

## Research on Optimization Strategy of Classified Management and Control Model of SOEs Based on Classification Reform

Haiyun Song<sup>a</sup>, Jianhui Liao, Xiaoxuan Zhang, Xiaobin Lin, Li Ma

State Grid Energy Research Institute Co., Ltd., Beijing 102209, China

<sup>a</sup>songhaiyun@sgeri.sgcc.com.cn

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**Abstract:** Different types of SOEs have different functional positioning factors, and their management and control models must also require certain differences. This paper firstly reviews the literature on classification reform and classification control. Secondly, it studies the optimization choice scheme of the classification control model of SOE groups. Finally, this paper puts forward the group management and control modes which are suitable for public welfare enterprises, commercial enterprises and commercial enterprises respectively.

### 1. Introduction

With the development of China's economy and the reform of SOEs, the scale of operation of SOEs has continued to expand in recent years, and the business composition has become increasingly complex. After a large number of large SOEs were formed into enterprise groups in the form of multiple legal entities, the strategy and boundaries have undergone major changes. In order to meet the needs of large-scale complex organization management, these SOEs have carried out management and control structure transformation in exploration or imitation, trying to achieve the matching of the group strategy and management structure. However, many group-owned SOEs implementing business diversification strategies maintain a functional management structure that clearly does not match their strategy type due to various factors. For example, Some SOEs have adopted the mode of "small headquarters", but excessive decentralization has led to the blurring of management. Some SOEs have to set up "big headquarters" to maintain or strengthen their headquarters control capabilities. SOE groups have a lack of self-organization mechanism, chaotic management relationship, low degree of business management integration, difficulty in achieving management integration, and large risk of out-of-control risks (Jing Yongchun, 2009) [1], which has seriously hindered the high-quality development of SOEs. Therefore, how to optimize the SOE group management and control model is the key to enable SOEs to continuously improve quality and efficiency and achieve high-quality development.

There are a large number of SOEs in China, and different SOEs have great differences in terms of industry attributes and functional positioning. This requires SOEs to design a reasonable management and control model for their special attributes. The Third Plenary Session of the 18th Central Committee opened the prelude to a new round of SOE reform, and the reform of SOE classification has become the main tone of SOE reform. On October 13, 2015, the Central Committee of the Comprehensive Deepening Reform Leading Group reviewed and approved the "Guiding Opinions on the Definition and Classification of SOEs". According to the main business and core business scope, the opinion divides SOEs into commercial and public welfare categories. Commercial SOEs are required to operate in accordance with market operations and to enhance the vitality of the state-owned economy. Public welfare SOEs aim to protect people's livelihood and provide public goods and services. It also proposed to implement classified reform, classified development, classified supervision, classification and responsibility, and classified assessment to promote the in-depth integration of SOEs with the market economy. Therefore, how to optimize the management and control mode of state-owned enterprise groups based on classified reform is a

major problem to be solved urgently to balance the interests of state-owned enterprises and the interests of society and achieve high-quality development of enterprises under the new situation. This is also the significance of this study.

## **2. Literature review on classification reform and classification management**

Due to the differences in political and economic systems and cultures of various countries in the world, SOEs in different countries also have large differences in their functions and business objectives. Therefore, there are great differences in the basis and methods of classifying state-owned enterprises in different countries. According to the degree of competition in the industry, SOEs can be divided into monopoly SOEs and competitive SOEs. For example, France and Singapore classify SOEs according to this standard, and the development orientation and supervision methods of different types of SOEs are different. According to the government's positioning of the interests of SOEs, they can be classified according to commercial, public welfare or special tasks. For example, Finland, Sweden, Norway, New Zealand and other countries will implement classified supervision of SOEs according to this dimension. According to the degree of government control over SOEs, they can generally be divided into wholly-owned SOEs, holding SOEs and share-holding SOEs. For example, the United States, Japan, South Korea and other countries generally classify SOEs according to this dimension, but the category titles are different.

Based on the characteristics of emerging market economies and national conditions, many scholars have studied how to classify China's SOEs. Gao Minghua, Yang Dan and Du Wencui etc. (2014) classify SOEs into three categories according to the different business objectives and functions of enterprises in various countries: public welfare SOEs, rational monopoly SOEs and competitive SOEs [2]. Huang Qunhui and Yu Jing (2013) proposed three types of public enterprises, namely, public policy instead of public welfare, and general commercial enterprises instead of competition and some specific functional enterprises in between, according to the differences in the mission, goals and positioning of SOEs [3]. Gao Wenyan (2013) constructed the "three forces model" of SOE classification reform from the three dimensions of influence, control and vitality, and based on the proportion and number of SOEs, classified SOEs into three categories: national security, public security and market guidance [4].

After the Chinese government clarified that SOEs promoted classification reforms in accordance with commercial and public welfare categories in 2015, some scholars conducted further research on the classification reform of SOEs. For example, Liu Xiaolu (2017) believes that for industries where there is no natural monopoly and competitive links in natural monopoly industries [5], we should focus on introducing competition on the basis of deregulation. SOEs with natural monopoly links should limit their market power through effective mechanism design and price control, and actively explore ways to achieve mixed ownership, so as to improve the operating efficiency of natural monopoly links. The classification reform of SOEs is the current institutional innovation to promote the deep integration of SOEs with the market economy, and also the institutional choice to resolve the conflict between the "profit mission" and "policy mission" of SOEs (Hu Feng, 2017) [6].

However, although the current SOEs and local SOEs generally recognize the necessity and rationality of the classification of SOEs, the design of the governance mechanism of SOEs has not been adapted to the "class"(Gao Minghua, Yang Dan and Du Wencui, etc., 2014) [2]. The reform of SOEs should design different governance mechanisms for different types of SOEs, which is the key to deepening the reform of SOEs (Li Wei'an, 2014) [7]. To promote classified governance and reform, differentiation of governance mechanisms applicable to different types of SOEs should be reflected in six aspects, including law application, classified assessment, enterprise leader selection and appointment system, executive compensation system and so on (Huang Qunhui, Yu Jing, 2014) [8]. However, although only a few literatures, such as Wang Yuliang (2016) [9] and Zhang Xiaojun (2018) [10], have studied the functions and organizational structures of SOEs and given some consideration to the group management and control that focuses on capital management, they have

not conducted in-depth studies on the classified management and control mode of SOEs that adapt to the classified reform. Therefore, it is hoped that the research in this paper can fill this gap.

### 3. Research on optimization and selection of classification and management mode of SOE groups

Combined with the practice of classification reform of Chinese SOEs, this paper divides SOEs into three categories: public welfare, commercial, and commercial. Public welfare SOEs refer to SOEs whose main objectives are to protect people's livelihood, serve the society, and provide public goods and services, such as China Grain Reserves Group Ltd. Company and China National Cotton Reserves Corporation. Commercial first-class SOEs refer to businesses in which the main business is in a fully competitive industry and field. SOEs, such as China Resources, COFCO, Huaneng, etc.; commercial second-class SOEs refer to commercial SOEs whose main business is in important industries and key areas that are related to national security and national economic lifeline, and mainly undertake major special tasks, such as PetroChina, State Grid, military enterprises, etc. The classified reform has brought at least four important influences to the classified management and control of SOEs, which are business division, policy implementation, organizational structure adjustment, process optimization and system innovation.

#### 3.1 General idea of optimization and selection of classification management and control mode

The group management and control model is the group's management and control strategy based on the degree of divergence of subordinate enterprises. The traditional theory divides the group management and control model into three types: financial management, strategic management, and operational management, as shown in Table 1. Among the various factors affecting the group's management and control mode, the group's functional positioning plays a decisive role, and the management and control mode must be compatible with the group's functional positioning. Each type of management and control mode has its own advantages and disadvantages. In reality, enterprise group management and control is often a combination of multiple modes dominated by one model. Moreover, the management and control model is not static and will be dynamically adjusted as the enterprise transitions or internal and external conditions change.

Table 1 Three Group Management Models

Influencing factor	Financial management	Strategic management	Operational control
<i>Headquarters positioning</i>	Investment decision center	Strategic decision center, investment decision center	Business decision center
<i>Management focus</i>	Finance, investment	Strategic planning, business plan	Production management, specific business
<i>Degree of control</i>	Weakest	Moderate	Strongest
<i>Dividing rights</i>	Decentralization	Dividing rights	Centralization
<i>Business relevance</i>	low	Moderate	high

The group function positioning of public welfare, commercial first and commercial second enterprises is different. The degree of competition is as follows: commercial first-class > commercial second-class > public welfare class, that is, the commercial class has the highest degree of competition and the public welfare class has the lowest level. Therefore, the management and control models of different types of SOE groups should be different. In order to adapt to the classification reform and the situation requirements of "management capital", the management and control modes suitable for different types of SOE groups are optimized and selected in the next part of this paper, according to the different factors such as functional positioning, headquarters positioning, management focus, degree of control and control, centralization and decentralization, and degree of business connection.

### **3.2 Public welfare enterprise management and control mode**

According to the classification of SOEs, public welfare enterprises have a clear development strategy and service objectives, and their business relevance is generally higher. The focus of this type of corporate group management is how to improve management efficiency and reduce operational risks. Therefore, the group headquarters should have the function as a business decision-making center. It is necessary to focus on the specific business of production and operation, control the key operational businesses, maximize the mobilization of the Group's resources, and achieve coordinated operations in all aspects of capital, human resources, assets, and brand operations. Such enterprises have the strongest management and control, which is embodied in centralization. Therefore, the group management and control of public welfare SOEs should use the operational management and control model to further strengthen the Group's management and control, resource allocation and service functions, and create a strong and efficient management and control system. At the same time, in order to ensure the realization of the strategic goal of safeguarding people's livelihood, serving the society, and providing public goods and services, public welfare state-owned enterprises must also have the function as a strategic decision-making center, that is, they must also pay attention to strategic planning and business plans in management. Therefore, the public welfare group can adopt the management and control mode with the main control of operations and management, supplemented by strategic management and control, as shown in Table 2.

### **3.3 Commercial first-class enterprise management and control mode**

Commercial first-class SOEs face more intense external environmental uncertainty and market competition. Due to the high environmental uncertainty, it is difficult for such companies to formulate a long-term group strategy, and it is difficult for the group headquarters to respond to changes in the external environment faced by the subsidiaries in a timely manner. In addition, excessive operational process control will result in a long chain of decision-making and a decline in market responsiveness. In addition, excessive centralization will also lead to more constraints on the behavior of subordinate enterprises and lower enthusiasm. Therefore, the commercial first-class SOEs is suitable to adopt the financial control model, take the headquarters as the investment decision-making center, focus on the financial and investment management, only make requirements on the operating results of enterprises and the return on investment of the group, and do not interfere in the strategy formulation and daily operation of enterprises. Its group control is the weakest, reflected in decentralization. However, if the competitive business industry develops rapidly and has a significant impact on the overall revenue of the group, it should be considered to be included in the Group's unified strategic plan. Therefore, the group management and control of commercial first-class enterprises should adopt a mode that is dominated by financial management and control mode, and supplemented by strategic management and control mode.

### **3.4 Commercial second-class enterprise management and control mode**

As the main business of second-class commercial SOEs is related to national security and the lifeblood of national economy, such SOEs should adopt strategic management and control mode focusing on capital management. Its headquarters should function as a strategic decision-making center as well as an investment decision-making center, with strategic planning and business plan as the management focus, with moderate control and decentralization as the embodiment. Due to the moderate degree of business relevance of such enterprise groups and the compatibility between related industries, or similar management, or resource sharing, or by analogy, the distribution of group resources and service support should also be considered to ensure the effective use of the group's overall resources. Among them, for industries with critical influence on the group's

development or industries with high and frequent utilization of group resources, the group should consider the preference in resource and service allocation strategy. Moreover, in order to further improve the utilization efficiency of the Group's resources, it is necessary to strengthen the supervision and control of the operation process of the enterprise, thereby gradually forming and solidifying the core competitiveness of the enterprise. Therefore, commercial second-class SOEs should adopt a group management and control model with strategic management and control as the mainstay and operation control as the supplement.

Table 2 Selection of SOE Classification Management and Control Mode

SOE classification	Financial control	Strategic control	Operational control
<i>Public welfare</i>	☆	★★	★★★
<i>Commercial first-class</i>	★★★	★★	☆
<i>Commercial second-class</i>	☆	★★★	★★

Note: ★★★ indicates dominant position, ★★ indicates secondary status, and ☆ indicates lowest status.

#### 4. Conclusion

Based on the consideration of the functional positioning, headquarters positioning, management focus, management and control, collection rights, and business relevance of various SOE groups, this paper proposes different types of SOE group management and control models. The conclusion is that the SOEs with public welfare should adopt the group management and control mode with operation and control as the mainstay and strategic management and control as the supplement. Commercial first-class SOEs should adopt a group model with financial management and control mode as the mainstay and supplemented by strategic management and control mode. Commercial second-class SOEs should adopt a group management and control model with strategic management and control as the mainstay and operation management and control as the supplement. And the division of powers and responsibilities of the parent and subsidiary companies of different types of SOEs is also different.

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