Privatization in China: Ways Forward

——— Wayne Chen

As an overall summary of the various overlapping and, in some cases, conflicting regulations, rules and notices relating to state-owned assets and state-owned enterprises (SOEs) in China, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) on November 30 2003 issued its *Opinion on Regulating SOEs' Reorganization Work* (Opinion). The Opinion generally establishes the framework of SOE reorganization and is presented in rather general and theoretical terms. Detailed implementation rules are expected to be issued soon.

The Opinion covers 10 areas relating to the reorganization of SOEs, namely: approval regime; balance sheet verification; auditing, assets appraisal; administration on trades; pricing; payment of purchase price; creditor protection; employees benefit; and management buyout. The more noteworthy points of the Opinion are highlighted below.

Approval regime for SOE reorganization

The Opinion provides a fairly open definition of "SOE reorganization" and, as such, many kinds of corporate activity fall under the term. For example, transfer of the state-owned equity interest or shares, and increase of the shareholdings by non-state capital in an SOE, are all categorized as SOE reorganization work which falls within the scope of the Opinion's definition and must therefore be approved or agreed to by the relevant government authorities.

The Opinion specifically leaves the issue of transfer of state-owned shares in listed companies to be determined by future legislation.

Administration on trades

Unlike earlier regulations, the Opinion expressly requires that transfer of state-owned assets be conducted in the assets and equity exchange markets. Given that such exchange markets have not yet been established in many localities, in practice it may not be possible to enforce this requirement for some time. Should the authorities insist on rigid enforcement, it is likely to quickly lead to a backlog of transactions waiting to be traded.

More determinants for the pricing

Before the Opinion was issued, a trade price was generally acceptable to the authorities if it was not below the appraised price of the assets. However, the Opinion stresses that pricing shall now also be made with reference to other factors, such as market demand, technologies, etc. For the price of state-owned shares in listed companies, the listed companies' capital returns and market performance shall be referenced. However, the price must not be below the net worth per share or the book value of the listed companies. This restriction appears to be a move by the SASAC to avoid or mitigate the risk of "losses of state-owned assets".

New requirement on payment of transfer price

The introduction of this new requirement is expected to have an immediate impact on transactions. Installment payments are only allowed when a lump-sum payment from one party to the other proves difficult and is only permitting following the approval of the relevant authorities. Further, in such cases where approval is obtained, the first installment must be at least 30% of the price and the balance must be cleared within one year after the first installment. The Opinion is not clear with regard to the timing of lump-sum payment, but seems to suggest that payment must be made immediately after the transaction has been approved.

Creditors' interest protection reinforced

The consent of financial institution creditors is listed as one of the conditions precedent for an SOE reorganization. However, such provisions in the Opinion are vague and operational obstacles are expected in practice.

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