State Advancing:
China’s State-Owned Enterprises after the Global Financial Crisis

Sihan Chen
Yale University

&

Jeremy L. Wallace
The Ohio State University

May 23, 2014

Abstract:

This paper uncovers specific mechanisms through which state-owned enterprises (SOEs) advanced their political and economic importance domestically and globally during the recent global financial crisis. SOEs engaged in a massive investment binge, much of which was funded by directed loans and other types of government favoritism. State-owned Yanzhou Coal’s 2009 acquisition of Australian-firm Felix Resources depicts the uneconomical side of much of the investment binge engaged in by many major SOEs during the financial crisis. The dubious, court-ordered 2009 bankruptcy of privately-held East Star Airlines contrasts with the government’s favoritism towards and protection of SOEs during the same period. The resurgence of China’s SOEs, often referred to by the phrase “state advance, private retreat” (guojin mintui), was facilitated by strong government support through complex mechanisms, at the expense of private competitors and others should give pause to undue optimism over the role of markets in China’s economy today.
China’s private sector grew rapidly in the 1980s and 1990s while the state-owned sector declined. The privatization of state-owned enterprises (SOEs) was a key piece of China’s transition from a planned to a market economy. After the major SOE reforms started in mid-1990s, SOEs appeared to be retreating on all fronts: thousands of SOEs were shut down every year while most of the remaining ones were struggling to keep themselves profitable, as they dealt with the withdrawal of government support and faced increasing competition from domestic private enterprises and foreign companies.

However, by 2013, China’s SOEs had become stronger than ever—among China’s 500 largest companies in 2013, SOEs possessed 91% of the total assets, generated 82% of the total revenues and reaped 86% of the total profits.¹ Moreover, there were 84 Chinese SOEs on the 2013 Fortune Global 500 List; in 2008, the number was merely 26.² In contrast, there were only 5 Chinese private enterprises on the 2013 Fortune Global 500 List.³ Thus, instead of being squeezed out by the more efficient private enterprises, today’s SOEs overshadow their private counterparts and have outgrown companies in other major economies.

This paper examines the financial crisis’s impact on China’s SOEs, as the 2008 crisis represents an important turning point in their history. Through a close examination of two cases during the crisis, this paper aims to uncover some specific mechanisms through which the SOEs enhanced their political and economic importance domestically and globally. We argue the resurgence of China’s SOEs was facilitated by strong government support, sometimes by favoritism at the expense of private competitors, shareholders, taxpayers and other entities

involved. This paper identifies five key patterns on the SOEs and their institutional environment during the financial crisis—reckless expansion, existence of conflicts of interests, collusion with the government, localization of political interests, and exploitation on the weakness of the legal system—each of which has significant political, economic, and social implications.

This paper is organized into two major sections. The first examines the investment binge engaged by China’s SOEs during the financial crisis, while the second analyzes governmental favoritism and protectionism that facilitated the growing dominance of the SOEs during the same period. Yanzhou Coal’s acquisition of Felix Resources demonstrates the phenomenon of the “investment binge.” The bankruptcy of East Star Airlines is dominated by government favoritism and protectionism. The paper concludes with a discussion of the implications going forward of the state advancing in the economic sphere.

**Literature**

SOEs are of paramount economic, political and social importance in China today. There is a significant literature on China’s SOEs that focuses on the SOE reforms in the 1990s and early 2000s, exploring the problems facing SOEs before the reforms, the driving forces and mechanisms of the reforms, and their impacts.

China’s SOEs have long been criticized for their inefficiency and negative impacts on the overall economy. Allen et al. (2005) find that China’s economic growth from 1980s to 1990s was primarily driven by the private sector, despite the fact that the SOEs consumed most of the state’s resources. There are two major views on the root causes of the problems of China’s SOEs. The more tolerant view holds that SOEs are inefficient because they need to produce

---

social and political goods, which serve the overall interests of the state and society rather than just those of the enterprise. For example, Lin et al. (1998) illustrate several such root causes: first, many SOEs were involved in the production of basic industrial goods or life necessities, the prices of which were heavily suppressed to facilitate national economic development and to safeguard people’s basic needs; second, SOEs bore the costs for all social benefits of their employees; third, SOEs needed to keep redundant workforce to avoid social unrest caused by unemployment. The infiltration of political and social concerns in the management of an SOE also means that many of its business decisions are made by government officials, who often have limited business expertise. For example, Li (1996) shows that local governments are directly or indirectly involved in over 75% of the investment decisions of SOEs.

The harsher view holds that the root cause of the SOE’s problems is its defective governance structure. Zhou and Wang (2001) argue that the obsolete state asset management system led to high agency cost which resulted in the SOEs’ problems. Similarly, Vickers and Yarrow (1991) argue that SOEs inadequately monitor their managers, who thus have limited incentives to improve the enterprises’ performance. Alongside the principal-agent problem, SOEs tend to operate with soft budget constraints. Groves et al. (1995) argue that since government officials cannot determine whether the poor performance of an SOE is attributable to

---

its inherently low productivity, its heavy policy burden, or managerial incompetence, the state will always have to subsidize for SOE losses without punishing the managers.  

The empirical analysis of SOE reforms yields mixed conclusions about their impacts. Wei and Varela (2003) find that there were insignificant changes in an SOE’s profitability after it was privatized, either partially or completely, while Song and Yao (2004) find that privatization had a significantly positive impact on firm profitability. On the other extreme, Wang et al. (2004) find that return on sales declined 8.3% around the time of an SOE’s privatization, damaging firms. Some scholars address such contradictory results by breaking the SOEs into several categories. Ng et al. (2006) find that the performance of partially privatized companies was on average inferior to either completely privatized or completely state-owned companies due to the ambiguity in ownership and control rights. Rousseau and Xiao (2008) support the finding of Ng et al. (2006) by showing that privatization, when accompanied by a change of control, has had positive effects on profitability and the productivity of labor. Bai et al. (2006) argue that privatization resulted in significant gains in the operating margin for SOEs affiliated with the county or city governments, but not for SOEs affiliated with the provincial or central governments, suggesting that larger SOEs were better at utilizing government support. This finding is particularly significant, as SOEs associated with the phenomenon of “guojin mintui”

---

(the state advances while the private retreats)—which is a key concept behind this paper—are overwhelmingly affiliated with these high-level governments.

More generally, scholars argue that the reforms did not fundamentally change the institutional structures or the behaviors of the SOEs. For example, Hu (2000) argues that the government's actual policies and practices were in stark contrast with the official goals of the SOE reforms.\textsuperscript{15} As a result, the government continued its direct involvement in the economy and much of the society. Similarly, Sun and Tong (2003) argue that there was limited change in the governance and thus behavior of SOEs because the government was still the controlling shareholder and kept its effective control of the partially privatized enterprises.\textsuperscript{16}

Financial Crisis and China’s SOEs

Academic interest in China’s SOEs waned after the “completion” of the reforms as it became accepted that SOEs would lose their dominant positions in China’s economic, political and social landscapes. Developments in the roles and prospects SOEs after mid-2000s have been chronicled by a limited literature, with even less on the relationship between the global financial crisis and the SOEs.

An exception to this lacuna on the impacts of the global financial crisis on the SOEs is found in a short essay titled “Guojin Mintui: The Global Recession and Changing State-Economy Relations in China” by Dali Yang and Junyan Jiang in the recently published book The Global Recession and China’s Political Economy.\textsuperscript{17} Yang et al. (2012) argue that government


favoritism towards SOEs facilitated the phenomenon of “guojin mintui.” We build on their analysis by exploring the political forces that drove the observed changes and elaborating on the specific mechanisms by which these changes took place in both domestic and international spheres.

**Investment Binge**

The overall patterns of the investment binge engaged by China’s SOEs can be seen by examining global FDI outflow and overseas investments by Chinese enterprises. The data on global FDI outflow are based on and tabulated from “World Investment Report 2013,” a report compiled by United Nations Conference on Trade and Development. The data on overseas investments by Chinese enterprises are based on and tabulated from “China Global Investment Tracker,” a dataset compiled by The Heritage Foundation.

The global financial crisis enabled the major SOEs to engage in an investment binge which rapidly and drastically enhanced their dominance domestically and influence globally. As shown by Table 1, overseas investments by Chinese SOEs grew rapidly from 2005 to 2008; from 2009 onward, the growth moderated but remained steady. On the contrary, overseas investments by Chinese private enterprises were insignificant from 2006 to 2009. Only after the worst of the crisis had passed in 2010 did overseas investments by Chinese private enterprise begin to enjoy sustained growth.

---

18 Ibid.
Table 1: FDI Outflow by Chinese Enterprises

One may argue that the overseas investment binge, partly attributable to the financial crisis, did not benefit the SOEs vis-à-vis their private counterparts, since the private enterprises enjoyed faster growth in overseas investment from 2010 onward. However, the SOEs consistently enjoyed around 90% share of the total overseas investment, while contributing less than half of China’s economic output. As shown in Table 2, the top 15 enterprises ranked by total overseas investments from 2008 to 2012 are all SOEs.

Table 2: Top 15 Chinese Enterprises by Total Overseas Investment from 2008–12

One may also argue that the overseas investment by Chinese SOEs after the start of the financial crisis was not even a “binge,” since growth of such investments from 2009 onward was moderated. Again, the existence of a “binge” should be viewed from a relative perspective. As shown in Table 3, FDI outflow by developed economies in 2012 was roughly half of its value in 2007, whereas total global FDI outflow in 2012 was only slightly more than half of its value in 2007. In comparison, as also shown in Table 1 using the China Global Investment Tracker data, FDI outflow by Chinese SOEs in 2012 was more than double its value in 2007. As China’s SOEs significantly outpaced their foreign competitors in overseas investment during the financial crisis, they gained competitive advantages—in scale, synergy, technology, new markets, and branding, among others—over their foreign counterparts.

Table 3: Global FDI Outflow

There are three major reasons why the SOEs managed to engage in such an investment binge. First, the export sector’s sudden collapse forced the government to rely more heavily on

---

21 The Heritage Foundation, “China Global Investment Tracker.” See also the Appendix Tables.
22 See Appendix Table 2.
23 The Heritage Foundation, “China Global Investment Tracker.”
investment for economic growth. Since the early 2000s, exports and investment have been the two major engines for China. From 2005 to 2007, exports averaged 38% of China’s GDP, making China’s one of the world’s most export-oriented economies.25 However, in the first quarter of 2009, when the central government announced many of its policy directives to battle the financial crisis, China’s export dropped 20% from a year earlier—implying that to achieve the central government’s goal of an 8% real GDP growth rate, investment would have to increase roughly 40% from a year earlier. A shift from export to investment disproportionally favored the SOEs at the expense of private enterprises, since SOEs dominated capital intensive sectors.

Second, the rapid expansion of bank loans in China after the start of the global financial crisis supplied the SOEs with enormous amounts of capital available for investment projects. In an effort to significantly increase investment activities, the central government in November 2008 urged the state-owned banks to increase their lending to support China’s economy. A surge in new bank loans soon followed. For example, new loans originated at Bank of China recorded a compounded annual growth rate of 33% from 2008 to 2010.26

Third, the global financial crisis temporarily depressed the prices of various assets across the world, making it a potentially golden opportunity for the SOEs to invest overseas. From March 2008 to March 2009, the S&P 500 index dropped approximately 50%, which means that an average S&P 500 company could be bought in early 2009 for half of its early 2008 price.27

27 Google Finance, “S&P 500.” Accessed online at: https://www.google.com/finance?q=INDEXSP%3A.INX&e=PT7Y9U8CIMoJkS4g6twE. The average market price for smaller companies dropped even more in percentage terms due to higher risk perceptions and lower stock liquidity.
With enormous amounts of bank loans available, China’s SOEs seized the opportunity to enlarge and strengthen themselves. However, as illustrated in Yanzhou Coal’s acquisition of Felix Resources below, China’s SOEs were not always able to exploit the depressed prices of global assets, and sometimes ended up paying inflated prices for overseas acquisitions.

**Yanzhou Coal**

In August 2009, Yanzhou Coal (Yanzhou) entered into a binding scheme with Felix Resources (Felix), to make an acquisition of the entire equity interest in Felix for US$2.9 billion. Felix was an Australia-based explorer and producer of coal. Felix owned equity interests in a number of coal mines located in New South Wales and Queensland, including Ashton Coal Mine, Minerva Coal Mine, Yarrabee Coal Mine and Moolarben Coal Mine, with a total coal reserve of 1.4 billion tons attributable to Felix. Before the acquisition of Felix, Yanzhou had an insignificant overseas presence. The deal initiated Yanzhou’s overseas expansion, which was followed by more acquisitions in Australia (discussed below). The size of the deal was substantial for Yanzhou, which was China’s fourth largest coal producer. As of July 31, 2009, the market capitalization of Yanzhou was US$7.6 billion, which was less than three times the market capitalization of Felix. Moreover, as of June 30, 2009, Yanzhou only had a cash balance of US$1.5 billion on its book, which means that even if Yanzhou decided to exhaust all its cash balance for the acquisition of Felix, it still needed to rely on banks for about half of its financing, at a time when the global financial market was in bad shape.

28 There have been significant fluctuations in exchange rate between RMB and USD, and that between RMB and AUD. We use RMB since it is the reporting currency of Yanzhou Coal. The conversion to USD, only if necessary, is based on historical (instead of current) exchange rate.
29 Yanzhou Coal Mining Co Ltd., Annual Report 2009
30 Google Finance, “Yanzhou Coal Mining Co Ltd (ADR).” Accessed online at: https://www.google.com/finance?q=NYSE%3AYZC&ei=WFdAU_CEDuSJsQeQ-wE
31 Yanzhou Coal Mining Co Ltd., Interim Report 2009
The acquisition of Felix was not an isolated event for Yanzhou. From 2009 to 2011, Yanzhou engaged in investment sprees both domestically and overseas. After the acquisition of Felix, Yanzhou continued to expand its business in Australia.

- In August 2011, Yanzhou acquired Syntech Holdings Pty Ltd and Syntech Holdings II Pty Ltd, both of which were coal producers in Australia, for US$222 million.\(^{32}\)
- In September 2011, Yanzhou acquired Wesfarmers Premier Coal Limited (Wesfarmers Premier) and Wesfarmers Char Pty Ltd. (Wesfarmers Char), for US$289 million.\(^{33}\) Wesfarmers Premier was engaged in the exploration, production and processing of coal whereas Wesfarmers Char was engaged in the research and development of the technology and procedures relating to processing coal char from low grade coal. Both companies were based in Australia.
- In December 2011, Yanzhou acquired Gloucester Coal (Gloucester), a coal producer in Australia that also owned a stake in a coal exporting port, for US$2.1 billion.\(^{34}\)
- In addition to the acquisitions in Australia, Yanzhou also expanded in Canada. In September 2011, Yanzhou acquired 11 potash mineral exploration permits and eight potash mineral exploration permits for US$260 million.

In sum, in a mere span of three years, Yanzhou made five major acquisitions overseas that had a combined price tag of US$5.8 billion. Domestically, Yanzhou also made various investments, including an RMB2.8 billion acquisition of Inner Mongolia Xintai Coal Mining Company (Xintai) in 2011 and spent RMB8.6 billion on property, plant and equipment in the same year, more than four times it spent in 2008.\(^{35}\)

Table 4 shows the breakdown of the acquisition price of RMB 20.6 billion (USD 2.9 billion) of Felix. The most striking part of the table is that Yanzhou made a fair value adjustment of RMB 16.5 billion on the intangible assets of Felix, without any apparent justification in its


\(^{35}\) For more on these domestic investments, see the annual reports of Yanzhou Coal from 2008 to 2012.
public filings or press release. This “fair value adjustment” essentially made up for 80% of the total price that Yanzhou paid for Felix.

Table 4: Breakdown of the Acquisition Price of Felix by Yanzhou about here

Another way to determine whether the Felix deal was overpriced is to look at the market value of the assets acquired from Felix after the global financial market stabilized. The assets acquired from Felix, Syntech, Wesfarmers and Gloucesters were all absorbed into Yancoal Australia, Yanzhou’s Australia subsidiary. In June 2012, Yancoal Australia was listed in Australian Stock Exchange with a debut market value of US$1.5 billion. By March 30, 2014, the market value of Yancoal Australia had declined to US$396 million. In comparison, Yanzhou paid a combined price of US$5.5 billion for the four acquisitions in Australia, and US$2.9 billion for Felix alone. That is, the market value of the Australian assets acquired by Yanzhou has declined by more than 90% in less than five years. In other words, at the time of the acquisitions, Yanzhou might have paid prices which could be inflated by more than ten times from the intrinsic value of the assets.

An examination of the entire process of Yanzhou’s acquisition of Felix reveals the reasons why the acquisition price was so inflated at a time when global asset value had been severely deflated. When Yanzhou first expressed interest in Felix in December 2008, the shares of Felix were trading at about A$5 a share, which corresponded to a market capitalization of

---

36 Yanzhou Coal Mining Co Ltd., Annual Report 2009. It is important to note that intangible assets are generally insignificant for energy companies, such as oil & gas, coal, and metals, whose values are primarily based on the reserves of oil, gas, coal and metal ore they have. Some other companies, such as Internet companies, may have very substantial amounts of intangible assets.

37 Yanzhou Coal Mining Co Ltd., Annual Report 2011


39 Google Finance, “Yancoal Australia Ltd.” Accessed online at: https://www.google.com/finance?q=ASX%3AYAL&ei=X1dAU9iAEvDLsQf9Wg
US$0.8 billion. Market speculation in the subsequent eight months pushed up the price to about A$17 a share right before the acquisition. As the acquisition price is usually based on the market price immediately before the deal plus an agreed-upon premium, the more than three-fold surge in the stock price of Felix over the course of the speculation significantly pushed up the cost of acquisition for Yanzhou. Although market speculation often can increase the stock price of a target company in anticipation of an acquisition, the scale of the surge Felix’s stock was exceptional. Even more unusual was Yanzhou’s persistence on completing the deal after the drastic surge in price, which might reflect Yanzhou’s mentality of "expanding at all cost."  

Initially, in August 2009, when the deal with Felix was announced, Yanzhou indicated that it would finance the deal with existing cash and bank borrowings. In September 2009, Yanzhou amended its financing proposal. Under the new proposal, all financing needs of the Felix deal would come from bank borrowings from the financing group led by Bank of China, Sydney Branch. Eventually, in October 2009, Yanzhou signed an agreement with Bank of China, China Construction Bank and China Development Bank for a loan of US$2.9 billion, which covered the full acquisition price of Felix.

Table 5: Borrowings of Yanzhou Coal about here

Included in the balance as of December 31, 2009 are loans amounting to approximately RMB 21 billion (USD 3 billion) obtained by Yanzhou for the purpose of settling the acquisition

---

41 Ibid.
42 Another possibility is personal profit taking by Yanzhou insiders at the company’s expense, although there is currently little evidentiary basis for this speculation.
45 Yanzhou Coal Mining Co Ltd., Annual Report 2011
46 Ibid.
of Felix. These borrowings carried an annual interest of approximately 4%, which was exceptionally low. Putting to perspective, one year fixed deposit interest in China is approximately 3%, whereas benchmark one year loan interest in China is approximately 6%. The existing bank loans that Yanzhou acquired from Felix carried an annual interest of approximately 7.6%, which means that Felix could only borrow at 7.6% annual interest from local Australian banks before its affiliation with Yanzhou.

From 2009 to 2011, Yanzhou was 53% owned by Yankuang Group, which was wholly owned by the Shandong Provincial Government. Yanzhou was under the direct control of Shandong SASAC (State-owned Assets Supervision and Administration Commission). The investment binge engaged by Yanzhou and the consequent expansion of its business would not be possible without strong government support.

Indeed, Yanzhou lists “strong support from the PRC government” among its key competitive strengths in its 20-F (annual filing to the U.S. Security and Exchange Commission, or SEC), which provides detailed elaboration of such strong support:

- The majority of Yanzhou’s directors and senior managers maintained close professional relationships with the government officials, regulatory authorities and industry experts;
- The majority of directors and managers of Yankuang Group (parent company of Yanzhou) were jointly appointed by the Organization Department of the Communist Party of China and the SASAC of the Shandong Provincial Government;
- The government encouraged the overseas expansion of Yanzhou through its “Go Out” policy, which facilitated Yanzhou’s overseas acquisitions;
- Yanzhou received other government support, including financing arrangements at reduced costs, preferential tax and foreign exchange treatment and governmental subsidies for its foreign investment projects.47

Yanzhou’s acquisition of Felix illustrates the recklessness of China’s SOEs’ expansion. The size of the deal, the amount of debt raised, and the price paid all reflect Yanzhou’s

47 Yanzhou Coal Mining Co Ltd., Annual Report 2011
determination to expand at all cost. However, Yanzhou was not an isolated case. Many major SOEs engaged in similar reckless expansions through acquisitions in the aftermath of the financial crisis. Although China’s SOEs can gradually learn to improve their valuation of foreign assets, financing of the deals, and subsequent management of the acquired assets, the main danger in the SOEs’ reckless expansion lies in incentives, not expertise. As the managers of SOEs typically have short tenures, they thus have the incentive to place heavy emphasis on short-term performance while neglecting the long-term interests of their companies. Some benefits of an acquisition, such as scale and prestige, can be realized immediately; but the problems that may arise from an acquisition, such as the difficulty to repay debt and the depreciation of the asset value, generally only start to emerge a few years after the transaction. As a result, the managers of SOEs have the incentives to engage in overseas investments, even if such investments are economically irrational.

**Government Favoritism/Protectionism**

Despite to the Chinese government’s rhetoric in support of the growth of private enterprises and a competitive market economy, the government has consistently exhibited favoritism and protectionism towards the SOEs. The government has excluded many of the most essential, and often most profitable, industries from private competition.\(^{48}\) For example, In December 2006, the State Council announced that, “the State should solely own, or have a majority share in, enterprises engaged in power generation and distribution, oil, petrochemicals and natural gas, telecom and armaments. The State must also have a controlling stake in the coal, aviation, and shipping industries.... Central SOEs should also become heavyweights in sectors

\(^{48}\) One principal slogan along these lines was “grasp the large, let go of the medium and small.”
including machinery, automobiles, IT, construction, iron and steel, and non-ferrous metals.” In addition, the state sector retains overwhelming dominance in banking, insurance, media, tobacco, and railways, setting aside a huge chunk of China’s economy for the SOEs.

After the start of the financial crisis, there have been a large number of instances in which government favoritism and protectionism towards the SOEs had severely hurt the interests of private enterprises. Below are some such examples:

- In 2010, the SASAC announced the formation of a state-owned electric vehicle alliance which consisted of 16 SOEs, including car producers, battery manufacturers and charging station operators. At a time when the electric vehicle industry was both highly promising and competitive, the formation of the alliance greatly benefited the SOEs at the expense of their private competitors, as the 16 SOEs in the alliance would “receive $15 billion in funding from the government to collaborate on electric vehicle R&D and determine a set of standards for plug-ins in China.”

- In the iron and steel industry, the central government and some provincial governments used “carrot and stick” (primarily the latter) during the financial crisis to force the smaller and generally more profitable private companies to be absorbed into their inefficient but bigger state-owned counterparts, or otherwise denied the opportunity for private and foreign companies to compete against the SOEs. For example, Rizhao Iron & Steel was forced to be acquired by Shandong Iron & Steel; Ningbo Iron & Steel was forced to be acquired by Baosteel; Delong Steel was denied a potentially highly profitable deal with Evraz Group (Russia) by government bureaucracy.

- In the aluminum industry, China Zhongwang, which was the second largest industrial aluminum extrusion product manufacturer in the world and Asia’s biggest, was a major victim of government favoritism and protectionism during the financial crisis. First, Zhongwang’s major acquisition of a state-

---


51 Ibid.


owned aluminum company was called off unexpectedly and without explicit reasons, possibly due to government intervention. Second, Aluminum Corporation of China formed a close partnership with Sapa AS (Norway), which is the global industry leader, with the almost explicit goal to contain the competitive threats from Zhongwang. In the coal industry, central and provincial government policies forced the smaller coal companies (most of which were private) to be closed down or acquired by bigger coal companies (many of which were state-owned). In particular, most of the acquisitions were eventually carried out by SOEs since their private counterparts, even if comparable in scale, did not have the financial backing of state-owned banks which was often necessary in these acquisitions.

These cases all illustrate the general mechanisms through which government favoritism and protectionism transformed into competitive advantages for the SOEs during the financial crisis. The bankruptcy of East Star Airlines during the financial crisis detailed below illustrates the mechanisms by which government favoritism and protectionism facilitated to crush private enterprises and strengthen SOEs in the airlines industry.

**Bankruptcy of East Star Airlines**

Before 2005, the airlines industry in China was completely state dominated, with the market shared among the Big Three – Air China, China Southern Airlines and China Eastern Airlines – and their subsidiaries. However, in 2005, private airlines started to emerge and by 2008, there were already seven private airlines companies in China: Spring Airlines, East Star Airlines, Okay Airlines, United Eagle Airlines, Hefei Lianhua Airlines, Shanghai Juneyao

58 Ibid.
Airlines, and China Express Airlines.\textsuperscript{59} For a brief period of three years, private airlines experienced rapid growth and quickly became popular among travelers, mostly by offering lower prices than those offered by state-owned airlines.

However, in 2008, the entire airlines industry in China faced serious challenges. In the first half of 2008, the record oil prices drastically increased airlines’ costs. In the second half of 2008, the onset of global financial crisis brought about a significant decline in the demand for both passenger and cargo service, hurting their revenues. Even a sharp decline in oil prices was not beneficial and resulted in enormous losses to airlines on their oil derivative contracts.\textsuperscript{60} As a result, almost all airlines in China suffered disastrous losses in 2008. Air China, China Eastern Airlines and China Southern Airlines had net losses of RMB 9.4 billion, RMB 15.3 billion, and RMB 4.8 billion, respectively.\textsuperscript{61} In particular, the net loss of China Eastern Airlines represented over 500\% of its equity, which meant that it had become insolvent and needed an enormous amount of new capital to keep it alive.\textsuperscript{62}

The government quickly stepped in to alleviate the grave challenges faced by state-owned airlines. In the case of China Eastern Airlines, although its liabilities had already exceed its assets by RMB 12.6 billion by the end of 2008, no entity ever pushed for its bankruptcy or restructuring, as would typically occur for such an insolvent company. Instead, China Eastern Airlines received generous financial supports from government associated entities. In January 2009, China Eastern Airlines obtained a two-year credit facility of RMB10 billion from Shanghai

\textsuperscript{60} These derivatives are financial instruments used to hedge oil price risks. Essentially, firms had locked in higher prices in a bid to protect themselves from possible further oil price increases.
\textsuperscript{62} China Eastern Airlines Corp. Ltd., Annual Report 2008
Pudong Development Bank. In February 2009, the company obtained a three-year credit facility of RMB15 billion from Agricultural Bank of China. In the same month, the government injected RMB7 billion of new capital into China Eastern Airlines. In March 2009, the company obtained a three-year credit facility of RMB11 billion from Construction Bank of China. In a span of three months, China Eastern Airlines received RMB43 billion of financial assistance from state-owned entities. As a result, China Eastern Airlines faced no existential threats, experienced no disruption in operations, and quickly rebounded in its financial performance. Similarly, Air China and China Southern Airlines received generous financial assistance from state-owned entities. The state-owned airlines not only received enormous amounts of finance, but also did so with minimal collateral, which is typically required in bank’s lending to private entities. For example, even for Air China, the most financially healthy among the Big Three, about 80% of its bank loans in 2009 were unsecured, which means no collateral was pledged to the bank loans.

In contrast, private airlines which faced similar difficulties at a much smaller scale received very limited, if any, assistance from the government. Indeed, the state-owned airlines saw the financial crisis as a perfect opportunity to squeeze out their private competitors. Exploiting the financial difficulties faced by the private airlines, the state-owned airlines colluded with the government to force the private airlines out of the market through acquisition, bankruptcy and restructuring. Among the biggest four private airlines, only Spring Airlines survived through the financial crisis: East Star Airlines was forced into bankruptcy; United

Ibid. Note: the 2008 Annual Report includes “post balance sheet events” which were significant events that happened after December 31, 2008, but before the company filed its annual report in June 2009.

Ibid.

Ibid.

Ibid.

Air China Ltd., Annual Report 2009. RMB28 billion out of RMB35 billion.
Eagles Airlines was acquired by Sichuan Airlines (a joint venture of several state-owned airlines); and Okay Airlines was acquired by DTW Logistics and subsequently exited the air passenger market.

East Star Airlines at the Beginning of the Crisis

East Star Airlines was founded in 2005 in Wuhan by the East Star Group, a private conglomerate. By 2008, East Star had become the second largest private airlines company, flying nine aircraft and more than twenty flight routes centered in Wuhan. East Star operated. As Wuhan was becoming an increasingly important aviation hub, East Star once had bright prospects. However, the record high oil price in first half of 2008 and the sharp decline in demand in second half of 2008 severely hurt East Star in similar ways as they did to the airlines industry in general. As a result, East Star experienced a liquidity crisis. Consequently, some of the counterparties started to terminate non-essential services to East Star and threatened to terminate all services if East Star continued to fail to repay in time. It should be noted that a liquidity crisis—as East Star experienced—differs fundamentally from a solvency crisis—as China Eastern Airlines faced during the same time period. In the case of East Star, it still had

http://baike.baidu.com/view/377273.htm?fromtitle=%E4%B8%9C%E6%98%9F%E8%88%AA%E7%A9%BA&fromid=10928394&type=syn
70 新浪旅游 (Sina Travel), “因拖欠机场服务费 杭州萧山机场封杀“东星”航空,” Jan 6, 2009. Accessed online at:
RMB 160 million in net assets, which means that its assets were more than sufficient to cover its liabilities; the emergency arose from East Star not having enough cash in hand.\textsuperscript{71} China Eastern Airlines, on the other hand, had liabilities that far exceeded its assets.\textsuperscript{72}

A typical response for a solvent company to its liquidity crisis would be to borrow a bank loan, issue a corporate bond, or issue some new capital shares. However, obtaining bank financing had always been one of the major difficulties faced by private enterprise in China, whereas issuing bonds or shares was not a feasible option at the trough of the financial crisis. Thus, in second half of 2008, East Star started to search for strategic partners or investors with sufficient financial strength to help East Star get through its liquidity crisis and preserve its promising business. In particular, East Star had a series of negotiations with Aviation Industry Corporation of China (AVIC), the parent company of Air China.\textsuperscript{73} The negotiations had initially proceeded well, and by early March 2009, Kong Dong (Chairman of Air China and General Manager of AVIC) disclosed to the media during the annual meetings of the National People's Congress and Chinese People's Political Consultative Conference that the acquisition of East Star by AVIC would be completed within one month.\textsuperscript{74}

The main objective of AVIC in its attempt to acquire East Star was to strengthen its market position in the central China region. Wuhan, the economic center of central China, was also the aviation center of central China.\textsuperscript{75} Moreover, Wuhan was expected to have above-average economic growth in the subsequent years, due to favorable central government

\textsuperscript{71}民航资源网 (CARNOC), “东星态度积极 萧山机场“欠费门”初步解决”
\textsuperscript{72} And, as such, could be forced into bankruptcy or restructuring under normal economic institutional framework.
\textsuperscript{73} 南方周末 (Southern Weekend), “东星航空停飞，总裁被监视居住？”
policies. By 2008, Wuhan was an important market for domestic airlines and was expected to become even more important in the subsequent years. However, as of 2008, Air China did not have any planes based in Wuhan, and had very limited access to its market. In comparison, Air China’s major competitors were much more established in Wuhan: China Southern and China Eastern had 20 and 15 aircrafts based in Wuhan, respectively. East Star Airlines was the third largest player in the Wuhan market. Thus, if Air China was able to acquire East Star, it would gain a significant foothold in an increasingly important market.

On the other hand, the Hubei government’s main objective in its attempt to facilitate Air China’s acquisition of East Star was the promotion of local economic and political interests. The evaluation of local government officials in China is in large part based on local GDP performance; headline projects also enhance the standing of local officials in the political hierarchy. Exploiting the incentive structure of local government officials, AVIC signed an agreement, titled “Agreement between Hubei Provincial Government and AVIC on Establishing Wuhan as an Aviation Hub” on March 10, 2009. The agreement promised that AVIC would open international flights between Wuhan and Paris, Tokyo and Singapore by 2010, and those between Wuhan and Los Angeles, London and Berlin by 2015. This plan, if realized, would boost the prestige and political standing of Hubei and Wuhan officials, since only a very small...
number of cities in China had direct flights to each of the aforementioned foreign destinations.\textsuperscript{81} Thus, local government cadres had strong incentive to support AVIC’s plan to acquire East Star, which was essential for the expansion of Air China’s business in central China.

**East Star’s Rejection of AVIC’s Offer**

Although the acquisition of East Star by AVIC would well serve the interests of AVIC and the Hubei Government, the interests of East Star also need to be considered since they are the party being acquired. On March 13, 2009, East Star’s Board of Directors announced that the company would reject AVIC’s acquisition offer and terminate all negotiations with AVIC, citing differences in philosophies and business practices, and foreseeing difficulty in effective cooperation.\textsuperscript{82} However, a close examination of statements from those party to the talks reveals that the deal was rejected over treatment of existing employees and acquisition price.

One of the major factors that led to East Star’s rejection of AVIC’s acquisition offer was AVIC’s proposed treatment of East Star’s existing employees. According to an East Star press release, AVIC’s interests in the acquisition centered on East Star’s strong position in a promising airlines market while AVIC had limited interest in retaining the physical properties and employees of East Star.\textsuperscript{83} As a result, AVIC planned, as part of the acquisition proposal, to conduct massive layoffs of existing employees of East Star, according to Wan Yijian, Chief Marketing Officer of East Star.\textsuperscript{84} For example, AVIC planned to keep only three employees out of an existing group of 500 in the market department and only one third of the existing group of

\begin{itemize}
\item \textsuperscript{81} Mostly Beijing, Shanghai, and Guangzhou.
\item \textsuperscript{82} 南方周末 (Southern Weekend), “东星航空停飞，总裁被监视居住？”
\item \textsuperscript{83} 凤凰财经 (iFeng Finance), “中航称不存在野蛮收购东星航空”
\end{itemize}
several hundred employees in the R&D department of East Star.\textsuperscript{85} Unsurprisingly, virtually all employees, including those who could participate in the decision-making process (such as managers and shareholders), opposed AVIC’s offer.\textsuperscript{86}

In a blatant attempt to aid AVIC, the Wuhan Government deployed police to visit the employees of East Star one by one and forbid them from voicing their opposition.\textsuperscript{87} Moreover, AVIC, with the assistance of the government, forced the pilots of East Star to sign agreements to reduce their remunerations after the completion of the acquisition.\textsuperscript{88}

Even more than the treatment of the existing workforce, the acquisition deal was broken off because East Star and AVIC had very disparate price targets. East Star had asked for an acquisition price of RMB 600 million, whereas AVIC was only willing to offer RMB 160 million as of March 13, 2009 (when East Star rejected AVIC’s bid).\textsuperscript{89} East Star’s confidence in its evaluation partly came from Goldman Sachs’ attempted investment the year before. In early 2008, Goldman Sachs was in talks with East Star to acquire 25% of the latter’s equity for US$100 million (approximately RMB 700 million at that time), which implied a price tag of approximately RMB 2.8 billion for the entire company.\textsuperscript{90} To be fair, the market valuations of most companies in early 2008 were inflated and most had declined substantially by early 2009 (for example, the S&P 500 index dropped approximately 50% from March 2008 to March

\textsuperscript{85} Ibid. The scales of layoffs in other departments were likely comparable.
\textsuperscript{86} 凤凰财经 (iFeng Finance), “中航集团收购东星航空迷雾.” Accessed online at: \url{http://finance.ifeng.com/topic/dxbk/}
\textsuperscript{87} 凤凰财经 (iFeng Finance), “中航集团收购东星航空迷雾.” According to anonymous employees of East Star.
\textsuperscript{88} Ibid. Again, the sources here are anonymous East Star employees.
East Star had a clear idea of the market situation, and willingly cut its asking price by more than 75% from its valuation in early 2008.

However, for AVIC, even RMB 600 million was far too expensive for the acquisition. AVIC’s offering price was based on the net asset value on the balance sheet of East Star, which was around RMB 160 million as of early March, 2009. Valuing East Star based on the book value of its net assets is problematic as many valuable assets—flight routes, pilots, customer network and loyalty, brand image, and licenses—are considered intangible and so not included in the book value. Indeed, these assets—the flight routes in particular—were the key focus of AVIC in its acquisition attempt, as explained above. Further, East Star had experienced rapid growth, while book value is typically used for mature companies that match the economy’s overall performance. Indeed, at the time of the acquisition attempt, even Air China, a more mature and slower growing company than East Star, was trading at more than three time its book value. It was thus unsurprising that East Star rejected AVIC’s acquisition offer.

East Star’s rejection of AVIC’s acquisition offer antagonized the local government and AVIC as both stood to reap substantial benefits if the deal came to pass and AVIC had already announced that the deal would be completed in March. In response, on March 15, 2009, Wuhan Government demanded that local branch of the Civil Aviation Administration of China (CAAC)

---

93. According to international accounting rules, such assets are internally generated intangible assets, which should not be recorded on a company’s balance sheet and hence book value. Thus, in the creative accounting of Chinese SOEs analyzed here, the intangible assets of an anonymous energy commodity company (Felix) were highly valued, while the value of the flight routes and other intangible assets that were precisely named as the source of interest were deemed as possessing no value.
94. As of March 13, 2009, the day that East Star rejected AVIC’s offer, Air China had RMB 20 billion in net assets on its balance sheet, but had a market value of RMB 63 billion. Google Finance, “Air China Ltd.” Accessed online at: https://www.google.com/finance?q=SHA%3A601111&ei=EOA9U9jgMiDLsQf9Wg.
terminate East Star’s rights to operate civilian commercial flights. The next day, Lan Shili, founder and CEO of East Star, was detained by the police in Zhuhai Airport and brought back to Wuhan for house arrest. On March 18, an anonymous East Star employee sent an email to the media to reveal the behind-the-scene events of the acquisition negotiations. The email accused Wuhan Commission of Transport officials, who were led the negotiation between AVIC and East Star, of actively lobbying for the suspension of East Star’s operation, due to personal conflicts with East Star. Another employee of East Star revealed these “personal conflicts” resulted from a RMB 40 million dispute where the Wuhan Commission of Transport allegedly refused to pay East Star for its services.

The forced suspension of East Star quickly worsened its financial conditions as its costs amassed while its revenue streams evaporated. By April, the Wuhan Government had submitted a proposal to the Intermediate People’s Court of Wuhan to force East Star into bankruptcy. Bankruptcy in this case, if passed in court, would entail East Star ceasing to exist, the auctioning off of its tangible assets at likely fire sale prices, and the disappearance of a significant portion of its intangible assets. East Star as an operating entity would be more valuable and capable of repaying a larger portion of its debts, than as a liquidated entity. Consequently, most of its creditors preferred restructuring East Star, and expressed willingness to contribute to the

96 南方周末 (Southern Weekend), “东星航空停飞，总裁被监视居住？”
97 凤凰财经 (iFeng Finance), “东星航空员工曝与中航合并谈判破裂内幕”
98 Ibid.
99 Ibid.
restructuring by postponing debt repayment, converting debt to equity, or even injecting new capital into the airline.  

On April 8, China National Aviation Fuel (CNAF), the largest creditor of East Star, submitted an application to the Wuhan Court for a restructuring of East Star. However, on June 16, the Wuhan Court rejected the application of CNAF. Subsequently, other creditors, such as Zhengzhou Airport, Guangzhou Airport, and Shenzhen Airport, all filed applications to the Wuhan Court for a restructuring of East Star. However, Wuhan Court rejected all such applications and ruled that East Star had lost the material foundation of a restructuring as it had become impossible for East Star to resume normal operation. The suspension of East Star’s operations in March and subsequent three months of inaction by the court worsened East Star’s financial condition and made it difficult for East Star to resume normal operations by June. Moreover, according to Yin Zhengyou, the lawyer representing CNAF, Wuhan Court had no legal basis of rejecting the creditors’ applications for a restructuring of East Star: first, after East Star entered the process of bankruptcy protection, ownership and control of the enterprise was transferred from the shareholders to the creditors (but not the government), who thus had the right to decide whether East Star should be restructured or liquidated; second, Wuhan Court had no legal obligation and no business expertise to decide whether East Star had the material foundation for a restructuring.

In addition to the creditors, some third-party investors attempted to restructure East Star. In particular, Wang Chaoyong, a wealthy private entrepreneur and friend of Lan Shili, was

---

101 Ibid.
102 Ibid.
103 Ibid.
104 Ibid.
105 Ibid.
willing to commit the RMB 200 million that he deemed the firm needed to resume operations. On August 25, Wang’s active lobbying brought some hope for East Star as the High People’s Court of Hubei ordered the lower-level Wuhan Court to re-examine the applications for restructuring East Star. However, within 24 hours, the Wuhan Court made a final ruling, rejecting the applications and announcing the official bankruptcy of East Star.

It is difficult to comprehend the determination of the Wuhan Court to force East Star into bankruptcy without understanding the involvement of AVIC (or Air China) and local government officials in the dispute. While East Star was fighting for a restructuring, Air China established Air China (Wuhan), which rented the East Star’s office building and absorbed some of East Star’s pilots, ground staff, and aircraft. On June 25, 2009, Air China (Wuhan) commenced its commercial flights and ironically used all the flight routes, time, and numbers of East Star. These events took place two months before the court announced the official bankruptcy of East Star on 25 August. The Wuhan Government extended valuable support to AVIC in other ways as well, extending it land grants, renting it office space, and easing the transfer of pilots from East Star to Air China.

AVIC/Air China won the East Star crisis, inheriting most of the intangible assets at no cost and acquiring most of the tangible assets at very low prices in the bankruptcy liquidation. East Star’s owners lost their equity stakes, while its creditors only managed to recover 10% of their loans.

---

106新浪财经 (Sina Finance), “东星航空破产之谜：为何非死不可.”
107 Ibid.
108 Ibid.
109 凤凰财经 (iFeng Finance), “谁在导演东星航空破产.” East Star’s aircraft had been leased from General Electric, but Air China took over the leases.
110 Ibid. For example, East Star used to have a flight from Wuhan to Shenzhen at 9am with flight number “8C 8233”; now the same flight at the same time by Air China had a flight number “CA 8233.”
111 Ibid.
Conclusion

In contrast with views from the mid-2000s that expected the state sector’s place in the Chinese economy to continue to diminish, we find that SOEs remain crucial economic and political actors in contemporary China. Their position was further enhanced during the global financial crisis as can be seen in their investment behavior as well as the clear favoritism of government officials at different levels for state over private firms.

The cases of Yanzhou Coal and East Star Airlines show how government financed reckless investments can evaporate, how conflicts of interest can hurt the economic performance of firms and tilt the playing field strongly in favor of SOEs, how local and national political interests can undermine markets, and how China’s weak legal system can be exploited by politically powerful firms. Particularly troubling is the extent of collusion between SOEs and government officials, as seen in the favoritism displayed to AVIC/Air China over East Star by the Hubei and Wuhan governments, and especially the Wuhan court that ordered the firm’s bankruptcy. Such collusion is increasingly institutionalized as prominent political leaders have more connections with and backgrounds in SOEs; indeed, a growing group of active SOE chiefs are concurrently holding political positions in the party-state apparatus.112 The incentive structures facing officials at different levels can also be taken advantage of by politically powerful SOEs, privileging parochial over general interests.

In the much celebrated 3rd Plenum of the 18th Party Congress in 2013, policy statements decreed that reforms were to closely resolve that the market would maintain a decisive role in the

allocation of resources in the economy. Our analysis cautions against interpretations that such statements represent a continuous linear progress on this dimension in China’s reform era. A more optimistic perspective could take the 3rd Plenum’s calls for the market to play a greater role as responding to private firms, foreign enterprises, investors, and consumers frustrated at the extent to which the state-owned sector advanced during the global financial crisis.

Table 1: FDI Outflow by Chinese Enterprises\textsuperscript{114}

<table>
<thead>
<tr>
<th>USD in billions</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOE</td>
<td>8.3</td>
<td>19.7</td>
<td>30.1</td>
<td>57.6</td>
<td>55.2</td>
<td>64.4</td>
<td>65.6</td>
<td>69.4</td>
</tr>
<tr>
<td>Private</td>
<td>1.7</td>
<td>0.1</td>
<td>0.3</td>
<td>0.9</td>
<td>0.8</td>
<td>3.6</td>
<td>8.7</td>
<td>7.9</td>
</tr>
<tr>
<td>Total</td>
<td>10.0</td>
<td>19.8</td>
<td>30.4</td>
<td>58.4</td>
<td>56.0</td>
<td>68.1</td>
<td>74.3</td>
<td>77.4</td>
</tr>
</tbody>
</table>

\textsuperscript{114} The Heritage Foundation, “China Global Investment Tracker.” A similar result is found in Table 1 [X] in the Appendix.
Table 2: Top 15 Enterprises in China by Total Overseas Investment from 2008 - 2012\textsuperscript{115}

<table>
<thead>
<tr>
<th>Rank</th>
<th>Total Investment (USD in billions)</th>
<th>Investor</th>
<th>SOE?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>46,210</td>
<td>Sinopec (China Petroleum and Chemical Corporation)</td>
<td>Yes</td>
</tr>
<tr>
<td>2</td>
<td>38,390</td>
<td>CNPC (China National Petroleum Corporation)</td>
<td>Yes</td>
</tr>
<tr>
<td>3</td>
<td>31,330</td>
<td>CIC (China Investment Corporation)</td>
<td>Yes</td>
</tr>
<tr>
<td>4</td>
<td>29,730</td>
<td>CNOOC (China National Offshore Oil Corporation)</td>
<td>Yes</td>
</tr>
<tr>
<td>5</td>
<td>18,960</td>
<td>Chinalco (Aluminum Corporation of China)</td>
<td>Yes</td>
</tr>
<tr>
<td>6</td>
<td>10,970</td>
<td>SAFE (State Administration of Foreign Exchange)</td>
<td>Yes</td>
</tr>
<tr>
<td>7</td>
<td>8,070</td>
<td>Sinochem</td>
<td>Yes</td>
</tr>
<tr>
<td>8</td>
<td>6,850</td>
<td>Yanzhou Coal</td>
<td>Yes</td>
</tr>
<tr>
<td>9</td>
<td>6,370</td>
<td>Minmetals</td>
<td>Yes</td>
</tr>
<tr>
<td>10</td>
<td>5,970</td>
<td>Three Gorges</td>
<td>Yes</td>
</tr>
<tr>
<td>11</td>
<td>5,040</td>
<td>China Ocean Shipping</td>
<td>Yes</td>
</tr>
<tr>
<td>12</td>
<td>4,270</td>
<td>Huaneng Power</td>
<td>Yes</td>
</tr>
<tr>
<td>13</td>
<td>3,560</td>
<td>China Railway Construction</td>
<td>Yes</td>
</tr>
<tr>
<td>14</td>
<td>3,260</td>
<td>MCC (Metallurgical Corporation of China)</td>
<td>Yes</td>
</tr>
<tr>
<td>15</td>
<td>2,990</td>
<td>Jilin Huroc Nonferrous</td>
<td>Yes</td>
</tr>
</tbody>
</table>

\textsuperscript{115} The Heritage Foundation, “China Global Investment Tracker.”
Table 3: Global FDI Outflow

<table>
<thead>
<tr>
<th>USD in billions</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed economies</td>
<td>744</td>
<td>1152</td>
<td>1890</td>
<td>1601</td>
<td>828</td>
<td>1030</td>
<td>1183</td>
<td>909</td>
</tr>
<tr>
<td>Developing economies</td>
<td>140</td>
<td>245</td>
<td>330</td>
<td>344</td>
<td>273</td>
<td>413</td>
<td>422</td>
<td>426</td>
</tr>
<tr>
<td>China</td>
<td>12</td>
<td>21</td>
<td>27</td>
<td>56</td>
<td>57</td>
<td>68</td>
<td>75</td>
<td>84</td>
</tr>
<tr>
<td>Transition economies</td>
<td>19</td>
<td>31</td>
<td>52</td>
<td>61</td>
<td>48</td>
<td>62</td>
<td>73</td>
<td>55</td>
</tr>
<tr>
<td>World Total</td>
<td>903</td>
<td>1428</td>
<td>2272</td>
<td>2006</td>
<td>1149</td>
<td>1505</td>
<td>1678</td>
<td>1390</td>
</tr>
</tbody>
</table>

It is important to note that intangible assets are generally insignificant for energy companies, such as oil & gas, coal, and metals, whose values are primarily based on the reserves of oil, gas, coal and metal ore they have. Some other companies, such as Internet companies, may have very substantial amounts of intangible assets.

Table 4: Breakdown of the Acquisition Price of Felix by Yanzhou

<table>
<thead>
<tr>
<th>Item</th>
<th>Carrying amounts</th>
<th>Fair value adjustments</th>
<th>Fair values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank balances and cash</td>
<td>872,435</td>
<td>—</td>
<td>872,435</td>
</tr>
<tr>
<td>Term deposits</td>
<td>91,941</td>
<td>—</td>
<td>91,941</td>
</tr>
<tr>
<td>Bills and accounts receivable</td>
<td>292,008</td>
<td>—</td>
<td>292,008</td>
</tr>
<tr>
<td>Inventories</td>
<td>306,444</td>
<td>(39,349)</td>
<td>267,095</td>
</tr>
<tr>
<td>Prepayments and other receivables</td>
<td>214,501</td>
<td>—</td>
<td>214,501</td>
</tr>
<tr>
<td>Derivative financial instrument assets</td>
<td>27,928</td>
<td>—</td>
<td>27,928</td>
</tr>
<tr>
<td>Tax recoverable</td>
<td>46,777</td>
<td>—</td>
<td>46,777</td>
</tr>
<tr>
<td>Other current assets</td>
<td>350,676</td>
<td>—</td>
<td>350,676</td>
</tr>
<tr>
<td>Property, plant and equipment, net</td>
<td>2,842,046</td>
<td>704,861</td>
<td>3,546,907</td>
</tr>
<tr>
<td>Available-for-sale financial assets</td>
<td>1</td>
<td>—</td>
<td>1</td>
</tr>
<tr>
<td>Interests in jointly controlled entities</td>
<td>1,257</td>
<td>—</td>
<td>1,257</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>1,312,393</td>
<td>16,535,630</td>
<td>17,848,023</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(390,927)</td>
<td>—</td>
<td>(390,927)</td>
</tr>
<tr>
<td>Receipts in advance and other payables</td>
<td>(700,833)</td>
<td>—</td>
<td>(700,833)</td>
</tr>
<tr>
<td>Borrowings</td>
<td>(1,573,956)</td>
<td>—</td>
<td>(1,573,956)</td>
</tr>
<tr>
<td>Derivative financial instrument liabilities</td>
<td>(28,333)</td>
<td>—</td>
<td>(28,333)</td>
</tr>
<tr>
<td>Deferred taxation</td>
<td>(376,526)</td>
<td>(596,585)</td>
<td>(973,111)</td>
</tr>
<tr>
<td>Provision for land subsidence, restoration, rehabituation and environmental costs</td>
<td>(48,170)</td>
<td>—</td>
<td>(48,170)</td>
</tr>
<tr>
<td>Other long-term payables</td>
<td>(28,367)</td>
<td>—</td>
<td>(28,367)</td>
</tr>
<tr>
<td>Net assets acquired</td>
<td></td>
<td></td>
<td>19,815,852</td>
</tr>
<tr>
<td>Minority interests</td>
<td></td>
<td></td>
<td>(23,542)</td>
</tr>
<tr>
<td>Goodwill arising on acquisition</td>
<td></td>
<td></td>
<td>766,816</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20,559,126</td>
</tr>
</tbody>
</table>

Yanzhou Coal Mining Co Ltd., Annual Report 2009. It is important to note that intangible assets are generally insignificant for energy companies, such as oil & gas, coal, and metals, whose values are primarily based on the reserves of oil, gas, coal and metal ore they have. Some other companies, such as Internet companies, may have very substantial amounts of intangible assets.
Table 5: Borrowings of Yanzhou Coal\textsuperscript{118}

<table>
<thead>
<tr>
<th>RMB millions</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowings – due within one year</td>
<td>82</td>
<td>1,598</td>
<td>615</td>
<td>19,588</td>
</tr>
<tr>
<td>Borrowings – due after one year</td>
<td>176</td>
<td>20,912</td>
<td>22,401</td>
<td>14,869</td>
</tr>
<tr>
<td>Borrowings – total</td>
<td>258</td>
<td>22,510</td>
<td>23,016</td>
<td>34,458</td>
</tr>
</tbody>
</table>

\textsuperscript{118} Yanzhou Coal Mining Co Ltd., Annual Report 2011.
Appendix

Brief Explanation on Methodology and Sources

This paper utilizes case studies to study the specific impacts of the financial crisis on a given SOE and the specific mechanisms through which these impacts were realized. In the selection of cases and the subsequent in-depth research on the cases, this paper mainly uses news articles and public filings of listed companies as the primary sources. First, a thorough search of news articles, both in English and in Chinese, was conducted for the period since January 2008, with a focus on the two year immediately after the start of the financial crisis in September 2008. In particular, local Chinese news articles sometimes offer detailed narratives on important events in local companies, but such valuable primary sources are rarely picked up by western media or academic scholars. Chinese news articles also offer detailed accounts and analysis of important government directives when they are released.

Second, public filings of listed companies are another important primary source for the paper. Many of the companies covered in this paper are publicly listed companies, which are required to file various documents with the stock exchanges or other regulatory agencies. These documents offer rich primary evidence that is often overlooked or inadequately studied by academic scholars. Since it is illegal to present false information in such public filings, these documents are more credible than news articles in offering insights on various aspects of a company.

News Articles and Other Sources

Air China Ltd., Annual Report 2008
Air China Ltd., Annual Report 2009
Google Finance, “Air China Ltd.” Accessed online at: https://www.google.com/finance?q=SHA%3A601111&ei=EOA9U9igMfDLsQf9Wg

Google Finance, “ConocoPhillips.” Accessed online at: https://www.google.com/finance?q=NYSE%3ACOP&ei=lVRJU5CSFMPMS6AGS8gE


Google Finance, “Yancoal Australia Ltd.” Accessed online at: https://www.google.com/finance?q=ASX%3AYAL&ei=X1dAU9iAEvDLsQf9Wg

Google Finance, “Yanzhou Coal Mining Co Ltd (ADR).” Accessed online at: https://www.google.com/finance?q=NYSE%3AYZC&ei=WFdAU_CEDuSJsQeQ-wE


Yanzhou Coal Mining Co Ltd., Annual Report 2009

Yanzhou Coal Mining Co Ltd., Annual Report 2011


百度百科 (Baidu Wiki), “东星航空有限公司.” Accessed online at: http://baike.baidu.com/view/377273.htm?fromtitle=%E4%B8%9C%E6%98%9F%E8%88%AA%E7%A9%BA&fromid=10928394&type=syn


Academic Bibliography


**On the Heritage Foundation’s “China Global Investment Tracker”**

This dataset only includes investments which could be tracked from public media. As a result, investments of a relatively small scale are likely excluded from the dataset. However, this would not compromise the quality of the analysis as the major investments usually make up for an overwhelming portion of the total FDI outflow of a country. For example, in 2012, the total FDI outflow by Chinese enterprise (according to the dataset from Heritage Foundation) was US$77.4 billion, which made up for 92% of the total FDI outflow of China (which was US$84.2 billion, according to the UN World Investment Report 2013 data.

Appendix Tables

Appendix Table 1: Year-on-Year (YOY) growth of FDI Outflow\textsuperscript{120}

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOE</td>
<td>137%</td>
<td>53%</td>
<td>91%</td>
<td>-4%</td>
<td>17%</td>
<td>2%</td>
<td>6%</td>
</tr>
<tr>
<td>Private</td>
<td>-94%</td>
<td>155%</td>
<td>207%</td>
<td>-9%</td>
<td>365%</td>
<td>140%</td>
<td>-9%</td>
</tr>
<tr>
<td>Total</td>
<td>97%</td>
<td>53%</td>
<td>92%</td>
<td>-4%</td>
<td>22%</td>
<td>9%</td>
<td>4%</td>
</tr>
</tbody>
</table>

Appendix Table 2: Share of FDI Outflow by Type of Enterprise\textsuperscript{121}

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOE</td>
<td>83%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
<td>95%</td>
<td>88%</td>
<td>90%</td>
</tr>
<tr>
<td>Private</td>
<td>17%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>5%</td>
<td>12%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Appendix Table 3: YOY Growth Rate and CAGR of Global FDI Outflow\textsuperscript{122}

<table>
<thead>
<tr>
<th>FDI Outflow</th>
<th>YOY growth rate</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed countries</td>
<td>-15%</td>
<td>-48%</td>
</tr>
<tr>
<td>Chinese SOEs</td>
<td>91%</td>
<td>-4%</td>
</tr>
<tr>
<td>World</td>
<td>-12%</td>
<td>-43%</td>
</tr>
</tbody>
</table>

\textsuperscript{120} The Heritage Foundation, “China Global Investment Tracker.”
\textsuperscript{121} The Heritage Foundation, “China Global Investment Tracker.”