they have the support of their home countries and in many cases of

¹²² Yongqiang Gao (2008), *op. cit*; Yi-Ru Regina Chen, *Op. cit*; Ingmar Bjorkman and Gregory E. Osland, *Op.cit*.

¹²³ Chun-ju Flora Hung, "The Interplays of Relationship Types, Relationship Cultivation, and Relationship Outcomes: How Multinational and Taiwanese Companies Practice Public Relations and Organization Public Relationship Management in China" in Yongqiang Gao, "Institutional Environment and MNEs' Strategy in Transitional China", *Managing Global Transitions* 6, No. 1, (2008): 15.

¹²⁴ Yi-Ru Regina Chen, *op. cit*.

¹²⁵ Yi-Ru Regina Chen *op. cit.*: 404-405.

the whole neo-liberal international trade system. Under such circumstances even the power of an authoritarian regime can be mitigated.

4. Analysis and Application of Theories.

4.1 Stakeholder Analysis.

In the previous chapters, the relationship of the Chinese government with each one of its stakeholders has been reviewed. The analysis was based on a power and interest framework of these stakeholders against the dual objective of the Chinese government to maintain the momentum of the economy without however take any risks regarding its political domination of the country. The findings can be summarized as follows:

- 1) SOEs show an interest on the preservation of the political system in China since not only public employees enjoy certain privileges, but also because of the dominance and occupation of vital positions of the state owned economy by governmental and CCP members. As a result, SOEs have been attached in the broader governmental mechanism. On the other hand, SOEs lack the power to influence the decision making of the Chinese government due to their dependency on the state structure. The fact that CCP officials manage SOEs to a great extent, highlights not the power of SOEs over the government but rather the influence of the CCP to the government.
- 2) The Chinese private sector and its remarkable growth results into high levels of power not only due to its contribution to the Chinese economy but also because represents the welfare of a very significant part of the Chinese population. In fact, it concerns all those people who witnessed an actual improvement of their quality of life. Research shows that this sector has no interest in challenging the authority of the ruling party at least as long as development and growth continuous. However, a change towards more liberalization and democratization might not be the worst case scenario for private entrepreneurs in China.
- 3) Foreign MNEs have been playing an important role in the Chinese business environment. As it was shown, foreign capital is interested not only for the huge

human resource pool of China but also for its massive domestic and increasingly consuming market. Considering the fact that a potential disturbance of the current order would result in insecurity and huge losses on behalf of the MNEs, they would rather support the current regime. Regarding their power, foreign MNEs are empowered by their home countries, international institutions and by a sense of common interest. Moreover, they hold technology and knowledge in various levels which the Chinese leadership considers as a valuable resource for its future plans. Additionally, a factor which reduces the power of the Chinese government derives by its own decision to form SEZs as the main locales where foreign capital would be invested.

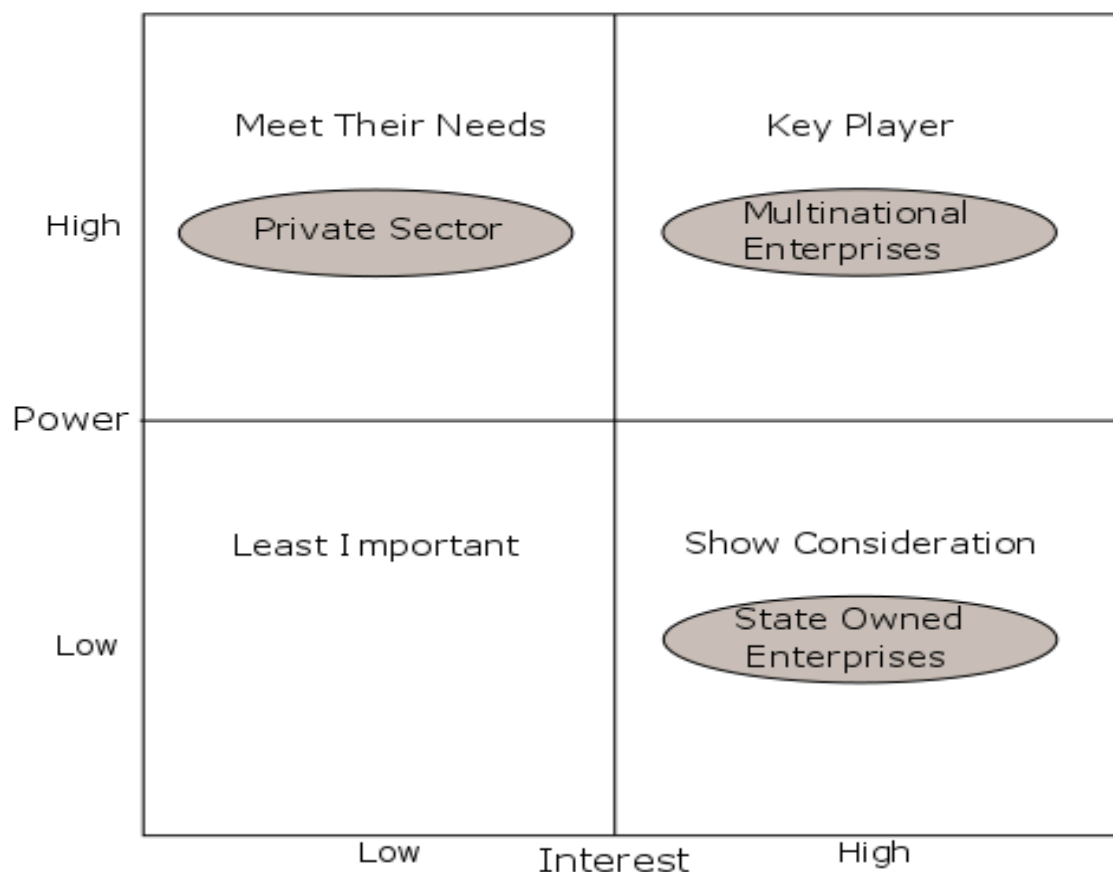


Figure 6: Map of the three stakeholders in a power/interest grid and according their significance to the Chinese government.

Based on the aforementioned notes, a stakeholder analysis will be carried out in order to show whose interests the Chinese government is more likely to take into consideration when planning its strategy for the future. Figure 6 (p.46), constitutes a depiction of the relative power/interest relations of the three business types with the Chinese government. The vertical axis represents the power a stakeholder can apply on the Chinese government in order to satisfy its interest, which in turn is depicted on the horizontal axis. In this simple model, power and interest can either be high or low. Therefore, four possible outcomes can emerge and each one equals to a distinct strategy according to the capabilities of the stakeholders.

The high interest and power of MNEs in their relation with the government, positions them to the upper-right quadrant and therefore they are deemed as the most important stakeholders. As a result the government needs to pay attention to their demands since they are seen as suppliers of significant and scarce resources of the Chinese economy. Evident to that is the very fact of the establishment of SEZs in China where the interests of the foreign MNEs are being served better. Moreover, it was shown that MNEs possess and make use of tools in order to either influence the decision making process of the Chinese government or handle its pressures.

Additionally, the private sector is positioned to the upper-left quadrant because it holds significant power but not the interest to challenge the regime. There is a paradox however here. Both the private sector and foreign MNEs do not seek to challenge the status quo. Why then MNEs are positioned as having high interest on the Chinese government while the private sector as having low interest? The answer lies to the source of power for the two sectors. The economic power of the private sector in China derives from the willingness of the government to facilitate the operation of private entrepreneurs as long as they do not pose a threat to the political regime. In the case of MNEs, they get powered by multiple sources including the international environment. Despite the fact that the current situation benefits MNEs, they do not rely on the political system itself. In contrast, the private sector is dependent on the Chinese government for maintaining a profitable operation which would be threatened by a potential increase in political interest. As a

result, an interest on the Chinese government on behalf of the private sector, could be easily interpreted as a threat on the political regime of China. In other words, foreign MNEs can maintain a high interest on the Chinese government without risking their core operations and even existence.

Thus, the private sector of the Chinese economy requires a policy which will keep it satisfied enough in order not to be tempted, or forced to utilize its economic power and influence for the pursue of political ends. Consistent with such an approach, the Chinese government has sought to increase the interest of entrepreneurs towards the preservation of the regime by allowing them to be members of the party, and to some extent to take part in the decision making process. The Chinese People's Political Consultative Conference (PPCC), stands as an entrance for private entrepreneurs who wish to engage in politics. As it was expressed by Chen, "during the last two decades {1991-2011} Chinese entrepreneurs have been encouraged in increasing numbers to become members of and participate in People's Political Consultative Conferences (PPCC) – local assemblies of notables (organized by the Chinese Communist Party (CCP) through its United Front Work Department) that works alongside the system of People's Congresses".¹²⁶ However and according to Cabestan's words, "In the last fifteen years, more and more celebrities (e.g. movie director Zhang Yimou, hurdler Liu Xiang) and wealthy entrepreneurs have been co-opted to what is often described as a "riches' club" (*furen julebu*)".¹²⁷ Moreover, the fact that the members of PPCC are selected instead of elected, makes unclear whether the entrepreneurs who join such political bodies, do so in favor of their own interests and potential profits, or in order to promote entrepreneurship in China. Nonetheless, the incorporation of private entrepreneurs to the political system in China will allow for the matching of the interests of the two parts, and as the political leadership aims, will lead to the minimization of potential threats and perpetuation of the current regime.

With regard to SOEs, their dependency on the state mechanism lies behind their high

¹²⁶ Minglu Chen, "Inside the 'Flower Vase': The Chinese People's Political Consultative Conference (CPPCC)," *Contemporary Challenges of Politics Research Workshop* NSW 2034 (2011): 4.

¹²⁷ Jean-Pierre Cabestan, "The Chinese People's Political Consultative Conference (CPPCC): Its Role and its Future," *Europe China Research and Advice Network (ECRAN) Short Term Policy Brief* 25 2010/256-524, (2011): 5.

interest on the Chinese government and at the same time it justifies the inability of the sector to oppose in any way the will of the country's leadership. Under such a perspective, the Chinese government rationally takes advantage of the state sector and uses it as a means to control the rest of the economy. Furthermore, the alignment of the interests of the government with those of the state sector does not mean that the latter does not need to be taken into consideration due to its reduced power and influence. On the contrary, the Chinese government shows its consideration on the state sector by providing informal and formal benefits, plus the acknowledgement that the state sector constitutes the backbone of the Chinese economic-political system as a whole.

4.2 Extraction of the Chinese Government's Strategic Orientation.

The stakeholder analysis of the previous chapter summarized the relationship of SOES, the private sector, and the foreign MNEs with the Chinese government. The aim was to turn the discussion around the power and interest of stakeholders, to a discussion on the strategy the Chinese government utilizes in order to deal with the relative importance of each sector. Although it is becoming clear that the foreign sector has been prioritized, stakeholder analysis does not say much about the aim of the government in positioning its stakeholders accordingly. It is providing information on the value of each stakeholder but fails to capture how the Chinese government utilizes its business environment in order to maintain its goal of growth and political control. Subsequently, the application of the Obel and Gurkov model of strategic orientation will be applied so as to both depict the above-mentioned relationships in a single diagram and also in order to justify the second argument of this thesis that the Chinese government utilizes an “analyzer” strategy.

According to Miles and Snow, *analyzers* react to their environmental changes by combining *defender* and *prospector* strategies.¹²⁸ That is, they maintain (defend) their market share while they attempt to be innovative in other markets. As it was expressed by Burton et al., “an organization defends its market share by exploiting some of its

¹²⁸ Miles and Snow, *op. cit.*

stakeholders while innovates by allowing others to explore”.¹²⁹ Finally, in Obel’s and Gurkov’s model, this strategy is depicted as shown in Figure 4, where the exploited stakeholders are positioned below the line of equivalent exchange meaning that they get returns lower than their inputs. In contrast, the exploring stakeholders are positioned above the line of equivalent exchange.

Foreign MNEs as a stakeholder possessing high power and interest are positioned above the line of equivalent exchange and close to the upper boundary line (Figure 7, p.51).¹³⁰ By positioning foreign MNEs to a privileged position, the Chinese government allows them to explore the market, meaning that it expects high returns in the form of development, investments, experience, know-how and advanced technology which will pave the way for the country’s future development. Costs are also high for the Chinese government in several fronts. First, there has been an exploitation of its workforce in terms of wages as well as its natural environment.¹³¹ Although wages in China have been dramatically rising since 1978, China is still a cheap labor market for multinational corporations.¹³² Moreover, the presence of MNEs and the establishment of SEZs projects a dual message domestically as well as to the world. On the one hand, the Chinese government shows that it can line up with the globalized world and maintain a competitive profile. On the other hand, it makes clear that business differ from politics and the liberalization of the economy does not lead to the liberalization of the political system.

Furthermore, the private sector’s placing to a more than satisfactory position (Figure 7), signifies the increasing returns the sector has been enjoying since the reform era started. Their growing economic power gradually limited the ability of the Chinese government to exploit the sector, but at the same time proved that the investment on this particular stakeholder provides increasing returns for both sides. The increased outputs toward the private sector should be read in a historical basis and always bearing in mind that private

¹²⁹ Burton et al. in Obel and Gurkov, *op. cit.*:3.

¹³⁰ Obel and Gurkov, *op. cit.*

¹³¹ Gethin Chamberlain, “Apple factories accused of exploiting Chinese workers” *The Guardian*, April 30, 2011; Ma Jun, “Multinationals Can Go From Polluter to Protector of China’s Environment”, *Carnegie-Tsinghua Center for Global Policy*, May 13, 2013.

¹³² Jonathan Wright and Manisha Sahni and Rowena Zamora, “Wage Increases in China: Should Multinationals Rethink their Manufacturing and Sourcing Strategies?,” *Accenture Management Consulting Organization* 2011, Accessed April 24, 2015.

entrepreneurship was not even allowed back in the late 70's. The sector's low interest however in politics holds it closer to the line of equivalent exchange and at the moment prevents further exploration. It can be interpreted as the Chinese government's doubts on the loyalty of private entrepreneurs and the potential use of its economic power to pursue political ends. Nonetheless, the Chinese government aims to "reap what it sowed" by allowing private entrepreneurship to flourish and utilize the transferred technology and experience from the developed countries and get benefited by the enormous benefits the private sector creates. Moreover, the improvement of the quality of life of the Chinese people serve as a guarantee for the preservation of the political system.

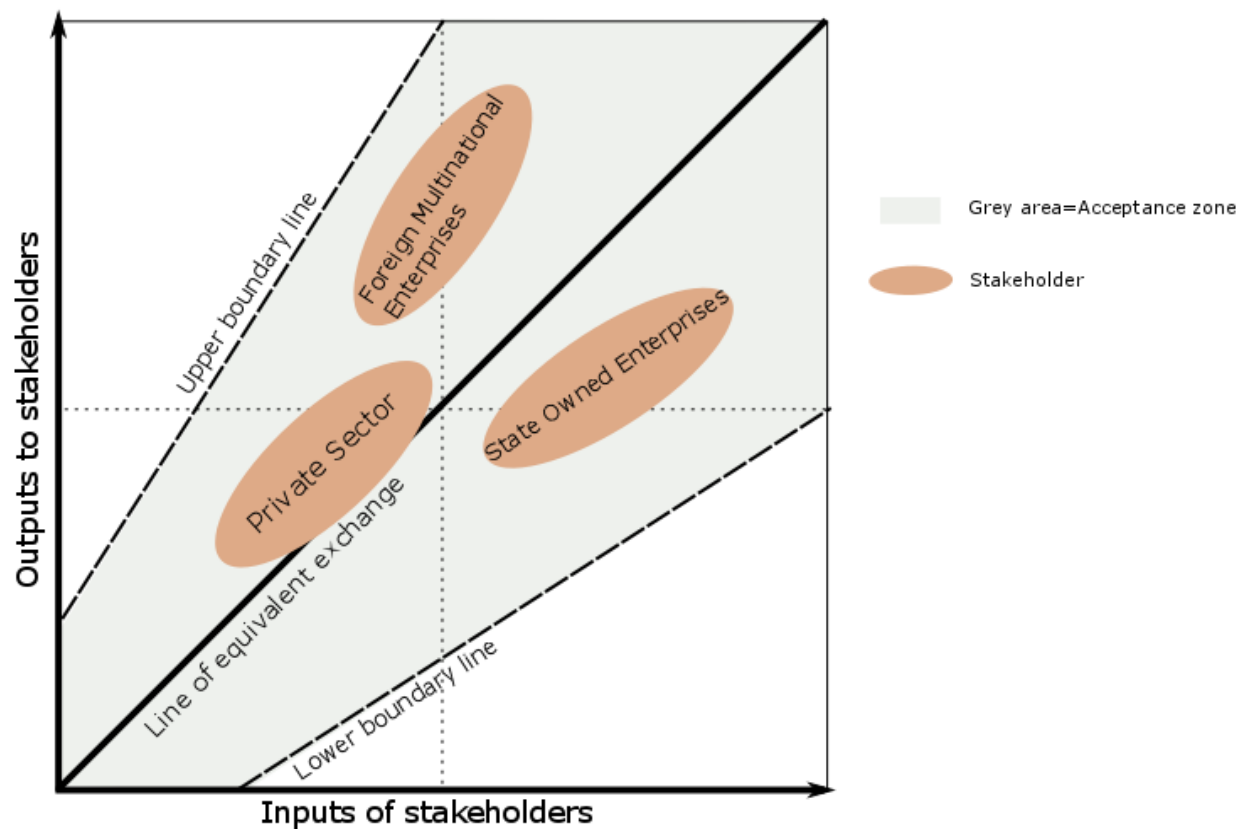


Figure 7: The "analyzer" strategy in the Chinese business environment, based on Børge Obel's and Igor B. Gurkov's, "Revisiting Miles-Snow Typology of Strategic Orientation using Stakeholder Theory", ICOA Working Papers 2013.

Regarding SOEs, they seem to have been placed in a position which allows their exploitation (Figure 7). According to theory, these stakeholders should be considered in a sense that they must be aware of the raised inputs they need to add in exchange with low returns.¹³³ They are placed below and close to the line of equivalent exchange because they lack in power but have a high interest on the Chinese government. On behalf of the Chinese leadership, the aforementioned placement of SOEs shows rather the rather political role the state sector is meant to play. In effect and despite being a business sector, SOEs are rather treated as a means to political ends. The example of SASAC which was established in order to manage SOEs and turn them into a competitive and sustainable sector, but crashes on the political ambitions of individuals and the CCP, highlights the level and meaning of exploitation the state sector suffers. Low power and high interest can be therefore interpreted as high dependency on the state mechanism. That is not a surprise though, since the main income and supporter of these enterprises derives from the state itself.

5. Discussion.

The overall strategy of the Chinese government therefore incorporates narrow ideology-based approaches and reveals a broader, more practical, and long termed targeting of the Chinese leadership. State Capitalism maintains the prioritization of the state sector on behalf of the government's interests. According to the proposed model of strategic orientation, the Chinese government utilizes its ownership and influence on SOEs in order to control the rest of the economy and by doing so, it attempts to perpetuate the regime. Following the same mentality, China as a Developmental State boosts the dynamic forces of its economy in order to bring development in the country. Once again, such an approach is included to the managerial model used in this study. The private sector and its rise serves also the perpetuation of the regime by being the "manufacturing" area of the incoming knowledge and by providing for a better quality of life for millions of Chinese people. In fact, the private sector is the only part of the Chinese economy which might be argued that moved from one position to another with regard to its relation with the Chinese

¹³³ Obel and Gurkov, *op. cit.*:16.

government. From an officially non-existent sector before 1978, to a relatively satisfactory relationship during the 80's and early 90's. From there to a position where its relationship with the government allows increased returns in several forms (Figure 8, p.53).

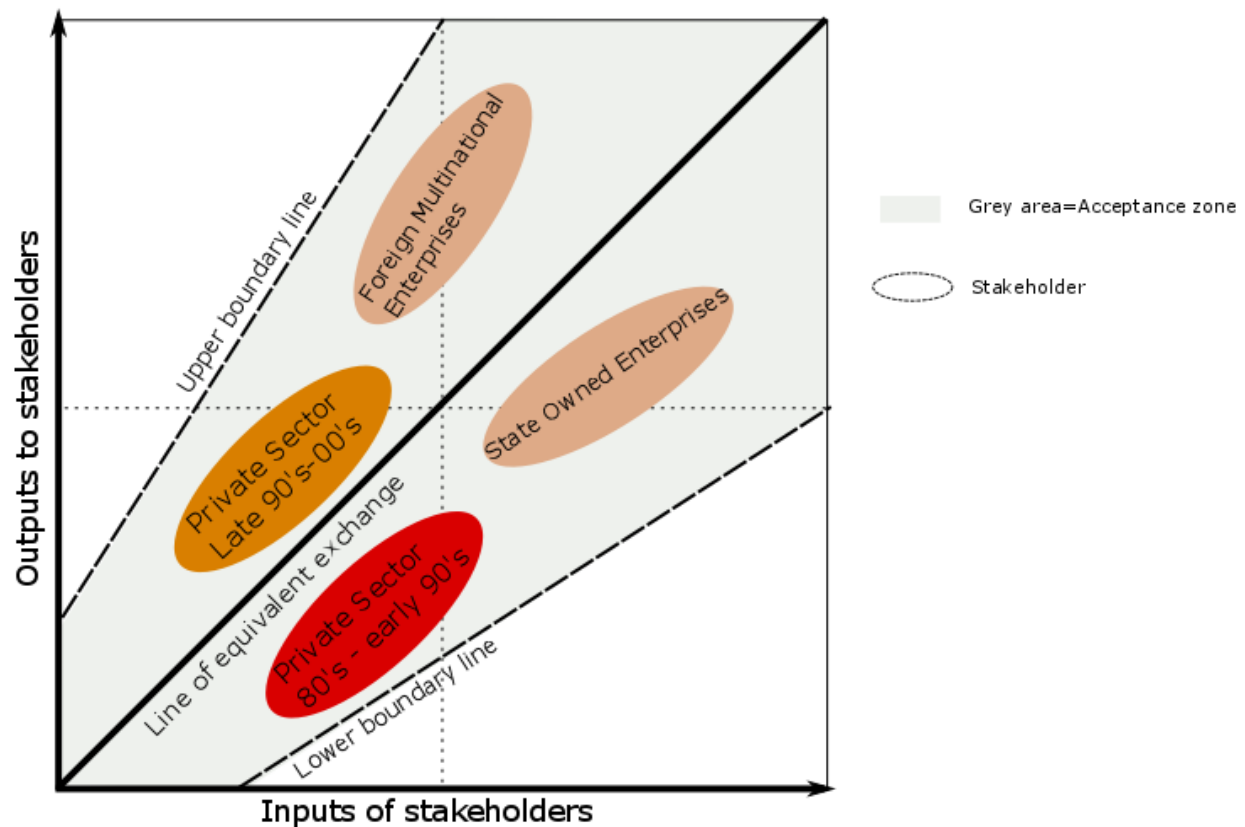


Figure 8: The movement of the private sector from exploitation to exploration mode according to the "analyzer" strategy.

While SOEs are being controlled politically as well as economically by the state, the private sector requires a different approach so as to be managed. In order for the government to counter its economic predominance, certain adjustments needed to be made. Hence, the private sector needs to be kept satisfied so as to avoid transforming its economic wealth to political power. It can be assumed thus, that the Chinese government's strategy deliberately allowed the change of economic roles between SOEs and the private sector. However, that change cannot be extended to the political domain where the government maintains power through SOE's. Nonetheless, both sectors constitute the great majority of the Chinese business environment and they essentially

supplement each other. The state sector provides for what is needed in order for the private sector to flourish and at the same time the private sector and the wealth it produces allows the government to maintain the state sector operational. Furthermore, it would be difficult for the domestically originated business sectors to bridge the gap with the developed countries in the pace China has been advancing for more than thirty years now.

The proposed model of strategic orientation, shows and explains the role of MNEs in this respect. By allowing these enterprises to explore their respective markets in China, the government aims at the fulfillment of several goals. First, it strengthens its legitimization by ensuring that the Chinese economy will continue to prosper. Second, it paves the way for future development, based on China's own innovation capabilities. The Chinese government is aware of past practices of rising powers such the one the US utilized during 18th century. As an emerging power, the US used to copy British technology until the point where it could innovate itself.¹³⁴ Consistent with such a tactic, the Chinese leadership takes advantage of the imported advanced technology and experience of foreign MNEs in order to acquire its own innovative economy in the future. Thus, the depiction of MNEs as a privileged and exploring stakeholder, which receives increased outputs by the government, derives from the unique at this point benefits it offers to the Chinese economy.

6. Conclusion.

This Master Thesis sought to extract the strategy by which the Chinese government handles its business stakeholders namely, the SOEs, the private sector, and the foreign MNEs, towards accomplishing its goals of preserving political power and high economic growth. In order to do so, it identified the business stakeholders of the Chinese government and analyzed their relation under a power and interest basis. The objective

¹³⁴ "John Bull and Uncle Sam: Four Centuries of British-American Relations" in the Library of Congress, Accessed, 24 April, 2015, url: <http://www.loc.gov/exhibits/british/brit-5.html>

has been achieved by utilizing a managerial model of strategic orientation in which all stakeholders were set-up against the influence and aims of the Chinese government.

The findings showed that in comparison with other approaches which project a heavy ideological background, the Chinese government has set in motion a rather practical strategy towards multiple goals. It stubbornly maintains the control of the most important SOEs in order to secure its political authority and power over the economy and country. At the same time, it utilizes the dynamic forces of the Chinese economy by gradually releasing the private sector in order to harvest the profits from the capitalist mode of production. Most importantly however, it completes the puzzle by prioritizing the smooth operation of foreign MNEs, which at this point constitute the main source of advanced technology and experience. As a result, the Chinese leadership, paves the way for future innovative capabilities of the Chinese economy that will allow for the continuation of the development and consolidation of China as a global power.

The utilization of Strategic Management approach indeed helped in the avoidance of ideological stereotypes which can be usually found in discussions regarding state matters. However, the model which has been used is also based on economics and therefore it would perform better with quantified data. Thus, further investigation is needed, namely data that would clearly and undoubtedly depict the contributions of each sector, the costs and benefits for and from all actors, in order to achieve precision in the results. In addition, there should also be a separate focus on the type of the government. Research on democratic and/or other types of authoritarian governments could further our understanding in the relationships conducted between governments and their respective business stakeholders which, after all, represent the society itself.

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