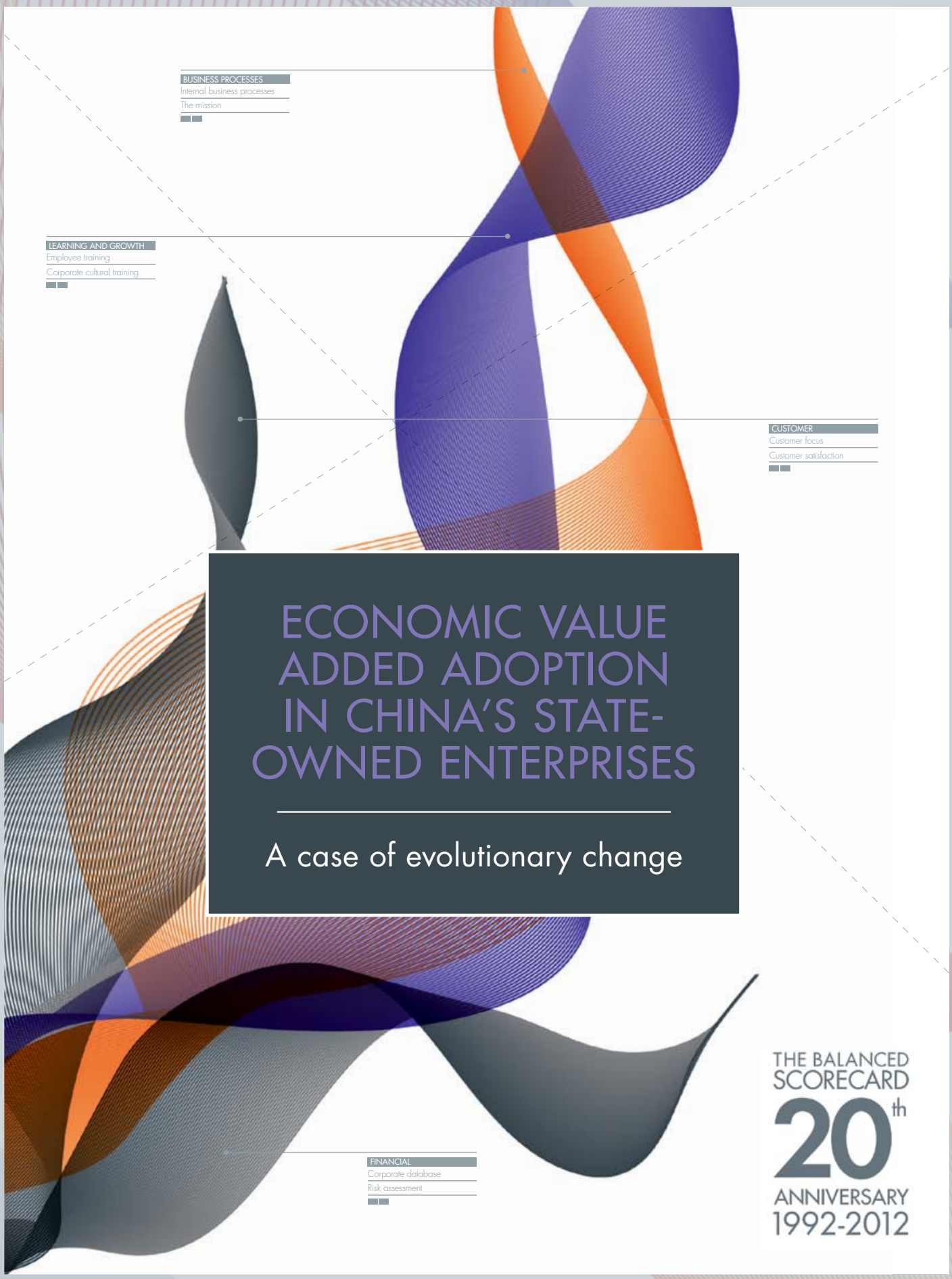

ECONOMIC VALUE ADDED ADOPTION IN CHINA'S STATE-OWNED ENTERPRISES

A case of evolutionary change

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Key words: performance measurement system (PMS), economic value added (EVA), China, state-owned enterprises (SOE), State-owned Assets Supervision and Administration Commission of the State Council (SASAC), management control systems (MCS), residual income (RI), value based management (VBM)

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KEY CONCLUSIONS

- The evolutionary change is achieved in Chinese state-owned enterprises by staged performance measurement system development in which economic value added is introduced gradually.
- This design is driven by the intertwined motives of legitimacy and efficiency, and has provided a mechanism to achieve a balance between maintaining stability and promoting changes in a company's management practice.
- Some changes are observed, including an improved awareness of the cost of capital, a greater willingness for investing in research and development, and an improved asset and operation efficiency.
- The extent of the impact is variable among the companies and it is largely determined by the motives behind implementing EVA, and the level of management effort.

OVERVIEW AND OBJECTIVES

This project investigated the design and implementation of performance measurement systems (PMS) based on economic value added (EVA) in China's state-owned enterprises (SOEs), aiming to explore the roles of PMS in the context of Chinese SOEs.

While EVA implementation has been mainly studied in Western companies from the perspective of improving economic efficiency, we take a different angle, looking at the motives of EVA adoption and their impact on the design and implementation in a major emerging economy. The study provided evidence that evolutionary change is achieved by means of staged PMS development in which EVA is introduced gradually, and revealed some changes in managerial attention and behaviour that seemed linked to EVA implementation.

Imposed by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), a new EVA-based performance assessment policy has been introduced to the 129 Chinese SOEs under direct administration of central government since 2010.[1] Established by the State Council in 2003, SASAC at the national level handles the state's ownership interests as well as regulation and supervision of Central SOEs. This EVA initiative was applauded by Erik Stern, the director of *Stern Stewart & Co.* as a change that "could end up having an impact on China that rivals that of Premier Deng's 1978 reforms."

Based on the concept of residual income (RI) and trademarked by *Stern Stewart & Co.* in the 1980s, EVA is defined as adjusted operating income minus a capital charge. The academic research examining the use of RI has mainly compared the performance of firms having adopted RI to those that have not, but has produced mixed results.

One of the factors contributing to the mixed results referred to above may be that distinguishing RI companies from others has been solely on the basis of RI use in forming compensation plans. From their field work in five Finnish companies, Malmi and Ikäheimo (2003) found that the use of value-based measures does not lead to management control mechanisms in their purest form. Similarly, McLaren's (2005) CIMA-sponsored investigation into the use of EVA in three companies in New Zealand found that EVA has not entirely replaced traditional measures, so its use is not 'all or nothing'. They argue that the different application may be due to different motives for adoption.

The principle motive for adopting management innovation has been assumed as a quest for economic efficiency. In the context of value-based management (VBM), the academic research has studied the effectiveness of new systems on aligning shareholders' and managers' goals, which has been presumed to be financial returns measured by share price. However, there are also some studies that investigate whether broader motives have been influential during the diffusion of management innovation. Relaxing the assumption that organisational choices are driven purely by economic rationality, an innovation could be adopted as a strategic response to institutional pressures for the reason of legitimacy. For example, in a longitudinal study of a company in which VBM was imposed by its parent, Siti-Nabiha and Scapens (2005) examined how the system was implemented ceremonially and how both stability and change of PMS intertwined. In their case, involving the issues of both legitimacy and efficiency and their interdependency, ceremonial implementation was observed as necessary to preserve stability. This stability, however, contributed to accounting change in creating a new PMS.

In the context of Chinese SOEs, the motive of introducing EVA could be regarded literally as pursuing economic efficiency, since the main objectives of EVA implementation are to increase returns on capital and strengthen risk control for the interests of the State as shareholders, as claimed by SASAC. However, SASAC and the sector of SOEs are under not just economic, but also political pressures for restructure and privatisation. The criticisms on SASAC's roles and SOE achievements have never abated. One recent example of these criticisms is the heated debates in 2012 on whether SOEs should be privatised, which was triggered by the Word Bank's report *China 2030*, as further discussed in the next section. Within this context, should there be other motives for SASAC to introduce an EVA initiative? How would those motives affect the design and implementation of the initiative? What impacts does the new system have on decision making in the companies? Answers to these questions will have both theoretical and practical implications.

Aiming to address the above research questions, we investigated the design and implementation of EVA based initiatives in China's Central SOEs by means of case studies. SASAC and four Central SOEs were visited, where interviews and focus group meetings were conducted.

MAIN FINDINGS

Evolution of PMS in Chinese SOEs – background of EVA introduction

Following SOE reforms in the transition from a centralised planned economy towards a socialist market economy, top managers' performance measurement in China's SOEs has evolved, as shown in Table 1.

TABLE 1: Evolution of performance measurement systems in China's SOEs

	Main reform schemes	Main performance measures
1980s	• Enlarging enterprises autonomy • Contract responsibility system	Profit
1990s	• Ownership restructuring • Grasping the large and letting go of the small	Profit State equity growth rate

The era of SASAC
Main reform schemes: corporatising

2004.1.1 – 2007.1.1 – 2010.1.1 – 2012.12.31

2004.1.1 – 2007.1.1	2007.1.1 – 2010.1.1	2010.1.1 – 2012.12.31
Two financial measures: • Annual profit • Return on net assets Two industry specific measures (usually non-financial measures)	Two financial measures: • Annual profit • Return on net assets Two industry specific measures Calculated EVA for all the SOEs, but only used in performance evaluation in several trial SOEs	Two financial measures: • Annual profit • Economic value added Two industry specific measures

SASAC was established by the State Council at the 10th National People's Congress of PRC held in 2003, mainly as an effort to create an institutional framework that separates the fiduciary responsibility for the state-owned assets from the government's social and public management functions. It has advocated improving corporate governance and profitability of SOEs since its establishment. The mission set out for the SOEs under the 11th five-year plan (2006-2010) is to "grow bigger and stronger". The statistics evidence the achievement of this scale-oriented strategy: by the end of 2010, the net profit achieved by the 122 Central SOEs reached 848.89 billion yuan, sizeable given that total profit by all China's SOEs was 21.37 billion yuan in 1998. The Central SOEs listed in the Fortune 500 have increased from 6 in 2003 to 38 in 2011.

However, the criticisms on SASAC's roles and SOE achievement have never abated and the debates have become more intense following Chinese SOE outperformance during the global financial crisis.

Firstly, the critics argued that the SOEs outperformed at the expense of the private sector. A catchphrase "*guo jin, min tui*" or "*the state advances, the private sector retreats*" has been used to describe the situation that is the expansion of the government role in the corporate sector and the growing political and financial influence of China's state-owned giants – 122 huge conglomerates run by SASAC and thousands of smaller ones run by the provinces and cities. Some researchers and analysts even warn that the 1980s and 1990s reforms that unleashed China's private sector and dismantled the state-owned sector are being partly undone (Wines, 2010).

Secondly, although it is hard to argue with success, the means by which China's SOEs have achieved success have been criticised. It is argued that overall SOEs produce a relatively small share of gross output and value added, but consume a large proportion of capital, raw materials and intermediate inputs relative to the private sector. The advantages that SOEs obtained from preferential access to bank finance and business opportunities, and even protection against competition, have created a profound inequality with private competitors (the World Bank, 2012).

Although there are many reasons, such as social and political ones, to support the existence of a strong SOE sector, it may be jeopardised if it fails to demonstrate its economic value-added capability. An important response from SASAC to the concerns and arguments on the value and the status of SOEs, apart from publicly highlighting the importance of SOEs to society and the economy, is to promote SOE identity as corporate, like any other private companies. This includes replacing the scale-oriented growth mission with the value-oriented one for the 12th five-year plan (2011-2015) as 'pursuing excellence' and introducing EVA into PMS. According to SASAC, an important reason for choosing EVA is its commonly accepted image of focusing on shareholder value maximisation, which suggests legitimacy as an important consideration for its PMS reform.

The design of EVA-based systems – a work of art

The calculation of EVA and the method of assessment in SASAC's initiative applied in 2010-2012 are shown in tables 2 and 3. The performance of the Central SOEs and their top managers is assessed annually based on total achieved scores. The SOEs are accordingly classified into five categories; A, B, C, D and E respectively. Executive salaries, bonuses and career development are significantly affected by the categories and the scores achieved.

The design of the policy embraced the basic concept of EVA as a measure of economic profit, but it has its own technical features if comparing to theoretical models. The SASAC official we interviewed commented facetiously: "We just borrowed the shell of Stern Stewart's EVA."

SASAC had years of studying, evaluating and debating almost all available methods and models before EVA was finally chosen. They cite that EVA was chosen technically because of its comprehensiveness and flexibility, satisfying their needs to reflect the objectives of reform, and achieving the right balance between maintaining stability and promoting change of management practice in the SOEs.

TABLE 2: EVA equation (2010-2012)

EVA = net operating profit (after tax) - adjusted capital X cost of capital	
Net operating profit (after tax)	net profit + (interest payment + R&D expense - non-recurrent income X 50%) (1-25%)
Adjusted capital	owner's equity + total liability - interest-free current liability - construction in progress (in defined core businesses)
Cost of capital	5.5% in principle 4.1% for those with heavy state/social responsibility and high-level assets specificity 6.0% for those with liability/assets ratio above 75%

TABLE 3: Performance assessment (2010-2012)

Total scores = (EVA scores + profit scores + industry - specific measures scores) x operating difficulty ratio +/- other awarded or deducted scores	
EVA: basic scores 40; achieved scores vary between 40 +/- 8	• The benchmark for target setting: the lower of last year's achieved EVA and the average of last three years' achieved EVA • Two scenarios for scoring based on the variance between actual and target EVA according to whether the annual EVA target is above or below the benchmark: S1, if the EVA target is above the benchmark – starting from 40 scores – for every 2% of positive variance, award one extra score, maximum 8 extra scores – for every 3% of negative variance, minus one score, maximum minus 8 scores S2, the EVA target is below the benchmark – starting from 40 scores – for every 3% of positive variance, award one extra score, maximum 8 extra scores – for every 3% of negative variance, minus one score, maximum minus 8 scores
Profit: Basic score 30; achieved scores vary between 30 +/- 8; similar method as above	
Industry-specific measures: Two measures, basic scores 30; achieved scores vary between 30 +/- 6	
Operating difficulty ratio: Based on the weighted average of total assets, sales, total profit, return on net assets, employees, and EVA	
Other awarded or deducted scores: • Outstanding contribution to state-required projects, add 0.5-2 scores • Any frauds, deduct 0.5-2 scores depending on the degree of severity • Not well established management control systems (MCS) in the firm, deduct 0.1-1 score • If the gap between achieved profit and profit target exceeds 50%, deduct 0.5-2 score	

The rationale behind the EVA equation design

Consistent with the mission of the 12th Five-Year Plan, the objectives of introducing EVA are to encourage SOEs to (1) become accountable for return on capital; (2) develop competitive advantage in core business areas; (3) strengthen risk control; and (4) increase emphasis on sustainable development. The choices of adjusted items in the EVA equation reflect these objectives.

Firstly, the principle concept of EVA is applied, aiming to change the mindset of SOE executives from focusing on scale-oriented growth towards emphasising value creation. The calculation of EVA has been a culture shock to them when it was revealed that many of those conglomerates were actually zero or even negative in terms of value-added.[2]

Second, the adjusted items are used flexibly to strengthen risk control and promote sustainable development. As shown in table 2, to motivate an investment mindset with an emphasis on innovation, research and development expenses are allowed to be added back to profit, and construction in progress is excluded from capital. Also, to encourage the development of competitive advantage in core business areas and strengthen risk control, non-recurrent income is cut to 50% from profit contribution, and only construction in progress from the investment in official core business areas is eligible as deduction from capital.

Mechanisms to enable interactions and limit game-playing

Certain mechanisms have been applied to enable the interaction between SASAC and the SOEs while simultaneously limiting the scope of game-playing.

In order to maintain management autonomy of SOEs and ensure the fairness of performance assessment, there are some areas marked as negotiable. These include the identification of core business areas and the recognition of the impact of unforeseeable and uncontrollable factors. The former can be discussed and adjusted every three years, while the latter could be raised when it occurs. These items affect the classification of deductible construction in progress, the recognition of non-recurrent income, and achieved profit, in EVA calculation. These mechanisms provide the channels allowing interactions between SASAC and the SOEs over strategic issues and uncertainties.

However, how to set a challenging but achievable target has been an issue for most PMS models. Bargaining and game-playing could become endless, due to information asymmetry and conflicts of interests between the superior and subordinate levels. Facing the situation of one superior versus 129 subordinates, SASAC acts proactively and puts the efforts into the initiative design to make the goal-setting an executive's decision based on their risk and return trade-off.

As shown in table 3, the executives have been given freedom to set the targets higher or lower than the benchmarks. However, two rules have been set to motivate them to choose the former one.

Firstly, the firms set the target lower than the benchmark, therefore they would have no chance to enter the 'A' class, no matter the performance achieved. The effect on executives of their firms being labelled 'A' class is significant and is alleged to affect three *zi*: *mianzi* (face), *piaozi* (money), and *weizi* (position).

Secondly, the firms that with targets higher than the benchmark could get extra scores more easily (one score for every 2+ per cent), compared with one score for every 3+ per cent for the opposite.

Furthermore, a punishment 0.5-2 score is set aside for firms having a variance exceeding 50% between the budgeted and actual, in order to discourage unrealistic target setting.

Our data supports the success of the strategy in deliberately limiting the scope of game-playing over goal setting. Both officials and executives we interviewed commented that there was not much to negotiate over the goal setting for profit or EVA: it is mainly an executive's decision. It is described that an important job for budgeting is to carefully work out the optimal target to achieve the possibly highest scores.

Balance between stability and change

Contrary to designing in theoretically purist form of a PMS but decoupling it from day-to-day operations as a result of resistance to changes, as observed by researchers in Western companies, SASAC takes this initiative as a first step forward, which represents the first phase of a 10-year plan to raise corporate efficiency and return on capital. The innovation was introduced gradually, aiming to maintain a balance between stability and change for the consideration of legitimacy and efficiency.

Technically, SASAC's initiative possesses the following characteristics: (1) EVA has not fully replaced profit as a performance measure; (2) the cost of capital is lower than the market rate; (3) non-recurrent income is deducted only 50%; and (4) the impact of the EVA assessment on executive remuneration is still limited.

Multiple folding motivations for this decoupled design are identified from the investigation. Firstly, the consideration of reducing resistance. To make a PMS work effectively, firms need to understand not just how it affects performance assessment, but also how the firms' decisions could impact on the result. Keeping a familiar measure, eg profit, could help in maintaining a firm's confidence while they come to fully understand the new concept, eg EVA. Secondly, a fully market-based EVA could show a very negative image of SOE performance, which would not be acceptable for the State, the public, SASAC, and the SOEs themselves. Therefore, in consideration of legitimacy, it is necessary to ensure a reasonably positive result for most of the firms.

SASAC is proposing to increase the weighting of EVA in performance assessment, and raise the cost of capital in the forthcoming three-year contract term.

It is worth noting that choosing an evolutionary change pattern is not a SASAC innovation or a special feature of PMS reform, but a characteristic of China's economic reform. In the context of PMS evolution, the methods have been changed from time to time, but there have been certain features retained from each stage up until the most recent EVA initiative, eg the three-year contract format from the 1980s, the methods of scoring, and the usage of industry-specific measures from the 1990s and early 2000s. This strategy may result in lagging reactions to required changes, but it is certainly successful in ensuring smooth transition.

The impact on decision making: changes in the companies

To investigate the implementation of EVA-based PMS and its impact within Central SOEs, we visited four case companies, identified as C1, C2, C3 and C4 respectively. All four achieved a positive EVA in 2011, and two were classified as 'A' and two as 'B' in performance assessment. The main characteristics of implementation in the case companies and impact on decision making are summarised in table 4.

TABLE 4: Implementation of EVA-based PMS and its impact in the case companies

Case companies	Background	Cost of capital		Integration with existing MCS	Impact on decision making		
		At group level	Within the groups		Investment	Financing	Operating
C1	Central SOE, listed in Fortune 500 with an asset of over 260 billion RMB ($41 billion US) and a net profit of 8 billion RMB ($1.2 billion US) in 2011	5.5%	Calculating WACC based on 9% return on equity and actual debt interests rate and capital structure of individual companies	Used in the subsidiaries and business units, weighting 25%	• EVA as an important measure in project appraisal • has certain impact • investment on research and development increased	Yes, eg replace the fund from the parent company by bank loan	yes
C2	Listed in Fortune 500 with an asset of over 260 billion RMB ($41 billion US) and a net profit of 6 billion RMB ($0.95 billion US) in 2011	4.1%	2%, 4.1%, 5.5%, 6.5%, depending on the industries	Used only in first-tier subsidiaries	No substantial impact or changes	no	yes
C3	Central SOE with an asset of over 60 billion RMB ($9.5 billion US) and a net profit of 1.5 billion RMB ($0.25 billion US) in 2011	5.5%	5.5%	Used only in first-tier subsidiaries	• Require positive expected EVA in project appraisal • but more in a ceremonial way • investment on research and development increased	no	yes
C4	Central SOE with an asset of over 25 billion RMB ($3.95 billion US) and a net profit of 0.5 billion RMB ($79 million US) in 2011	5.5%	5.5%	Trial in some subsidiaries	• Using 5.5% as a hurdle rate • but no substantial impact or changes	no	yes

Since SASAC maintains very strong control over its SOEs, the new system is something that has to be implemented. However, the extent of integration of the new system into existing management control systems (MCS) varies among the companies. In our cases, C1, C2 and C3 have substantially integrated EVA into their internal MCS and used it in performance assessment of their first-tier subsidiaries, and C1 has even extended it to the business units, but C4 has hardly used it within the group. It is worth noting that C4 is the only case company that did not participate in the trial, and has only delivered a minimum level of SASAC required training for its managers.

According to SASAC, the impact of EVA implementation on decision making is significant. The indicators of the impact in 2011 include: (1) a more moderate investment growth of 8% for Central SOEs, much lower than both previous years' and the national ratio; (2) 38% growth in research and development investment, compared to 5-8% before EVA adoption; and (3) a 0.2% increase in total asset turnover.

Our case studies generally support the view of SASAC, but revealed in more detail a variation in impact on decision making, as summarised in table 4.

Firstly, regarding investment decision making, the main positive impact remains the changing mindset through including expected EVA in project appraisal and requiring a positive EVA. It increases managers' awareness of efficiency at project appraisal and implementation stages. However, the real impact on behaviour is still limited, even in those companies applying EVA in appraisal, because "you can always work out a positive expected EVA in a project appraisal report", as observed by most interviewees. Exceptionally, C1 has made a difference by using the expected EVA in appraisal as the goal in performance assessment in implementation. However, it would allegedly only work to a certain extent, because "if you've got a negative EVA, you lose the bonus; but if you lose the project, you lose your job and the related status!"

Secondly, to some extent, the impact on financing decisions within the groups is observed, but not at the group level. One of the four case companies has provided examples of subsidiaries replacing parent company funding with bank borrowing, or paying dividends to the parent companies more than mandatorily required. Yet at group level, it is still an overwhelming choice not to relinquish any funding obtained, or opportunities to do so, from the State.

Thirdly, the positive impact on asset turnover ratio and inventory control observed in the case companies is consistent with SASAC's statistics. All the case companies are aware of the positive impact of a higher asset turnover ratio on EVA. The tactics applied include shortening receivable days, reducing inventory, but also such 'games' as manipulating inventory purchase timings to suit the financial year end.

Overall, EVA implementation has had certain impact on decision making in the four case companies, although the extent of the impact is variable among the companies and the types of the decisions. The most significant changes occurred in the areas potentially improving profitability, such as awareness of the cost of capital in investment project appraisal, and operating efficiency. The changes from profit and size towards value creation orientation were evidenced more significantly on executives' mindset than on behaviour.

Factors contributing to variation in implementation and impact

Overall, the EVA-based PMS imposed by SASAC has been integrated into the existing MCS in the case companies to different degrees, with notable variation in its impact on decision making. What are the contributors to the extent that EVA is integrated with existing MCS? What factors influence the effectiveness of the promoted changes within SASAC's initiative? Although a finer answer to these questions requires further investigation with perhaps a larger sample, we identified some preliminary indicators below:

1. Motives for introducing and implementing EVA-based PMS

The intertwined motives of securing legitimacy and pursuing efficiency in the design and implementation of EVA-based PMS are observed at both SASAC and SOE level.

For SASAC, enhancing SOE efficiency has never been more important, and it is an integral part of securing legitimacy in the current social, political and economic environment. However, it takes time to make enhanced efficiency visible; there is an urgent need for SASAC to present an image (to the public, the State and national/international financial markets) of SOEs having been market-oriented and well governed. Decoupling the design and electing this evolutionary development, which could arguably be deemed a sacrifice in efficiency, suggests that securing legitimacy is intertwined with improving efficiency as an important motive for SASAC's EVA initiative.

Among the SOEs, the imposition of SASAC's new system has ensured implementation at group level at the very least. Whether the implementation is substantial or merely ceremonial, however, depends on the extent of executive acceptance with the EVA concept and pressure from EVA assessment. The implementation could be more ceremonial and less significantly impactful when executives exhibit greater reluctance over the EVA initiative (eg in C4) and/or feel more relaxed with regard to assessment (C2 and C3). Alternatively, the implementation could have more substantial impact when executives exhibit a greater degree of acceptance towards the EVA concept (C1 and C2) and/or feel more pressure with regard to assessment (C1).

2. Management efforts

A better understanding of the EVA concept facilitates the implementation of new systems. SASAC encourages SOEs to integrate the EVA initiative into existing MCS, but has not provided any practical models. The training courses and participation in the trial pre-2010 have enhanced management capability in these areas, but it is not adequate if simply limited to SASAC training. The case companies with the most concentrated integration of EVA into existing MCS have spent more resources on studying EVA within the organisational context, and also provided more training to middle management (eg C1 and C2). In contrast, C4 has lagged behind, having just initiated trials in certain subsidiaries from 2011.

Implications

- The introduction of EVA-based PMS does not need to be in its 'purest' form to be effective.

The design of EVA-based PMS currently applied in China's Central SOEs considered the promoter's needs (motives) within China's economic, social and political context, and is not at its theoretically or conceptually 'purest' form. It provides an example of large-scale EVA application in SOEs that could largely be regarded as successful, although its full impact cannot be fairly assessed yet because it remains at the first three-year application.

It is commonly accepted that EVA-based PMS is well developed within certain models, including the *Stern & Stewart Co.* trade-marked model, and it is applied mostly in large companies in Western economies with the assistance of consultancy firms. This impression is reinforced by 'all or nothing' measurement of EVA application, as applied by most previous studies on EVA. As an exceptional case, China's initial model has practical implications to companies, especially those SOEs in emerging economies, considering introducing new PMS.

- Significant long-term evolution could be achieved by a gradual series of reforms.

Accompanied by introducing EVA into its PMS at the first phase, it is a long-term plan for Chinese PMS reform in SOEs. This includes a series of changes amounting to an evolution which could be tracked back to the 1980s and projected over the next ten years. Such practice has effectively achieved in China's SOE reform a sense of equilibrium between stability and change. This required balance in PMS development, or in introducing organisational changes in general, could be seen as a challenge to most organisations. How can a company build up a rolling planning mechanism which is able to maintain certain extent of stability and simultaneously initiate consistent reforms? The Chinese case provides valuable implications to companies, consultants and researchers in this regard.

- Managers' training is important for the success of PMS reforms.

Our study supports the importance of management training, not just at group but also at middle and business unit level, for improving the effectiveness of the EVA initiative. In the case of China's Central SOEs, normal training courses provided by SASAC are helpful but not sufficient. Tailor-made training courses including guidance on implementation and best practice providing alternative implementation models, are recommended to both SASAC and any other large firm considering introducing new PMS.

- Further reforms in corporate governance are needed to promote fundamental changes in the case of Chinese SOEs.

While EVA implementation has promoted a mindset change from scale-growth to value orientation, the changes in behaviour, particularly at group level, are still not significant. An important reason is that the impact of EVA assessment on executives' interests is still limited. Although SASAC is planning to increase the impact of EVA assessment on executives' remuneration, the benefit and interests of an executive in a Chinese state-owned conglomerate extend beyond mere financial rewards. Fundamental changes in executives' mindset and behaviour require further reforms in corporate governance.

CONCLUSION

The project investigated the design and implementation of EVA-based PMS in China's SOEs. The study identified a staged PMS design in which EVA is gradually introduced to reflect the reality of acceptance that staged organisational development would be better received in the current Chinese environment.

Distinct from most Western models with a perfect design but possible decoupling in the process of implementing, China's design is driven by the intertwined motives of legitimacy and efficiency; and the consideration of the balance between maintaining stability and promoting changes in its SOEs. This therefore determines the optimal pattern of evolutionary change – the initial steps in a series of long-term planned change.

The study observed some changes that seemed linked to EVA implementation, including significantly improved awareness of the cost of capital in investment appraisal, higher willingness for investment in research and development, and improved asset operation efficiency. These changes are supported by SASAC's statistics. The changes from size towards value creation orientation were evidenced more significantly on executives' mindset than on behaviour. The behaviour changes in the two key areas of investment and financial decision making were observed to a certain extent within the groups, but not significantly at the group level. This could have risen out of the new system being applied recently, or from technical flaws in the imperfect design, which are the result of pursuing legitimacy at the expense of efficiency, or from the problems of SOE reform not yet providing strongly competitive markets.

Although whether the expected changes can be fully achieved depends on the success of further PMS developments and other SOE governance reform schemes, this long-term planned pattern of evolutionary development certainly provides a mechanism to achieve a balance between maintaining stability and promoting changes in a company's management practice, which has practical implications not only for SOE reform in other emerging economies, but also any organisations promoting fundamental changes.

Abstract

The project was seeking to explore the role of performance measurement systems (PMS) in Chinese state-owned enterprises (SOEs). It investigated the design and implementation of PMS based on Economic Value Added (EVA) in China's SOEs. The study provided evidence that evolutionary change is achieved by means of a staged PMS design in which EVA is introduced gradually. It revealed that the design was driven by the intertwined motives of legitimacy and efficiency, and the consideration of the balance between stability and change. Some changes in the case companies were observed, including an improved awareness of the cost of capital, a greater willingness for investment in research and development, and an improved asset and operation efficiency. However, the promoted changes from size towards value creation orientation were evidenced more significantly on executives' mindset than on behaviour.

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Footnotes

[1] These entities were also known as Central SOEs. Due to continuous restructuring, the number of Central SOEs has been declining from 129 in 2010 to 121 in 2012.

[2] The trial calculation of EVA in 2009 showed that over 50% of Central SOEs gathered negative EVA.

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