

# Implications on Increasing Number of Bankruptcies of Private-Owned Enterprises in China

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## ABSTRACT

Since the Reform and Open-up, private-owned enterprises (POEs) contribute dramatic growth to China's economy. This paper analyzes the importance of private-owned enterprises in China. This paper aims to make all-around comparisons between private-owned firms and state-owned firms by comparing government policies on them, GDP and tax contribution by them, Job Provision by them, and Technological Innovations from them. After researching on these aspects, it found that POEs contribute more to economic growth, provide more job positions, and achieve more technological innovation with relatively unfavorable government policies, compared to state-owned enterprises (SOEs). In short, POEs are operating at higher efficiency than SOEs and contributing more to people's daily lives. Therefore, the government may need to come up with more ideas on supporting POEs to help the economy recover from the damage brought by the Covid-19 pandemic. Besides, technological innovation helps China gain international competitiveness and be in a better position in the trade war.

**Keywords:** State-Owned Enterprise, Private-Owned Enterprise, Unemployment Rate, Market Share, GDP Contribution, Technological Innovation

## 1. INTRODUCTION

### 1.1 Background

Since the Covid-19 breakout in early 2020, a vast number of private-owned firms in China closed doors due to little-to-no businesses. Many plazas are left with merely big brands and empty stores with rental commercials. Chinese government successfully leads people to overcome difficulties brought by the virus, but a new problem is worth our attention. POEs have played a crucial role in economic development for decades, but they are currently in a seriously challenging time.

### 1.2 Related Research

Lin et al. reviewed the importance of state-owned enterprises from the modern point of view and historic significance. SOEs are a critical portion of China's economy, and it has been growing rapidly over the past 4 decades. In the article, Lin et al divide their studies into four parts: the theories of SOEs and their reform, the performance, and financing strategies of SOEs, corporate governance in SOEs, and corporate social responsibility in SOEs. The SOE reform has brought many benefits to

China, but it must deal with efficiency problem in the future [1].

Chen and Feng studied the root of variation in economic growth in different provinces in China. They conducted researches in 29 provinces, municipalities, and autonomous regions from 1978 through 1989 to uncover the uniqueness of these places. They find that private and semi-private enterprise, higher education, and international trade has a positive effect on economic growth. They also find that the presence of large-scale SOEs leads to a reduced growth rate among provinces [2]. Wang analyzed many enterprises from the angle of places, industries, modes, and financing on 670 Chinese firms. The results show that state-owned enterprises overseas listing led by the Government with the motivation of establish a rational capital structure, improve corporate governance, improve the state-owned enterprise's reputation, and protect the capital market order; private enterprises based on their own internal needs select an overseas listing with a strong financial motivation and achieve security and equal motivation [3]. Stone et al. explored the pattern of political effect on China's foreign direct investment by using data on outward FDI from firms in China. They find that state-owned enterprise globally diversified firms appear to conform most closely

to official guidance. The growth of China makes it increasingly crucial for other countries to learn and understand China's foreign policies. China has a history of combining foreign aid and FDI by SOEs. This history makes it plausible to interpret correlations between FDI and political orientations as evidence of a deliberate state strategy [4].

Zhang studied the relationship between culture and development in China. The clan culture is positively associated with the likelihood of entrepreneurship and the share of the economy in the private sector. The clan culture helps private-owned enterprises to finance their firms [5]. Over the past three decades, China witnessed unprecedented economic growth. Zeng revealed that the numerous economic zones and industrial clusters that appeared after the reform contributed most to the growth. The special economic zones also supported technological advancement in China. The paper summarizes success factors, formation, difficulties of the development based on field visits, literature review, and case analysis [6]. The private sector is a crucial portion of economic growth in most countries, especially China, where private firms provide many jobs and international trades. Zhang computed that over 60 percent of China's GDP relies on private enterprise. The estimation suggests that the share of SOEs in China's GDP should be 23-28 percent and their share in employment is between 5 and 16 percent in 2017 [7].

As China's economy continues to grow, the global impact of the performance of China's companies increases. García-Herrero states that lack of competition between China's firms is shown due to policies tending to favor SOEs. POEs find it harder to borrow from banks in comparison to SOEs, and the gap is widened in 2019 [8]. Wu compares the performance of SOEs and POEs under the Covid-19 outbreak in China in the first quarter of 2020. The main finding of the paper can be concluded that SOEs perform significantly worse than POEs once a sufficient level of differences is controlled, despite SOEs' performance being superior to POEs' from raw data (Wu, 2021). Although the study is limited, the result is still useful to analyze the gap between POEs and SOEs' performance [9]. State-owned enterprise has played a critical in economic growth in China since the Reform and Opening-up. Qi and Kotz review the influence of SOEs on economic growth in China. They examine the influence through several facts that SOEs produced, including steady economic growth during economic downturns, promoting technological progress, and paying workers living wages [10].

### 1.3 Objective

The primary purpose of this article is to construct a clear idea that the survival of private-owned enterprises is crucial to China's economic growth and Chinese people's well beings. This article integrates researches

and papers focused on China's economy and private firms, including the current situation of POEs, social contribution by POEs, potential outcomes of closedowns of POEs, and policy analysis. These researches are divided into smaller researches on statistics like GDP and unemployment rate. In the fourth part, an analysis of policies is made to help find possible solutions for more closedowns of private firms.

## 2. CURRENT SITUATION OF POE

### 2.1 Policy Preferences

According to Qi and Kotz, SOEs are more favored by government policies than POEs in China. Understandably, the government supports SOEs to maintain steady growth during the pandemic, but the survival and growth of POEs are also tightly connected to people's lives. POEs face a situation that they are more restricted to borrowing from banks than SOEs. In Figure 1, it is easily found that the interest rate on POEs' borrowing is higher than the interest rate for SOEs'. Although POEs see a decline in total growth under the pandemic, they are operating at better efficiency than SOEs are. With resources becoming increasingly scarce, China will turn into an economic model with high-quality production and high efficiency. POEs are proved to be more efficient than SOEs in many industries. For people's daily uses like electricity and public transportation, it is better to have SOEs to operate, because SOEs directly take orders from the government, so the price of these commodities or basic services can be controlled at affordable levels. For industries like high-tech that involve strong international competition, it is better to support POEs to produce at higher efficiency [10, 11].

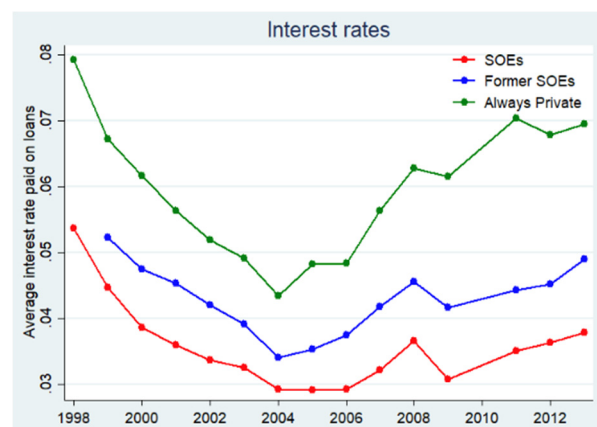


Figure 1 Interest Rates Comparison [12]

### 2.2 GDP and Tax Contribution

Since the policy of Reform and Open-up in China, the private-owned enterprise has become an essential engine for economic growth. POEs contribute more than SOEs to growth domestic product and government tax. The

private sector in China grows from small to large, weak to strong, and keeps growing. Till the end of 2017, there are over 27 million private firms in China. POEs have become one of the main sources of taxation. Over 50 percent of government income came from taxes collected from POEs. In Shandong province, 68.3 percent of tax was collected from private firms. The private sector is a crucial portion of economic growth in China. Zhang computed that over 60 percent of China's GDP relies on private enterprise. The estimation suggests that the share of SOEs in China's GDP should be 23-28 percent and their share in employment is between 5 and 16 percent in 2017. It is easily seen that the GDP contribution by SOEs is not even half of that of POEs [7, 13].

### 2.3 Job Provision

Employment in the private section has also grown tremendously since the Reform and Open-up. Over 80% of job positions are provided by POEs in urban areas of China. It helps bring the labor force in rural China into cities, enabling the productivity in China to increase consistently. In Figure 2, we can find that POEs are the main driver for urban employment growth since 1995. Before the Covid-19 pandemic in early 2020, the total number of employments in the private sector had been keeping growing yearly. Besides, companies like Tiktok and Huawei have extended their coverage to North America and Southeast Asia, bringing China more global influence in employment [12].

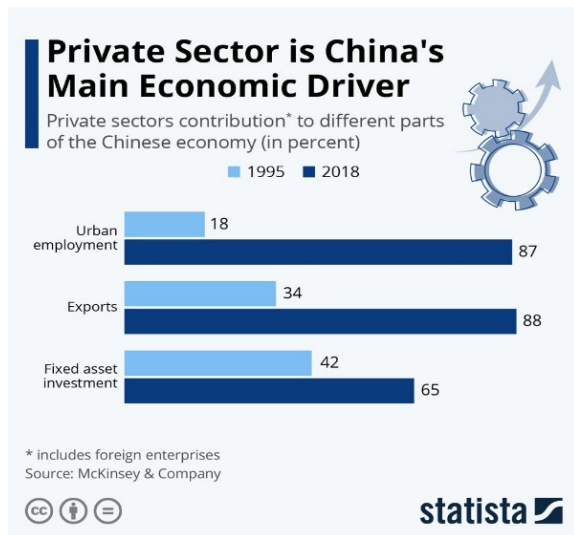


Figure 2 POEs' Social Contribution [14]

## 3. POTENTIAL OUTCOME OF CLOSURES OF POE

### 3.1 Rising Unemployment Rate

The past couple of years have not been that good for Chinese private companies. The effect of the same is about to come to normal citizens as well. The recent shutdown of several private companies in China will

increase the unemployment rate throughout the country. The recent pandemic has played a big role here. First, due to the pandemic and lockdown companies, small and medium private companies have failed to run efficiently and make revenue. As they are small in stature, they cannot get enough loans or capital to run in these new norms. Therefore, they must shut off their business. As a result, thousands of millions of employees of those firms had to leave the companies and unemployment rose. Secondly, due to the lack of private companies, future candidates will not be able to get their desired jobs which those already shutdown firms could have offered. Therefore, those candidates will have to struggle to find a new job. That is why unemployment will keep rising as the number of potential candidates will keep increasing. The situation will continue until new job opportunities are not generated. It is, even for a fast-growing country like China it would not be easy to cover the rising unemployment rate [5].

### 3.2 Less Competition in Market

An industry can not only consist of multinational companies. In an ecosystem of enterprises, small and medium-sized companies also need to coexist with "public listed companies". It takes several years for those companies to make a big impact but those comparatively smaller companies create an atmosphere of healthy competition for the bigger companies as well. Knowingly or unknowingly bigger companies depend a lot on smaller companies. Also, those smaller groups of companies themselves compete a lot to come out on top. This type of competition is quite gigantic in a country like China where several small and big companies run their business with almost similar vision and mission. Due to the rapid shutdown of Chinese private sector companies, the ecosystem will get hampered. It has already started. Less competition in the market means less motivation for other companies to excel in performance. China is a country where business is still booming and in this situation, it is very crucial to keep the progress on. But things have gone south since the pandemic and lockdown entered the scene. Less competition will not only demotivate other firms but will also slow down the fantastic ongoing economic growth of China [8].

### 3.3 Technological Innovation

To run a public company, a lot of support is needed from smaller and medium-sized companies as well. From supplies to promotion, the support of smaller companies is always needed. In the recent past, we have seen multiple bigger companies have shaken hands with smaller companies and eventually those initially smaller companies have gotten bigger with time. For instance, When Apple launched their first iPhone they had partnered with Corning, a fairly unknown company at that time to make the protective glass of their iPhone

displays. Now, almost 15 years later, Corning is also a listed company just like Apple. Apple's huge success in China proved that innovation will be accepted by the people of China. Similar examples can be found among Chinese firms as well. If the smaller and private companies shut down regularly in China then this type of rising of smaller companies and innovation will become very rare and for a country like China where innovation is equivalent to success, it is disheartening for any technology lover [15].

## 4. POLICY ANALYSIS

### 4.1 *Planned Economy*

The main cause of distinction between the productivity among POEs and SOEs is the planned economy system. The resources that different firms have access are predetermined, and this limits the potential of POEs. The planned economy perhaps performs more efficiently if the distribution of resources is planned according to the share of GDP and employment contribution by different firms. Although SOEs maintain a relatively optimistic amount of growth under the pandemic, POEs are still fundamental to a country's economic growth.

### 4.2 *Anti-Monopoly*

Anti-Monopoly legislation has been mentioned frequently lately. The current anti-monopoly movement mainly targets large e-commerce platforms and Tencent. These firms had strong power over their fellows in their markets. They either take over fellow's business or allow fellows to operate through their platforms. Many physical stores for clothes and other commodities were closed over the past decade. With the influence of Covid-19, the role of e-commerce platforms is becoming increasingly critical as they continuously push out competitors. Although these firms are part of the private sector, their scale and influence are similar to large state-owned firms. The anti-monopoly movement can be imitated to target SOEs in some markets.

### 4.3 *Supporting POEs*

Assuming Covid-19 will live with humans for a couple of years. Globalization will be limited and regress. Many countries must produce for themselves. Firms in China aim to promote technology use in the production of many goods. With the higher level of technology, China can produce at a lower cost and maintain sustainable development under the pandemic. As mentioned above in 3.3, technological innovations are mainly achieved by POEs in China. In this case, more support should be invested in this portion since it will benefit the whole country in both the short-run and long-run.

## 5. CONCLUSION

In brief, POEs are more efficient than SOEs in production and technological innovation, and POEs contribute more to economic growth. The government may support POEs more to alleviate the loads on small firms brought by the Covid-19 pandemic. This paper researches the current economic environment for POEs and SOEs and concludes that banks should treat SOEs and POEs equally to embrace more private business founders. They provide our society with more jobs, economic growth, and technological innovations. To acquire international competitiveness and stand in a better position in the trade war, China needs more high-tech products like chips. This can be achieved through assisting POEs that majoring in this field. Besides, expanding the international market can bring China more space for future development since domestic market is getting saturated. Under these situations, the survival and advancement of private-owned firms become increasingly critical to Chinese people's well-beings and China's future economic development and political position.

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