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IPOs, ORGANISATIONAL AND MANAGEMENT ACCOUNTING CHANGE IN LISTED CHINESE STATE-OWNED ENTERPRISES

KEY FINDINGS

- *Initial public offerings (IPOs) can lead to changes in management accounting and control practices of listed Chinese state-owned enterprises (SOEs).*
- *Often, it is the meaning attached to management accounting or the way in which management accounting and control is used that is changed following IPOs.*
- *The level of formalisation and tightness of the management accounting and control systems adopted by listed Chinese SOEs increases after IPOs.*
- *After IPOs, management accounting and control systems facilitate the accountability of listed Chinese SOEs toward all the shareholders.*
- *After IPOs, management accounting and control systems generate more information and contribute to making the operations of listed Chinese SOEs transparent.*

INTRODUCTION

State-owned enterprises (SOEs) play an important role in the Chinese economy. Since the early 1990s, under the programmes of 'corporatisation' and 'marketisation', stock exchange listing has become a central platform for a more recent round of SOE reforms in China.

The Chinese government has permitted profitable business units of an SOE or the enterprise as a whole to list shares on domestic and overseas stock exchanges. As a result of initial public offerings (IPOs), certain Chinese SOEs have been transformed from quasi-government agencies into profit-oriented corporations, and privatised at least partially, if not fully.[1] Recently, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) announced that all SOEs that are held by the central government would be listed fully in the next 10 to 15 years.

An IPO is a highly significant event for a Chinese SOE and may trigger a series of organisational changes. Stock market listing involves building a new system of corporate governance which in itself is linked to management control of an organisation. To list on a stock exchange, the organisation form of an SOE may need to change. More fundamentally, changes in ownership forms may give rise to changes in organisational missions, goals, beliefs, values, and norms, hence leading to changes in strategic choices, decision processes, communication systems, and control systems. Prior academic research has concerned mostly the effects of IPOs on financial performance, and the relationships between corporate governance, post-IPO financial performance of newly privatised Chinese firms, and government intervention. The impact of IPOs on the management accounting and control systems adopted by listed Chinese SOEs, however, has not been examined systematically. This research[2] aims to investigate this issue by addressing two questions:

- To what extent and in what way do management accounting and control practices change in listed Chinese SOEs following IPOs?
- How does management accounting change link to other organisational change as triggered by IPOs in listed Chinese SOEs?

To fulfil the research aim, two listed Chinese SOEs (C1 and C2) and one listed Chinese non-SOE (C3) are investigated. Data were collected mainly through interviews with key personnel involved in the IPO process from the three case companies. The IPO prospectuses, the annual reports, and materials from the website of the case companies were also referred to. Three aspects of management accounting and control practices are specifically looked into: budgeting, performance evaluation, and investment appraisal. Despite the small sample taken in this research, a number of key findings are highlighted which, if patterns continue, provides pointers to senior managers and management accountants in newly listed companies in China and other emerging countries.

FINDINGS

As triggered by IPOs, the three case companies under investigation have experienced management accounting change and other organisational changes to varying degrees. These changes are detailed below. Key findings from each case company are summarised in Tables 1, 2, and 3 respectively.

Case 1

C1 is a hydropower construction firm. Its IPO has significantly changed its ownership. Before the IPO, C1 was 100% owned by the central government via the SASAC. After the IPO, the SASAC still hold 65.63% of the shares of C1. Individual private investors own 31.25%, whilst the remaining 3.12% are owned by The National Council for Social Security Fund.[3] This change in ownership of C1 has been accompanied by major changes in the missions, goals, beliefs, values, and norms of this firm. Before the IPO, C1 was operating with a 'state rationale'. The mission of C1 was to protect state-owned assets. After the IPO, acting in the interests of all the shareholders has become the norm. Instead of being accountable only to the SASAC, C1 has to be accountable also to private investors. The goal of C1 has changed following stock market listing. Before the IPO, profitability was not a major concern of the SASAC. C1 was not under pressure to grow at a specified rate. After the IPO, profitability has become crucial. Concrete profit targets have been set and approved by all the shareholders. This strong emphasis on profitability may be related to the stipulation by the China Securities Regulatory Commission (CSRC) that a listed firm making a loss in two consecutive years will be designated as a 'special treatment' and face the risk of delisting. Furthermore, the identity of C1 as 'a listed company' has been established and an ethos of 'formalisation' articulated at C1 after the IPO. C1 has aimed to become a formalised organisation and develop formal management practices. In short, as triggered by the IPO, the underlying values of C1 has changed significantly. C1 has now been operating with a 'shareholder rationale'. These changes in the underlying ethos of C1 go hand-in-hand with changes in its management accounting and control systems.

For C1, technically, the method of preparing budgets has not changed after the IPO. However, the significance attached to budgeting has changed. Before the IPO, budgeting simply set out an internal goal for the firm. After the IPO, budgeting has become externally oriented and served as a promise for investors. The process through which budgets are approved and the personnel involved has changed after the IPO. Budgets have now been overseen and approved by the Budget Management Committee, the Executive Management Committee, the Board of Directors (hereafter, Board), and finally by shareholders at the annual general meeting (AGM). This process has become more formal, and the pressure for preparing budgets after the IPO has been stronger than before.

Also, after the IPO, the connection between budgets and corporate strategy has become clearer and closer. The strategy of C1 has been translated into specific targets for individual divisions and business units. In this way, the responsibilities of different divisions and business units are rendered clearer and may be tracked more easily. Furthermore, the frequency of preparing budgets and analysing variances has increased from yearly before the IPO to quarterly after the IPO.

Performance evaluation at C1 has been overseen mainly by the Personnel, Remuneration and Performance Evaluation Committee. This committee already existed before the IPO. Its function remains the same after the IPO. At C1, there is no obvious connection between the wages of employees and the IPO. The remuneration of employees has been determined largely based on their performance. There appears to be no fundamental change in the framework for evaluating employee performance within C1 after the IPO. However, the IPO appears to have shaped performance evaluation at C1 in an indirect manner. After the IPO, under the ethos of 'formalisation', C1 has planned to formalise its performance evaluation practice in the near future. C1 intends to improve the key performance indicators used to measure and evaluate the performance of employees. It is hoped that the position and responsibility taken by an employee and his or her performance could be better linked to reward. Also, C1 has planned to develop a more advanced human resource management system to optimise staff structure and enhance the quality of employees. Under this system, for instance, C1 has already started making investment in staff training after the IPO.

As triggered by the IPO, changes have occurred also in the investment appraisal practice of C1. For an investment project to go ahead, before the IPO, it only needed to generate an estimated positive return. After the IPO, only those investments that are estimated to exceed a required rate of return will be approved. Also, the investment decision making process and the personnel involved have changed quite significantly after the IPO. Investment projects were appraised only by the Investment Appraisal Committee and the Executive Management Committee before the IPO. After the IPO, investment projects are assessed also by the Board and by shareholders at the AGM. Thereby, the process of making investment decisions has become more formal and rigorous.

These changes in the process of making investment decisions have led to an increase in the amount of information about proposed investment projects communicated within C1 after the IPO. This may have contributed positively to the enhanced corporate transparency that is needed for C1 as a listed company. Particularly, if an investment were not approved by the Board initially, more information about the investment would be required to be shown to the Board at a later stage if it were to be re-considered. Furthermore, as information about proposed investments is compiled systematically within C1 after the IPO, it can easily satisfy the requirement of *The Securities Law of China* and the *Rules Governing the Listing of Stocks on Shanghai Stock Exchange*[4] that decisions on material investments must be publicly disclosed.

To summarise, after the IPO, the level of formalisation and tightness of the management accounting and control systems adopted in C1 has increased significantly. This has the effect of providing increased accountability to all of its shareholders.

Table 1: Key Findings from C1

Case Company 1		Before the IPO	After the IPO
Ownership	**State (via the SASAC)**	100%	65.63%
	Individual private investors	0%	31.25%
	The National Council for Social Security Fund	0%	3.12%
Organisational missions, goals, beliefs, values, and norms		State rationale: to protect state-owned assets; profitability not a major concern	Shareholder rationale: acting in the best interests of all the shareholders; profitability is crucial, and profit targets set and approved by all shareholders; corporate identity - a listed company - established; ethos of formalisation articulated
Budgeting		Budgeting set out an internal goal for the organisation	Budgeting is more externally oriented and serves as a promise for the investors; the process through which budgets are approved and the personnel involved changed; the connection between budgets and corporate strategy clearer and closer; frequency of preparing budgets and analysing variances increased
Performance evaluation		Remuneration of employees determined largely based on performance	No fundamental change in the framework for evaluating performance of employees; planned to formalise performance evaluation practice and revise key performance indicators; to develop a more advanced human resource management system
Investment appraisal		An investment only needed to generate an estimated positive return to go ahead	Only investments that are estimated to exceed a required rate of return will be approved; the investment decision making process and the personnel involved are changed; the amount of information about proposed investment projects increased
Overall nature of changes in management accounting and control systems		Greater formalisation, tighter control, and geared more toward providing increased accountability to shareholders	

Case 2

C2 is a life insurance company. The IPO has changed its ownership, but not fundamentally. Unlike C1, before the IPO, only 57.59% of its shares were held by the government through a state-owned investment company and a state-owned enterprise. The remaining 42.41% were held by domestic and overseas financial institutions. After the IPO, 46.38% of its shares belong to the government through the same state-owned investment company and enterprise and 35.38% of the shares are held by domestic and overseas financial institutions. The remaining 18.24% are held by domestic and overseas individual private investors. This moderate change in ownership has not been accompanied by fundamental changes in the underlying ethos of C2.

First, the mindsets with which C2 has been operating are not linked directly to the IPO. Instead, they have existed for a couple of years and been rooted deeply into the heart of this organisation. Second, C2 initially aimed to capture as much market share as possible and achieve growth in market share. Nowadays, C2 has emphasised more the value created for shareholders and paid increased attention to profitability. This shift from a 'scale' orientation toward a 'value' one may not be caused directly by the IPO. However, it reflects an extension of the 'shareholder rationale' that had already been implanted in C2 before the IPO. Third, before the IPO, an ethos of 'formalisation' had been developed. C2 had implemented management accounting and control mechanisms, such as comprehensive budgets and performance evaluation systems based on key performance indicators (KPIs), with the aim of reaching the level of formalisation required for a listed company. The IPO may simply have enhanced the degree of formalisation of the management practices of C2. Nevertheless, after the IPO, a new corporate identity has been established. C2 has positioned itself as 'a listed company' that specialises mainly in providing life insurance and endowment insurance products. Employees throughout C2 are made aware of the need to be accountable toward all the shareholders. In short, the underlying ethos of C2 has not been fundamentally transformed following the IPO. Stock market listing is a step, albeit an important one, taken by C2 to transit from one state to the other.

While investment appraisal practice appears to remain constant, the IPO has triggered some changes to budgeting and performance evaluation of C2. The IPO has catalysed the more intensive and formal use of comprehensive budgeting. Budgeting at C2 has been overseen by the Budget Management Committee, which already existed before the IPO. Technically, the method of doing budgeting has not changed fundamentally after the IPO. C2 has been using comprehensive budgets to control costs and variances are analysed on a monthly basis. After the IPO, the control exerted by the headquarters over the branches has been tightened through a more intensive use of comprehensive budgets. The operating expenditures of the branches have been subject to stricter control by the headquarters. To organise an event or execute a project, the branches have to submit detailed cost information to the headquarters and get its approval. In this way, the amount of cost information communicated between the headquarters and the branches has increased. The activities and operations of the branches are more visible in the eyes of the headquarters.

The impact of the IPO has also been imprinted in the performance evaluation of sales people at C2. Before the IPO, C2 made no distinction between products with different contribution margins when setting up performance targets. Sales people were evaluated based on the total premium they collected during the year, regardless of the type or nature of the financial products sold. After the IPO, C2 changed its performance evaluation system. Under this new system, products having different contribution margins are given different weights. Sales people are evaluated based on the weighted sum of the premium they collect during the year. With the use of this new system for evaluating performance, sales people are incentivised to promote products that carry a higher contribution margin, as this may potentially increase the weighted sum of the premium collected and hence the rewards they will receive. Meanwhile, C2 has now publicly disclosed information about its performance evaluation of employees, even though such disclosure is not a requirement of the stock exchange. Performance evaluation of employees at C2 has become more transparent after the IPO. Shareholders are provided with more information about how employees are incentivised, and how their performance is measured and assessed.

To sum up, the ownership structure of C2 has not changed fundamentally following the IPO. However, its management accounting and control systems have become even more formal and tightened, which helps to facilitate accountability of C2 toward its shareholders.

Table 2: Key Findings from C2

Case Company 2		Before the IPO	After the IPO
Ownership	State (through a state-owned investment company and a state-owned enterprise)	57.59%	46.38%
	Domestic and overseas financial institutions	42.41%	35.38%
	Individual private investors	0%	18.24%
Organisational missions, goals, beliefs, values, and norms		Organisational mindsets existed for years; aimed to capture market share; shareholder rationale; ethos of formalisation	Organisational mindsets do not change; shareholder value more emphasised and profitability attended to; shareholder rationale extended; ethos of formalisation extended; corporate identity - a listed company - established
Budgeting		Comprehensive budgeting used to control costs	The headquarters tightens control over the branches through a more intensive and formal use of comprehensive budgets; the amount of cost information between the headquarters and the branches increased
Performance evaluation		Sales people evaluated based on the total premium they collected during the year	Sales people evaluated based on the weighted sum of the premium they collect during the year; information about performance evaluation of employees disclosed
Investment appraisal		No obvious change	
Overall nature of changes in management accounting and control systems		Greater formalisation, tighter control, and geared more toward providing increased accountability to shareholders	

Case 3

C3 is a pharmaceutical and medical device distribution company. The IPO has changed its ownership, but not fundamentally. Before the IPO, 92.13% of the shares of C3 were held by domestic and overseas private companies. The remaining 7.87% were held by individuals who are senior and middle managers of C3. After the IPO, 82.4% of the shares are held by the same domestic and overseas private companies and 7.04% by senior and middle managers. The remaining 10.56% are floating on the Shanghai Stock Exchange. This moderate change in ownership has been accompanied by moderate changes in the organisational missions, goals, beliefs, values, and norms of C3. First, before the IPO, a 'shareholder rationale' had already been implanted in C3. After the IPO, this 'shareholder rationale' has simply been nurtured. C3 has to be accountable to all of its shareholders, including individual private investors. Second, the ethos of 'formalisation' started to be articulated within C3 when it was negotiating for finance with overseas private capital providers in the late 2000s. At that time, C3 started working toward becoming a formalised organisation due to the strict requirements set by foreign investors. The IPO appears to have moved the formalisation of the organisation one step further. Third, before the IPO, market share and profitability were both emphasised at C3. After the IPO, the corporate identity of C3, namely, 'a listed company', has been established. Profitability and shareholder value have now been perceived to be relatively more important than market share.

The IPO of C3 has triggered some changes to the actual management accounting and control systems adopted, to the way in which existing systems are used, or to the significance attached to certain systems. Budget, for instance, was prepared infrequently at C3 before the IPO. C3 started doing budgeting more formally just one year before the IPO. The initial purpose of making budgeting more formal was to better control costs and support cost management. After the IPO, technically, no fundamental change has been made to the way in which budgets are prepared. Budgeting, however, has been conducted in an even more formal and detailed manner. C3 has developed a set of performance indicators for which targets are set by different business units and departments every year. Actual results are compared against the pre-set norms and discrepancies between the targets and the actual results are investigated systematically.

Senior and middle managers of C3 hold shares of the firm. Before the IPO, these managers were not evaluated on the basis of their performance. Instead, in addition to a fixed salary, dividends constituted the other part of their annual income. This system had a problem that these managers would still be given the dividends, even if they did not work hard or perform well. After the IPO, C3 has changed the way in which the performance of senior and middle managers is evaluated. A performance-related pay system has now been introduced explicitly and formally. Similarly, performance evaluation for other employees has been tightened and become more formal after the IPO. A higher proportion of the wage received by employees has now been made to be performance-related.

As triggered by the IPO, changes have occurred also in the investment appraisal practice of C3. Before the IPO, managers at C3 had a relatively high level of freedom to choose whatever they liked to invest. After the IPO, this freedom has been constrained. The investment decision making process and the personnel involved have also changed after the IPO. Depending on the scale, some projects can simply be approved by the President. Some projects have to be overseen and assessed by the Board as a whole, while large-scale projects have to be discussed and approved at the AGM. In this way, the procedure of making investment decisions has become more rigorous and formal. The amount of information about the proposed investment projects is increased accordingly after the IPO. Investment decision making at C3 has become more visible after the IPO. This contributes positively to the enhanced transparency that is required for a listed company. In addition, *The Securities Law of China (2005)* and the *Rules Governing the Listing of Stocks on Shanghai Stock Exchange* require listed companies to disclose publicly decisions on material investments. C3 has satisfied this requirement and even gone further. If a decision has been made about how a material project is to be financed, then C3 will disclose this information publicly as well. Nevertheless, the rate of return is still the most important criterion to be attended to when evaluating investment projects.

To summarise, although the IPO has not led to a fundamental change in the underlying ethos of C3, it has triggered some substantial changes to its management accounting and control systems. The level of formalisation and tightness of these systems has increased. They are geared more toward providing increased accountability to shareholders.

Table 3: Key Findings from C3

Case Company 3		Before the IPO	After the IPO
Ownership	State	0%	0%
	Domestic and overseas private companies	92.13%	82.40%
	Senior and middle managers	7.87%	7.04%
	Individual private investors	0%	10.56%
Organisational missions, goals, beliefs, values, and norms		Shareholder rationale; ethos of formalisation; both market share and profitability were emphasised	Shareholder rationale extended; ethos of formalisation extended; corporate identity - a listed company - established; profitability and shareholder value be relatively more important than market share
Budgeting		Budget was prepared infrequently; budgeting started to be done more formally one year before the IPO	Budgeting is conducted in a more formal and detailed manner
Performance evaluation		Senior and middle managers were not evaluated based on their performance	A performance-related pay system is introduced explicitly and formally (for senior and middle managers); performance evaluation for other employees tightened and more formal
Investment appraisal		A relatively high level of freedom to choose whatever it liked to invest; the rate of return was the most important criterion	Freedom to invest has been constrained; the investment decision making process and the personnel involved changed; the amount of information about proposed investment projects increased; the rate of return is still the most important criterion
Overall nature of changes in management accounting and control systems		Greater formalisation, tighter control, and geared more toward providing increased accountability to shareholders	

CONCLUSION

This research has examined the impact of an important corporate event, the IPO, on management accounting and other organisational arrangements at three companies.

Overall, it is found that IPOs affect different organisations in different ways. For C1, a listed SOE, the IPO has led to a new underlying ethos for the firm. Change in the fundamental nature of C1 has been accompanied by change in its management accounting and control systems in a way that they are in line with the new underlying ethos of this organisation after the IPO. For C2, also a listed SOE, the IPO has not led to a significant change in its underlying ethos. The IPO, however, has triggered some changes to the nature of its management accounting and control systems. The new management accounting and control systems adopted, or the new way of implementing these systems, still live up to the missions, goals, and values of C2 after the IPO. The IPO has affected C3, a listed Chinese non-SOE, in a similar way as C2. What is in common among these companies, however, is that, following IPOs, management accounting and control has become more formal, tighter, and geared more toward providing accountability to shareholders.

The specific ways in which management accounting and control has changed vary between these companies. One speculation is that the ownership structures of the case companies before the IPOs were different and ownership changes for them following IPOs have also been different. Ownership change for C1 has been more fundamental. While C1 was 100% state-owned before the IPO, individual private investors own 31.25% of its shares after. Ownership change for C2 has been less fundamental. Before the IPO, 57.59% of its shares were state-owned and 42.41% were held by financial institutions. After the IPO, 46.38% of the shares of C2 are state-owned, 35.38% are owned by financial institutions, and 18.24% by individual private investors. Ownership change for C3 has been moderate, too. Before the IPO, 92.13% of its shares were held by private companies and 7.87% were held by its senior and middle managers. After the IPO, 82.4% of the shares of C3 are held by private companies, 7.04% by senior and middle managers, and 10.56% are floating on the stock exchange. There may be other factors that contribute to the different ways IPOs affect management accounting and control systems in these organisations. Future research may investigate these factors thoroughly. This research has attended to the immediate impacts of IPOs on the listed companies within a short time frame. Longitudinal studies may be performed in the future to explore the impacts of IPOs over a longer period. Furthermore, similar research on how management accounting changes following IPOs could be conducted in other organisations and/or in other emerging economies. Together with the insights from this project, a more general theory on the interrelationship between IPOs, organisational change, and management accounting change may be formulated in the future. While this future research is needed, the current research has demonstrated with substantial empirical evidence that IPOs do involve management accounting change that is implicated in overall organisational change.

IMPLICATIONS FOR PRACTITIONERS

- *Management accountants need to be aware that management accounting changes in response to IPOs tend to be more comprehensive and rigorous than those driven by less important corporate events.*

- *Management accountants need to bear in mind that the management accounting and control systems adopted in the listed SOEs will become tighter and more formal following IPOs. This tightness and formalisation is necessary to meet the expectation of non-state shareholders particularly.*

- *After IPOs, management accounting and control systems could generate more information. Corporate managers may use this information to better facilitate accountability of the listed SOEs toward all the shareholders.*

- *IPOs provide a good opportunity for executives and management accountants to initiate management accounting and other changes in the listed SOEs. Under the name of IPOs, middle managers and employees may be more cooperative and receptive toward changes.*

- *As triggered by the IPOs, goals values, and norms of the listed firms may undergo changes. Management accountants and other organisational participants are expected to adapt to the new organisational ethos where needed.*

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APPENDIX 1: SUGGESTED FURTHER READINGS

The current project is informed by and aligned with the following academic studies that interested readers may wish to explore:

Ahrens, T. & Chapman, C. S. (2006). Doing qualitative field research in management accounting: Positioning data to contribute to theory. *Accounting, Organizations and Society*, 31(8), 819-841

Broadbent, J. (1992). Change in organisation: A case study of the use of accounting information in the NHS. *British Accounting Review*, 24(4), 343-367

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O'Connor, N. G., Chow, C. W., & Wu, A. (2004). The adoption of "western" management accounting/controls in China's state-owned enterprises during economic transition. *Accounting, Organizations and Society*, 29, 349-375

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Tucker, B. (2013). Environmental disturbances, organizational transitions and transformations: A view from the dark side. *Critical Perspectives on Accounting*, 24(2), 242-259

Tyrrall, D. & Parker, D. (2005). The fragmentation of a railway: A study of organizational change. *Journal of Management Studies*, 42(3), 507–537

Yin, R. K. (2009). *Case study research: Design and methods* (4th Edition). California: Sage Publications

FOOTNOTES

[1] Stock market listing of business units within SOEs transforms business units into corporations that are owned partially by central or local government, governmental authorities, and SOEs, and partially by private investors.

[2] See Appendix 1 for studies that inform the present project.

[3] The National Council for Social Security Fund is a supplementary fund of China which is used for social security.

[4] http://english.sse.com.cn/aboutsse/support/law/c/en_sserule20090408.pdf.

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