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Management buyout in China

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MANAGEMENT BUYOUT IN CHINA

A Project

Presented to the

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California State University,

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by

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ABSTRACT

Reducing state-owned corporate share has recently stimulated a new Merger and Acquisition wave in China. Li Rongrong, Minister of the State Economic and Trade Commission (SETC), explained that opening up state-owned shares aimed at restructuring and reforming state enterprises by making use of foreign capital more quickly and effectively (Feng, 2003). Among varies types of Merger and Acquisition activities, Management Buyout recently emerged as a new tool for management and foreign investors to acquire state-owned enterprises and it is also considered the most effective financial vehicles for state government to reduce state-owned corporate shares. This paper explored the differences of Management Buyout in between China and United States. Since China has different economic environment, government infrastructure, and legal system from United States, investors claimed it might cause different Management Buyout procedures and results in China from what it is in United States. After careful exam current Management Buyout practice in China, the paper concluded that Management Buyout in China has been defined with new meanings. Management Buyout was originally created to increase efficiency and reduce agency cost in United States in 1960s. But Management

Buyout in China is a merely tool to provide incentive programs for current management team and reduce state-owned corporate shares.

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CHAPTER ONE

INTRODUCTION OF THE PROJECT

Introduction

Leveraged buyout (LBO) transactions can be defined as acquisitions of significant equity stake of an enterprise by private venture capital investors using additional debt financing and comprise both the case of the Management Buyout (MBO), in which the current management seeks help from outside providers of both debt and equity capital to take over the equity of the company from its previous owners, and the Management Buy-In (MBI), in which an external management team funded by outside investors takes over the control of a given target company (Gottschalg, 2002).

Leveraged Buyout originated in United States during 1960s, reached peak in 1980s, and then declined dramatically in 1990s. Management Buyouts as a special kind of Leveraged Buyout has just gained its popularity in China.

Though the concept of Management Buyout has been accepted by management and investors in China, many questions still remained unsolved, especially in the areas of regulatory framework of Management Buyout, sources of funds, and valuation.

Purpose of the Project

Management Buyout in China is still in its infant stage. The objective of this study is to provide an overview of Management Buyout in China through comparing the differences of Management Buyout processes in between United States and China, in order to identify the real purpose and procedure of Management Buyout in China.

Scope of the Study

The targets of Management Buyout in China usually can be divided into three major categories: (I) public company taken private (this is usually the takeover type of the Leveraged Buyout transaction), (II) public companies spinning off divisions, and (III) non-public traded companies transactions. And the companies in these three categories can be either state and collective-owned or private-owned. Most Management Buyout targets in China were state-owned and collective-owned companies. Since State-owned companies usually have better access to capital market and the ability to influent policy-makers, they actually have more "hidden value" than non-state-owned companies. These "hidden value" make them more attractive than other type of companies, however it also makes them more difficult to evaluate. This paper focused on the Management Buyout of state-owned public companies.

Significance of the Project

Management Buyout is a recent phenomenon in China and start receiving attention from academic perspective. Most discussion on Management Buyout in China is merely focused on its benefits to Chinese enterprises, rather than exploring the potential risks associated with Management Buyout. In fact, without recognizing the differences of Management Buyout between in China and United States, the real meaning and purpose of Management Buyout in China can not be fully understood by investors. This paper summarized current viewpoints and discussions in China regarding Management Buyout, and expanded discussion further into areas such as valuation and ownership structure.

Limitation of the Project

Currently, there are not many Merger and Acquisition activities fall into Management Buyout category. And many Management Buyout (mostly are state-owned companies) of private companies were not aware by the public. Statistic data from governmental sources and third party sources are not sufficient enough to support in depth research. Information in this paper is collected through Internet, newspaper, stock exchange, and governmental publications.

CHAPTER TWO

LITERATURE REVIEW

Management Buyout Improves Corporate Governance

The major advantage of Leveraged Buyout or Management Buyout perceived by China government was its effect on improving corporate governance. Leveraged Buyout forces organization's corporate governance change by adding large-block equity investors to the firm's board of directors, and therefore actively monitors management's performance (Palepu, 1990). Agency theory provided fundamental framework for this point of view. Agency theory concerned the contractual problems that occurs "one or more persons engage another person and to perform some services on their behalf which involves delegating some decision-making authority to the agent (Jensen & Meckling, 1976). Based on Agency theory, both parties, principles and agents, are dedicated to maximize their own benefits. Agency theory concludes that the agent does not always act in the best interest of the principal. The principal can reduce divergent agent behavior through control mechanisms, incentives for desired behavior and reducing discretionary decision space, with a cost to principal. The difference between total loss from divergent behavior termed as "agency costs" (Jensen & Meckling, 1976). Agency costs varied depends on individual company's controlling system, governance structure, and incentive programs, which could be overwhelming (Smith, 1990). Leveraged Buyout activities can change the determinants of agency cost (Jensen, 1986). Therefore, Leveraged Buyouts have a significant impact on the firm's agency costs (Kaplan, 1989). However, the number and type of firms that can be revitalized through Leveraged Buyout is limited. Leveraged Buyouts are appropriate solutions to corporate governance problems for only some public corporations. Government should set policy to encourage other vehicles for improving the governance of public corporations (Long & Ravenscraft, 1993).

Management Buyout Improves Management Incentive Program

Jensen (1989) concluded that the leveraged buyout organization creates an incentive structure that is superior to typical public corporation in lower growth industries. Leveraged buyout organizations typically have high financial leverage, high managerial equity ownership, and monitoring by active investors such LBO sponsors. Under this viewpoint, increased management ownership and high financial leverage of buyout organization generated strong incentives for managers to produce higher cash flows through improved operational results after leveraged buyout transaction. The high financial leverage also limits the possibility that managers invest free cash flow into unproductive investments because it is committed to serving the debt. Rappaport (1990) disagreed with Jensen that the LBO organization is superior to the public corporation (Rappaport, 1990). He argues that the high level of debt and concentrated ownership caused inflexibility to competition and change. And the typical active investor invests funds provided by outside investors who expect to be repaid in five to ten years. Therefore, Rappaport argues, buyouts are inherently transitory organizations. Rappaport also added that alone with managers' equity stakes increases in value, they also bear an increasing amount of undiversified risk. Over time, one exit strategy managers can employ to reduce or diversify this risk is to allow the company goes public again. Kaplan (1991) also finds that approximately 45% of the large LBOs completed between 1979 and 1986 returned to public ownership at some time prior to August 1990 (Kaplan & Stein, 1991). However, these firms remained debt and ownership concentration levels that are substantially higher than pre-buyout levels, suggesting that the firms maintain many characteristics of the LBO organization even after returning to public ownership status.

CHAPTER THREE

METHODOLOGY

Introduction

The process of the Management Buyout of public-traded companies (mostly state-owned) in China was compared with in United States. These data of these Chinese public-traded companies were collected through Sheng Zhen Stock Exchange. The research was divided into three steps. At first, 30 public traded companies were randomly selected, which were listed either by Sheng Zhen Stock Exchange or Shanghai Stock Exchange in Merger & Acquisition category. Varies industries and type of the businesses were included in selection. Then the second step was to send questionnaires to these selected companies, and researches their financial information. 7 companies were finally selected that have completed Management Buyout process, and all of them had announcements about Management Buyout in newspaper and annual reports. Then these companies' stock performance was evaluated based on before and after Management Buyout.

CHAPTER FOUR

FINDINGS AND RESULTS

It is found that public traded companies had quite disappointing stock price performance after Management Buyout transaction.

Table 1. Stock Price Comparison

Financial Data	Stock price change one month after Management Buyout	Stock price change one year after Management Buyout
Sheng Fang Da	-14.80%	-57%
Yu Tong Bus	-13.30%	-17%
Sheng Li Gu Fen	-3.10%	4%
Aomeidi	-5.10%	-48%
Fu Shu Gu Feng	-6.20%	-19%
Dong Ting Shui Zhi	-6.20%	-12%
Te Bian Dian Gong	-15%	-21.50%

The stock price percentage change one month after Management Buyout transaction compared to stock price percentage change one year after Management Buyout, based on Sheng Zhen Exchange data

All the companies in our data showed negative stock price change in one month after Management Buyout, which indicates investors' negative viewpoint toward Management Buyout. The stock prices slide even further one year after. The only exception is Sheng Li Gu Fen.

One of the purposes of Management Buyout is to improve the company's operational efficiency and to reduce agency cost. The associated changes in organizational ownership structure should improve managers' motivation to maximize stock value and therefore lead to better financial outcome. However, our study showed that Management Buyout in China indeed did just opposite. It actually makes managers even more short-term oriented and more vulnerable to financial distress. Three assumptions were summarized based on observation.

The first assumption is that, from the ownership structure perspective, Management Buyout in China did not improve management efficiency and effectiveness.

Segregation of ownership and management caused agency problem. Management Buyout in China is purposed to integrate two parties, stockholders and management, into one team. The management team supposed to have the same interest as stockholders. Consequently, it should improve efficiency, and reduced agency cost. However, after examination of the ownership structure of Management Buyout in China, it was found that management team does not have high percentage of ownership as it is in United States. Management Buyout in United States usually takes more than 90% stock ownership, and then "goes private". In Management Buyout in China, management team only has 6%-36% of the total share; none of these companies owned more than 50% stocks, which is significantly less than

Management Buyout in United States. Agency problem will still exist after Management Buyout.

Agency problem can exist in two particular areas. The first is that the management team can be benefited at outside investors' expenses through unfair pricing. Due to lack of sufficient financial monitoring system, Management Buyout can be utilized as a tool by management to compensate them, which made agency problem even more severe. Before the Management Buyout, management can easily manipulate financial statements and deliberately minimize net income, reduce revenues and assets on book prior to Management Buyout. These activities will lower the investor expectations, stress the stock price, and reduce the buyout cost. In the case of Yu Tong Bus (600066), management deliberately reported loss in revenue, reduced assets and increased liability before Management Buyout. Management of Yu Tong Bus then started Management Buyout process when the stock price was distressed.

The second area is that management can also utilize insider information to trade their stocks or simply pay out more dividends after Management Buyout. It will be easier for management to manipulate their stocks than ever. In all Management Buyout cases, management used personal debt financing, which can be another cause for agency problem. In order to reduce their personal debt, management will increase dividends payout ratio to pay their personal debt, which will apparently impact the stock performance. Outside investors therefore took the negative view of the company and sell off the stocks, which caused severely depressed stock price after Management Buyout.

The second assumption is, from valuation aspect, the Management Buyout might be unfair to outside investors and foreign investors under current state-owned ownership transfer process.

Table 2. Earning per Share Versus Management Hold Shares

Financial Data	EPS % change one year after Management Buyout	Management hold shares
Sheng Fang Da	-208%	36%
Yu Tong Bus	9%	31%
Sheng Li Gu Fen	-30%	6.85%
Aomeidi	-40%	22.19%
Fu Shu Gu Feng	41%	33%
Dong Ting Shui Zhi	5%	12.84%
Te Bian Dian Gong	0%	9.80%

** For the companies completed Management Buyout within last year, it represents the EPS % change from last fiscal year to current fiscal year.*
The total management hold shares and EPS percentage change one year after Management Buyout, based on Sheng Zhen Exchange data.*

Under current practices, state-owned shares were not sold to management through public-bidding or trading. Instead, they were transferred through negotiated contracts between government and management team. It becomes a very controversy practice. In most transactions, the government, which is usually the largest shareholder, transferred stocks it owned to management team at price that is much lower than the market price and book value. Outside investors therefore are accusing the unfairness of this type transactions and aggressively promoting public-bidding process. As table 3 indicated, except Sheng

Table 3. Acquisition Price Versus Book Value per Share

Completed Management Buyout transactions	Acquisition Price (Yuan)	Book Value per Share (Yuan)
Aomedi	2.95	3.81
Aomedi 2nd transaction	3.00	4.07
Sheng Fang Da	3.28	3.45
Sheng Fang Da 2nd transaction	3.08	3.45
ST Wan Jia Le	0.84	0.31
Fu Shu Gu Feng	2.95	3.19
Dong Ting Shui Zhi	5.75	5.84
Te Bian Dian Gong	2.50	3.36
Te Bian Dian Gong 2nd transaction	3.10	3.36
Te Bian Dian Gong 3rd transaction	1.40	3.36
Sheng Li Group	2.27	2.27

** For the companies completed Management Buyout within last year, it represents the acquisition price.*
The book value per share, based on Sheng Zhen Exchange data.*

Li Gu Feng (Sheng Li Group) acquired all the state-owned shares at price of book value, and ST Wan Jia Le paid higher than its book value, the rest companies paid acquisition price much lower than book value.

Traditionally, during Management Buyout process, stocks were acquired by different interest parties through different channels with fairness. Different entities can be composed of shareholder, management, and outsiders. However, in China, management team had much more advantages compare to outside investors and other interest parties during Management Buyout. Management usually explains the favorable treatment was because their contributions to the company have never been properly rewarded prior to China's economic reform. Therefore, privilege such as favored ownership transfer pricing is merely a way to reward management team for their past contributions. Apparently, most outside investors are not convinced by this argument. This is another reason investors start selling off stocks of the company after the company announced Management Buyout.

The solution to reduce the unfairness of ownership transfer is to require management bid in the public market for state-owned shares. It can reduce information asymmetric problems, and therefore lead to fair pricing.

Private capital and foreign capital involvement can possibly be the impetus that pushes the standardization of ownership transfer procedure. In order to attract foreign capital and private capital, China government must revise its policy and procedures regarding state-owned stock transfer. Recent "public company Merger and Acquisition procedure" and "Notice of transferring public company state-owned shares and legal entities shares to foreign investors" evidenced this trend. In these new policy and procedures, they identified importance of fairness of ownership transfer, and provide some regulatory framework to regulate certain transactions.

The third assumption is that Management Buyout is not a promised exit strategy for state-owned companies.

From the historical experience of many communist countries', Management Buyout was not a guaranteed exit strategy for state-owned companies. Russia and Eastern Europe utilized Management Buyout as a major privatize tool in 1990s. Management Buyout was considered the most practical way to transform state-owned companies to private companies. Indeed, due to the incompleteness of government infrastructure and the immature economic environment, Management Buyout actually failed badly afterwards. Russia's 500 state-owned companies valued more

Table 4. Debt Ratio Comparison

Financial Data	Debt Ratio	Prior Debt Ratio
Sheng Fang Da	26%	24.5%
Yu Tong Bus	44.0%	39%
Sheng Li Gu Fen	47%	46%
Aomeidi	67%	66%
Fu Shu Gu Feng	46%	46%
Dong Ting Shui Zhi	34%	23%
Te Bian Dian Gong	61%	49%

Debt ratio comparison before and after Management Buyout, based on Sheng Zhen Exchange data

than 1000 billion US dollars at the time, however, only sold for 7.2 billion - the loss is tremendous.

In China, after management acquired the control of the company through Management Buyout, management can decide to either create value or simply cash out. As table 4 indicated, after Management Buyout, companies did not have much change in their debt ratio, which indicates that these enterprises did not really "leveraged". Managers actually used personal savings or personal borrowed funds to complete Management Buyout. It can lead to dangerous consequences if the management wants to cash out immediately after Management Buyout. Management can simply pay more dividends to recover their personal savings.

Therefore, under current environment, without correct infrastructure in place for Management Buyout transactions, purely ownership structure change will not provide enough benefits for both government and outside investors.

CHAPTER FIVE

INTRODUCTION OF MANAGEMENT BUYOUT IN CHINA

Brief History of Leveraged Buyout

In the late 1970s and early 1980s, Leveraged Buyouts were initiated and thrived by a handful of sophisticated and visionary financial experts such as Kohlberg Kravis Roberts & Co. (KKR) and Wesray Capital Corp. (Wesray). The value of financial activities through restructuring the corporate financial structure was realized by the value gap between the acquisition cost of redundant corporate assets and their financial value. Through correctly identified financial tools and vehicle, the return of these activities were dramatic. On the one hand, the net investment is very limited in such transactions; on the other hand, return can be infinite. Leveraged Buyout firms achieved significant return that as high as 50 to 125 percent in net equity investment into transactions.

Value gap, or opportunities existed in 1980s mostly came from corporate restructuring activities. Many corporations were anxious to align the strategic assets and improve efficiency of corporate assets, which caused by conglomerate wave of late 1960s and early 1970s. The buyers for these types of corporate assets were limited by strategic reasons. Corporations must either sell the assets at a low price to attract buyers or to continuously deteriorate its financial condition. And many times, there are no buyers at all. And consequently private firms which not have pressures on earning reports become favorite model for these corporate assets. Leveraged Buyout therefore emerged as a lifesaver for these corporations because the targets of Leveraged Buyout firms are merely to reach the acceptable rate of return, rather than earning report.

Leveraged Buyout firms have its prime time in 1980s because of the economic environment. Interest rate was a important factor support Leveraged Buyout. However, after 1980s, failure rate skyrocket in Leveraged Buyout transactions, partially because Leveraged Buyout business became more of a fund-raising than an investment management business. In 1990s, despite the high price of Merger and Acquisitions, principles of Leveraged Buyout firms continuously contribute their equity into poorly balanced firms without careful evaluation of their return potential. Therefore, many investments were doomed to fail because they could not provide adequate return on investment.

A set of success factors, as well as failure factors if considered, were summarized afterwards by varies literatures. Corporations would have much chances of success if they followed these "golden rules" that made LBO firms successful in the 1980s. These include:

1) Pay the right price
2) Invest other people's money
3) Invest with an edge - management
4) Understand the risks
5) Understand the acquisition process
6) Focus on cash flows and market values
7) Buy wholesale
8) Undertake commonsense strategies.

Moreover, most Leveraged Buyout shared many characteristics:

1) Most target companies have tremendous hidden capital, or "improvement room." Leveraged Buyout can use corporate restructuring, redefine products and services, cost reduction, raise capital to provide abnormal return for its investors.
2) The target companies have potential in reducing agency cost.

3) The target companies are usually in the mature industry. Leveraged Buyout use financial leverage to buy off the company, and then use the cash flow generated from the operation to pay the debt. Therefore, cash flow stability is critical for Leveraged Buyout's success. Mature industry usually has higher stability then embryonic industries.

4) The management has access to capital market, and experience in dealing with financial and legal professionals. The process might be assisted by professional Leveraged Buyout consultants.

5) Leveraged Buyout usually goes public after certain period of time.

Development of China Financial Market and Financial Legal System

China's securities market has been through a long turbulent environment since it was initiated in 1990s. The development of regulation and procedures were both economic and political process, with the stronger forces from political side. Since its infant stage, the market has been full of speculators, as well as gamblers in a sense. Disaster type of financial pressure on stock market provided strong voice for central government intervention.

The basic institutional framework for securities industry regulation was established in the late 1990s Investors' dissatisfaction about the market have pressured regulators to improve the regulation system and expedited maturing process of the market. Consequently, market has turned attention from building rules and regulations into reinforcement of them.

China's stock market was intentioned to be an experiment when it was first introduced in 1990. Without much of experience and expertise in securities market and regulations in place, it is very sensitive about the future of the securities market, and more important its compatibility with social environment. After careful study and rapid introduction of western style security regulation, today, by 2001, China's securities market has grown to the second largest security market in Asia. Shanghai and Shenzhen stock exchanges were monitored and regulated by local People's Bank of China and local governments. Local governments were the main players in developing the growth of these infant markets. Due to their economic needs, these markets grow rapidly with very limited regulatory framework. On the other hand, People's Bank of China was under local authorities at the time. However, in 1992, the central government decided to centralized the control of securities regulatory system after protests related to corruptions and unregulated growth in stock exchange. The establishment of State Council securities committee and china Securities Regulatory Commission (CSRC) formalized controlling mechanism that the central government agency supervises the stock exchange and local government oversees its operation. National People's Congress soon then initiated the draft of Securities Law, which is based on existing practice. Securities Law significantly strengthened Shanghai and Shenzhen stock exchange, which were directly supervised by Securities Regulatory Commission. Securities Law takes into effect in 1997, which represents a benchmark in China's financial market development. Securities Regulatory Commission itself however, is not a representative of government agency. The State Council Securities Committee is merely a coordinating organization, which includes members from fourteen state agencies, such as The State Planning Commission, The Ministry of Finance, The Central Bank, The Economic Reform Commission, and the Supreme People's Court. Securities Regulatory Commission is lack of legal authority to enforce the regulatory and rules without local government's assistant. Securities Regulatory Commission has parallel authority in securities regulation with State Planning Commission, The Economic Reform Commission, The Ministry of Finance, and the People's Bank of China. The local securities committees were neither part of local governments nor the field offices of the Securities Regulatory Commission.

The Chinese government has keenly awareness of growing economic and political significance on stock market. The government starts to put serious efforts on curbing speculation and manipulation in stock trading. Regulators penalized a number of bank branches and brokerages that engaged in illegal activities. On December 16, 1996, the People's Daily published a special commentary on regulatory activities and pointed to the various problems in the stock market and warning investors to beware of investment risks. The market indices took a dive after the release of the article, however, recovered quickly. After, Regulators then used the adjustment of IPO quotas and of the stamp tax on stock trading. Regulators issued two major regulations to reduce the flow of funds into the stock markets in May-June 1997. The first is State Council Securities Committee, the People's Bank of China, and State Economic and Trade Commission banned state-owned firms and listed companies from trading in stocks. The second, the People's Bank of China prohibited banks from allowing various forms of funds into stock trading and speculation. And financial market bubble finally busted.

The market volatility and rapid speculation also prompted the central authorities to rethink of the regulatory framework for the securities industry. In August 1996, the State Council Securities Committee issued the Regulations on Managing the Stock Exchanges. In this new released regulation, the Securities Regulatory Commission was authorized to directly oversee and manage the stock exchanges, including the authority to nominate, with the concurrence of the local governments, the chairman and vice chairman of the boards of the exchanges as well as the general manager and deputy general manager of the exchanges. The balance of regulatory authority clearly tilted toward the center.

Asian financial crisis accelerated the efforts by the central authorities to gain direct monitoring over the stock markets. China government recognized that in most developed countries, government regulate their securities exchanges under one nationwide unified authority rather than parceling out regulatory authority to local governments. In August 1997, just before the fifteenth

Party Congress launched new reform initiatives, the State Council empowered the China Securities Regulatory Commission to directly oversee the Shanghai and Shenzhen stock markets rather than leave them to the dual leadership of the municipal governments and China Securities Regulatory Commission. With this regulatory change, the China Securities Regulatory Commission promptly appointed its own choices for the general manager and deputy general managers of the stock exchanges. In the meantime, the amended Criminal Law included provisions for prosecuting securities-related crimes including illegal issuance of stocks, insider trading, the spread of false information and other forms of stock manipulation. Most importantly, the financial crisis in the rest of Asia prompted central leaders, notably president Jiang Zemin, to push for the enactment of the Securities Law.

The central government did not just take over the stock markets, but also the revenue on stamp tax on securities transactions. Central government took 88 percent of the total revenue in stamp tax and left 12 percent to local authorities. And the State Council further the central government's stake to 91 percent in 2000, to 94 percent in 2001 and 97 percent in 2002. Stamp tax revenue reached 24.5 billion yuan for 1999 and 26.7

billion yuan for the first half of 2000, making it one of fastest growing tax source.

The growing size of the stock markets and rapidly expanding scope of public involvement indicates that the market can be an important economic institution, which the central government will not leave behind. Therefore, in 1997 National Conference on Financial Work also decided to reform the administrative organization for securities regulation. In 1998, while the restructuring of the People's Bank of China, the central government forfeit the local government authority to a national unified securities management system. Under this direct and unified leadership, China Securities Regulatory Commission, all the local regulatory authorities became branch offices representing China Securities Regulatory Commission. China Securities Regulatory Commission requires its branch offices emphasis on the protection of investors through regulation, standards, and discipline. In July 1, 1999, the China Securities Regulatory Commission's branches became operational nationwide, thus forming a centralized and unified network of securities supervisors.

There are more than 60 million brokerage accounts in China and the political implication of a falling marketing can devastate the stability of political situation. Despite the warning from securities publications, websites, and broadcast programs, more than 50% percent of stocks in the market maintains price/earning ratio at 50-60. Securities regulators and national leaders concern the consequences if the stock market does fall. The political importance of the securities markets has attracted much concern from the National People's Congress. In 2001, the National People's Congress Standing Committee sent an inspection team to four cities to learn about the implementation of the Securities Law. The result of investigation was not satisfied by National People's Congress. The inspection team reported issues like corporate governance, disclosure of unreliable information, stock price manipulation, and failure of majority owner to pay dividends, majority owner taking funds from listed companies at the expense of minority investors, corporate managers not using raised funds for indicated purposes, violation of laws and regulations by brokerages, incompatible law enforcement between the Ministry of Finance and the courts, and provide false information in order to go public. The inspection team also reported that some local governments have been involved in various reorganizations of listed firms, which makes it difficult for securities regulators to de-list the companies underperformed. The National People's Congress therefore launch a series of political actions to urge reform of China Securities Regulatory Commission.

The government was in alliance with increasingly diverse financial press to promote and protect the minority interest. The one the most influential press Financial and Economic Review has released a series of articles to expose problems and issues of market manipulation and false accounting by some companies. Some once high-flying companies therefore attracted investigation by Internal Revenue Services and China Securities Regulatory Commission after reported by Financial and Economic Review.

Under the pressure from public expectations, press criticism, and legislative demands, China Securities Regulatory Commission has launched many internal many internal reform themes and become more transparent to outside investors. For example, China Securities Regulatory Commission was looking for public opinion for a set of guidelines which requiring listed companies to have independent directors in 2001. In 2001, only 204 listed companies out of more than 1200 companies had independent directors. The proposed guidelines required all domestically listed companies to have at least one third of directors to be independent directors within a year. The public showed very positive response to the guidelines because majority owners can conduct transactions at the expense of minority shareholders before the guidelines were reinforced.

The Chinese securities and futures exchanges have been develop merely a decade. It has not only employed advanced technologies but also adopt the modern securities exchange regulatory system. In many areas, Chinese financial markets are not advanced enough to support many financial activities and transactions such as funding for Management Buyout. But a joint effort among banking, securities, and insurance regulators was initiated in Shanghai in mid-2000 to strengthen information sharing and coordination.

Current Management Buyout Market in China

In the past 50 years, China central government directly owned majority enterprises in China, which also made it the largest employer of the country. The government directly assigns goals and tasks to these enterprises, and designates management team. The whole economic system is also called "planned economy". Though government achieved firmed control over these enterprises, it also created a huge burden on its shoulder. Employment, retirement, health and medical become the obligation of government. Since early 1980s, China gradually open its door to world economy, the current control mechanism appears very inefficient and lack of competitiveness in dealing with foreign competitors. In 2001, with China's entering World Trade Organization, efficiency, employment and corporate governance issues become even more critical than ever. Therefore, China government start privatizing and unloading shares of these state-owned enterprises, in order to improve efficiency, corporate governance, and shift employment burden to private enterprises and investors.

With the push from both economic and political side, Merger and Acquisition activities increased tremendously during past three years. Boston Co.'s research shows that Merger and Acquisition in China increased at a rate of 70% annually over the past five years, making the country the third largest Merger and Acquisition market in Asia. Thompson Accounting Services statistics shows total 155 deals worth $11.9 billion in the second quarter of 2002 (Feng, 2003). Among varies types of Merger and Acquisition activities, Management Buyout and ESOP emerged as new methods for reducing state-owned corporate shares. Currently, State government owns about 6,600 billion Yuan in corporate assets, and 2/3 needs to be sold or restructured (Fei, 2002). From 2000 to 2002, Management Buyout activities are increasing at a promising trend. Even public traded companies start seeking ways out to Management Buyout. For example, public traded companies Te Bian Dian Gong (600089), Sheng Li Gu Fen (000407), Tong Ting Shui Zhi (600257) already completed their Management Buyout process. In foreign capital sources, U.S. capital has become a forceful power in the China business economic environment as well as Merger and Acquisition market. It is reported that Citibank is in negotiations with the Shanghai Pu Dong Development Bank for the purchase of a stake of 8-10 percent; the Hong Kong and Shanghai Banking Corp. (HSBC) has reached an agreement with the Beijing City Commercial Bank on becoming a shareholder. Many believe that allowing foreign investors to acquire part of equities of state-owned enterprises is a turning point in the development of China's securities market. Foreign investors can not only introduce foreign capital, advanced technologies and managerial expertise but also speed up the process of reducing state-owned shares, and therefore change the corporate governance structure. The U.S.

private-equity fund New-bridge capital Ltd. topped Chinese media coverage recently as the would-be buyer of a listed Chinese bank, the first foreign acquisition of its kind in China. It is learned that it plans to buy 15% of the stake of the Shenzhen Development Bank for 1.5 billion Yuan and become its largest shareholder.

Meanwhile, China's private capital is also aggressively pursuing buyouts. There are a few public companies is in the process or completed their Management Buyout, which includes Yutong Bus, Wan Jia Le etc. Management Buyout has received broad attention from many different areas.

Merger and Acquisition also take place in the fields of insurance, automobiles and public services. For instances, the U.S. based General Motors (GM) owns 34 percent equity of SAIC-GM-Wuling Automotive Co. Ltd. (the former Liuzhou Wuling Automotive Co. Ltd. (Under the Shanghai Automotive Industry Corp.) with an investment of $30 million; and General Des Eaux of France has acquired a 50 percent stake of the Shanghai Water (Pu Dong) Co. with an investment of 2.03 billion Yuan.

During the first 10 months of 2002, there were 495 Merger and Acquisition deals signed by Chinese listed companies with foreign partners, with the transaction volume totaling 41 billion Yuan. Lately, the trend has become stronger, with further opening of state shares to foreign capital. The year 2002 was regarded as a "year of foreign Merger and Acquisition in China." However, the interesting part is, most Management Buyout transactions are not aware by the public.

Despite the growing potential of Merger and Acquisition, Management Buyout in China hardly received support from banks because the banking industry is not allowed to fund Management Buyout transactions under current financial legal system. However, Management Buyout market still had substantial growth during the last two years. Lack of capital sources set some barriers on debt financing, but management employed many indirect ways to acquire capital resources. Some experienced investment bankers described process as "You can do it, but you can't talk about it." The reason behind the statement is that though there are no rules for alternative capital to support Management Buyout transactions, there are no rules to forbid alternative capital resources either, which stimulated "creativity" in this area.

Management team in Management Buyout transactions is both purchaser and employee, and therefore is a very sensitive area in Merger and Acquisition. In many developed countries, rules and regulations usually pay particular attention to this type of Merger and Acquisition to prevent kick-back arrangements. There are no special rules and regulations applicable to Management Buyout transactions in China yet. Since October 2002, China has promulgated a series of policies and regulations to unlock transferring state-owned shares to private and overseas investors, two major directives are "Public companies merger procedure" and "Notice of Issues Concerning the Transferring State-owned Corporate Shares". These policies and regulations have been marked as major breakthrough in Merger and Acquisition policies and rules. Management Buyout was addressed as a special type of Merger and Acquisition activity in "Notice of Issues Concerning the Transferring State-owned Corporate Shares". The only real regulatory base for Management Buyout is "Public companies merger procedure", which was published in Sep 28, 2002 and become effective on Dec 1, 2002. This procedure becomes the most important regulation in public company merger and acquisition activities, which recognized Management Buyout as a special Merger and Acquisition model and entailed basic legal requirements for Management Buyout transactions. For instances, it requires during negotiation process of Management Buyout, the Chairman of the company is required to address the impact on the company future and it is mandatory to hire an independent financial consultant and other professional consultants. The result of consulting services should be publicized and financial consultant fee should be paid by the company. The regulation set the same requirements on the acquisition side, which requires independent financial consultant to "analyze targeted Company's financial condition, fairness of acquisition contract, and potential impact on company operation". Management must allow Chairman and third-party financial institutions independently investigate the Management Buyout transaction. But the regulation did not specify requirements in source of capital, payment schedules and many other in-depth issues.

At the 16th National Congress of the Communist Party of China, the Chinese leadership stated that utilizing foreign capital should be combined with restructuring state-owned enterprises. Li Rongrong, Minister of the State Economic and Trade Commission (SETC), explained the purpose of unlocking state-owned shares is to restructure and reform state enterprises by making use of foreign capital more quickly and effectively. Minister of Foreign Trade and Economic Cooperation Shi Guang Sheng made the announcement in a forum that state departments are in the process of writing new rules and policies to encourage foreign investors' Merger and Acquisition activities in China. In response, Investment banks start taking actions to establish the framework to support Management Buyout transactions. A few financial institutions, such as Citibank, wutong funds, Hongta Investment fund, and Shenzhen State Investment, will work collectively to establish the first Management Buyout fund in Shanghai. At the same time, Shanghai Asian Business Enterprise Consultants LLC also initiated the project of establishing the first Management Buyout investment institution.

Sheng Li Gu Fen Management Buyout - Example of Management Buyout Process in China

Shandon Sheng Li Gu Fen was established by Sheng Li Group in 1994, and has been listed in Shenzhen Stock Market Since 1996. In the early days, the main businesses include wholesaling and retailing of finished petroleum products, international trade, and real estate development. Since 1994, the company successively invested 200 million Yuan in Plastics Pipe Field; In 1997, it involved in Agricultural Chemical Industry by investing in holding more than half of total shares of Shandong Greenland Chemistry Co.,Ltd.; In 1998, the company established a joint venture called Shandong Sheng Li Biology Technology Co.,Ltd. with the Institute of Plant under Science Academy of China, which goes in for the research and development of biology technology; Since 2000, "Sheng Li Biology Technology Industrial Zone" has been constructed in the Jinan High-new Technology Development Zone, which symbolizes an overall involvement in biology technology industry.

Shandong Sheng Li Gu Feng has very diversified owner structure. The largest shareholder, Dong Sheng Bang Investment (investment holding company created by Sheng Li Group) holds 41 million shares, 17.31% of total shares; the second largest shareholder, Tong Bai Hui, a Guangzhou based public-traded company, hold 36 million shares, 15.15% of total shares, only a slight 1.16% difference. Sheng Li Group has been fighting for a long time trying to control the votes. In 1999, Tong Bai Hui hold 13.77% of total shares, Shandong Sheng Bang holds only 6.98%. Since March, 2000, these two largest shareholders start fighting for the control of votes. Shandong Sheng Bang Investment received shares from Shandong State Property Bureau and Shandong Advertisement Corporation and increased ownership to 15.34% and become the largest shareholder. In the mid of March, Tong Bai Hui increased 2.98% of total shares to

16.67% through public bids, and took back the control of votes. Shandong Sheng Bang soon after acquired 0.67% shares from Shandong local construction company, Shandong Dong Yin Ying Xia Construction, to control the votes again. Since Tong Bai Hui promoting Internet concept, and Shandong Sheng Bang insist Biotech vision, the fight of control has never been ceased since then.

In September, 2002, Sheng Li Gu Fen (000407) became the first Management Buyout in Shandong province. This was the first Management Buyout of state-owned enterprise in Shandong province.

Jul. 23, 2002, Sheng Li Investment LLC was registered and formed by 43 nature person; all of them are employees of Sheng Li Group. From the report of the Board, Sheng Li investment has net assets totaled 110 million yuan, the main business is investment. The largest shareholders are the high ranked managers; include Jianguo Xu, Yin Ma, Lizhu Shui, and Peng Wang etc. Every of these largest shareholders own 3.18% of the total share evenly. The rest shareholders came from Shandong Dong Sheng Bang Investment Group and Sheng Li Group management team.

Jul. 24, 2002, Sheng Li Group, the proxy agent of state-owned shares, signed Ownership Transfer Agreement with Sheng Li Investment LLC. In Sep. 18, 2002, Sheng Li

Group then made amendment to the Ownership Transfer Agreement, transferred 16,410,000 shares (6.85% of total shares) from State Property Management Office to Sheng Li Investment LLC, at 2.27 Yuan per share.

Sep. 17, 2002, Sheng Li Group made announcement that Shan Dong government approved Stock Ownership Transfer Agreement.

Nov. 10, 2002, Sheng Li Group signed Stock Ownership Transfer Agreement with Sheng Li Investment LLC to transfer additional 25,890,000 shares (10.8% of total shares) of Sheng Li Gu Fen to Sheng Li Investment LLC. The transfer price was based on book value of Sheng Li Gu Fen's 2002 annual report, 2.27 Yuan per share.

Nov. 11, 2002, Sheng Li Group announced that Minister of Finance has approved Stock Ownership Transfer Agreement.

After stock ownership transfer, Sheng Li Investment LLC own 42,297,100 shares (17.65% of total shares) of Sheng Li Gu Fen, and therefore become the largest owner of Sheng Li Gu Fen. Sheng Li Group still holds 15,590,000 shares (6.5% of total shares) of Sheng Li Gu Fen, listed as the third largest owner.

On the management side, management team wants to have stable control of the company to protect itself from being taken over. The chairman Mr. Shui Li Zhu explains that stable ownership structure is the only way to ensure the long term growth of the company. Company also needs an incentive plan to allow management and employees to be motivated to work for company's long term growth.

Another important factor that pushed Management Buyout process is the support from Shandong local government. Local government realized that diversification of ownership is not a good way for the local government and company to protect its resources. Local government is especially reluctant to let a local company to be controlled by the company from other province. Therefore, the Management Buyout has been blessed by local government.

CHAPTER SIX

DIFFERENCES BETWEEN MANAGEMENT BUYOUT IN CHINA VERSUS UNITED STATES

Agency problem has tangled state-owned companies for many years. Government has tried varies ways to improve efficiency, reduce debt and agency cost of state-owned companies, but very often with failure. Until recently, privatization, leveraged buyout, merger and acquisition showed a chance of getting out of the riddle. However, the economic environment and financial legal system are not completely ready for Management Buyout.

In regulatory barriers, current "Corporate Law", "Security law" and other rules and regulations set varies limitations to financial buyers. For example, "Stock issuing and trading procedure" requires that individual investors are not allowed to own more than 5% of common stock of any companies. "Security Law" limits employees' total stock holding can not be more than 10% of floating volume.

In financial market, source of fund is another barrier. Due to current regulatory constraint, debt financing such as bonds are not viable to most investors. Commercial banks have very restricted requirement on loans, and completely shut to Management Buyouts. The management must find their own ways to the source of funds. It is also the reason most companies did not disclose the source of fund after management buyout transaction.

Therefore, due to differences in economic environment, financial legal systems, and ownership structure of state-owned enterprises, Management Buyout in China is dramatically different from traditional Management Buyout.

The following context summarized 7 differences in Management Buyout characteristics between China and United States.

Purpose of Management Buyout

In United States, the purpose of Management Buyout is usually to increase profitability of the company and prepare for public offering. The management therefore usually takes very high percentage of ownership in order to maximize their potential benefits.

The purpose of Management Buyout in China can be varied depending on it came from whose perspective. It consequently leads to different buyout process. Indeed, it will be quite difficult to find two exactly the same

Management Buyout process in China. China government's purpose of promoting Management Buyout is to reduce state owned corporate shares, improve efficiency and corporate governance, which is somewhat similar to Management Buyout in United States. However, innovative management team has made Management Buyout a multi-purpose tool.

From the government's perspective, Management Buyout is similar but different from Management Buyout in United States. The main goal of Management Buyout is to reduce state-owned corporate shares, and then improve efficiency and corporate governance. Consequently, Management Buyout can be a tool to solve many long-existed problems with the company, which including ownership structure issue, agency cost, and incentive pay issue. Through Management Buyout, government sells its shares to management with the hope that management team will be more motivated than ever in managing their "own business". Management's increasing equity stake increased un-diversifiable risks, as well as the potential gain of management's stock holding of the company. The incentives generated from increasing ownership should motive management team to achieve better operational performance, and possibly result in reducing non-performing loans and unemployment rate issues in the long run.

However, Management Buyout from management's perspective is quite different from what government wants. Besides all the good will government proposed, management also sees opportunity in strategic acquisition and incentive programs.

Management Buyout in China can be strategic acquisition in the purpose of claiming the ownership of the company. Traditional Management Buyout is usually financial acquisition. Due to political reasons, private businesses were generally not allowed to exist before economic reform in China. In order to establish businesses, many private investors "borrowed" state-owned or collective-owned title to operate private businesses. These "state-owned" enterprises are actually founded and managed by private investors. However, without switch back to private enterprises form, these investors can never realize their ownership. Therefore, investors, often also the management team, always try to claim their equity ownership of these enterprises. And Management Buyout becomes a tool for management and investors to switch the title. For instance, Management Buyout of Aomeidi is a typical strategic acquisition rather than financial acquisition. Aomeidi was organized as a collective-owned enterprise in 1968. Founder, Mr. He Xiang Jian, with 23 partners contributed total 5,000 Yuan to open the business of making bottle lids. In 2000, Aomeidi buy off all state-owned shares from local government through Management Buyout.

Management also utilized Management Buyout to be an employee incentive program. Including both state-owned and private-owned companies, most Chinese companies lack of a way to provide incentive programs, mainly due to legal constraints and financial market constraints. For example, Sheng Fang Da designed three stock option programs for its management team after it went public in 1995. However, option market was not exist in China, and therefore, none of these programs were approved by State Council securities committee and china Securities Regulatory Commission (CSRC). Until the success of Si Tong Management Buyout, Sheng Fang Da's Management realized the opportunity to utilize Management Buyout as an incentive program, and then soon launched their Management Buyout. In Management Buyout in China, management team often combines profit-sharing programs and stock option programs with Management Buyout process together, and create incentive feature of Management Buyout.

Therefore, the purpose of government is to utilize Management Buyout to reduce state-owned corporate shares, and the purpose of the management is to compensate managers' contribution. The focus of Management Buyout is not on returns, but on ownership structure. Investors are highly speculative in dealing with Management Buyouts, rather than motivated to force changes in corporate management in hopes of making returns to compensate the opportunity cost.

Source of Capital

In United States, in order to "go private", management usually purchase majority shares of the target company through debt financing. Many financial instruments were available for Management Buyout. Typical financing options include trust funds, bank financing and junk bonds financing.

Comparatively, there are not many financing options available for Management Buyout in China. Management Buyout in China was mostly funded by personal savings and the borrowed fund from related parties. Since management of state-owned companies usually was not highly compensated, the staggering amount of personal saving the management provided for Management Buyout becomes the target of investigation by outside investors.

The main reason of lacking source of capital for Management Buyout is due to limited availability of trust funds. Management Buyout is a very new concept in China. Usually only specialized trust funds will be willing to invest in Management Buyouts. The good news is that the market has been moving to the direction to provide more funds to Management Buyouts. Recently, a few Management Buyout funds were established or work in process. For example, Xing Hua Trust Funds raised 500 million Yuan capital to form Management Buyout fund. However, the scale is too small to meet the need of Management Buyout market. But it opened a new channel of capital resource for Management Buyout.

At least at current situation, personal saving is the major options for Management Buyout financing in China. Using personal saving to fund Management Buyout transaction leads to the question that where the personal savings came from. Most employees include management team of state-owned enterprises have relatively low income compare to employees of private-owned enterprises. The huge amount of capital required by Management Buyout is not affordable by management. Investors questioned the source of their personal income. For example, in Yu Tong Bus, top management were not compensated enough to afford to pay for the Management Buyout price. Based on Yu Tong Bus's financial report, management team has a major salary increase in year 2000; however, is only 2.52 million Yuan per year in total. During its Management Buyout process, each manager of Yu Tong Bus paid 4.37 million Yuan in average.

Management team uses personal saving rather than public money encouraged corruption and illegal actions. The sensitivity of using personal saving to fund Management Buyout transaction forced management team seeks for alternative source of capital, also alternative ways to complete the transaction. For example, Management team will try every way to lower the purchasing price, including bribe the governors, manipulate financial statement, debt financing without collateral, high volume stock incentive program etc.

Therefore, management of many state-owned enterprises was hesitated by the limitation of capital source in Management Buyouts. Management team sometimes needs to be creative and brave to design new ways to find capital source for the new venture.

Capital Structure

Management Buyout is a leveraged buyout. In United States, debt financing represent 80% of total financing in Management Buyout. Leveraged Buyout firms have generated huge returns for the investors in their funds (their shareholders or partners) by significantly leveraging their equity. In the mid 1990s 9 to 1 leverage ratios were the norm. In today's environment, where senior bank lending is being severely restricted, leverage ratio of 3 to 1 are more prevalent (Marren, 1993). Capital structure change of targeted company caused buyer's direct and indirect benefits in cash out. Much business after Management Buyout, the first thing to do is to look for ways to squeeze the cash out. For example, Martin Sorrell, whose small British advertising agency WPP Group took over the giant American advertising agency J. Walter Thompson in 1987 for $566 million, found $100 million on JWT's post-acquisition balance sheet in the form of undervalued real estate Silver, 1990).

Management Buyout in China, however, is not a real leveraged buyout. Source of capital is contributed by acquirer or management team's personal saving, not financial institution. The targeted company's debt structure remains the same after Management Buyout. The debt pressure is mainly resided on managers' personal finance. Though managers might still motivated cash out the business, the purpose is not to cash out to pay back the debt of the company, rather to payback to themselves, which could against other shareholders' interests. For example, after Management Buyout, Yu Tong Bus management announced after-tax dividend payout as high as 0.48 Yuan per share in year 2001, which gives management 15.84 million Yuan cash payout.

Ownership Structure

Management Buyout in United States is usually total buyout. There are three reasons for total buyout during 1980s. First, takeovers and financial restructurings were devices the financial markets used to discipline corporate managers and pressure them to increase cash flows and to pay out more money to shareholders and other investors. Second, the rational for apply this discipline is most compelling when firms have free cash flow, defined as cash flow in excess of that needed to fund investment opportunities. Finally, the return on investment required by the financial markets (the cost of capital) rose to unusually high levels in 1980s. Real interest rates on government securities and other safe financial instruments, which had hovered between zero and 2 percent since the mid-1950s, rose to 6 to 8 percent in the mid-1980s, driving-up the returns investors required for risky investments such as corporate stocks. Meanwhile, the returns to capital earned by firms in many industries were low during the 1970s and declined even further in the recession of 1981-82.

Management Buyout in China is target to relative control rather than total control of the target companies. It is not totally "go private". Based on the requirement of "public company merger procedure", the public company itself can not provide any assistance in capital source. Management will not have enough resource to finance the buyout process. As a result, management usually has only 6-36% total ownership after buyout.

Management Buyout in United States caused high concentration of equity ownership. The tradeoff which determines the optimal degree of concentration is due to two agency problems: (1) The managers of the firm may engage in empire building, thereby reducing expected cash flows and (2) employees may shirk and under-invest in effort. Ownership concentration has opposite effects on the significance of these two agency problems. Intuitively it mitigates the first agency problem but it tends to make the second one more severe. Both features are due to the fact that a more concentrated ownership structure internalizes more of the benefits from monitoring and thus increases the amount of monitoring that takes place. On the one hand this reduces the amount of empire building by the manager since active shareholders disallow projects which only serve to create private benefits to the manager. On the other hand, increased shareholder monitoring has a negative effect on the effort invested by employees. This effect is slightly more complicated. The tradeoff can explain a change from diffuse ownership structures to highly concentrated ones observed during a leveraged buyout and then a reversion back to a more diffusion ownership structure. This occurs if initially a concentrated ownership structure is desirable to reduce empire building by the manager and to breach existing contracts with employees. After this restructuring it becomes optimal to switch to a more diffuse ownership structure to make implicit contracts feasible.

Management Buyout in China has relatively diverse ownership. It acquired much less percentage of the equity compare to United States version. In most cases, management holds 25% of total shares in average after Management Buyout. The purpose is to gain control in fact, rather than absolute control. Even so, Management Buyout in China might cause the same results as in United States. Small shareholders do not have adequate ownership to control the votes, though 75% shares were hold by them. The managers of the firm may still engage in empire building, and employees may shirk and under-invest in effort.

Management Buyout is multi-lateral buyout in United States. Based on KKR's experience, financial buyers usually will select the key personnel of the target company who would be valuable to the company operation. Financial buyers provide attractive number of shares to management to ensure the continuity of the operation and retention. After Management Buyout transaction, equity ownership usually composed of top level management team, general partners (KKR), and limited partners (capital providers).

Management Buyout in China is also multi-lateral but involved more parties. Ownership structure usually includes from top to middle level management team, holding company's management team, and subsidiary company's management team, sometimes even regular employees. Therefore, Management Buyout in China is similar to an employee benefit program rather than traditional meaning of Management Buyout.

Buying Process

In United States, Leveraged Buyout firms were usually abided by certain predefined acquisition rationale. In the first stage of processing, Leveraged Buyout firms primarily rely on a set of generic criteria regarding industry-level dynamics and financial benchmarks. While many Leveraged Buyout firms are similar in their basic criteria for takeover candidates (mature industries, stable cash flows, low operational risk), some of them have successfully differentiated themselves from the industry mainstream through a specialization strategy (Why financial buyers doing better).

Management Buyout in China generally lack of generic criteria for industry-level dynamics and financial benchmarks. The initial stage of buying process mostly concerned employee benefits programs, corporate governance, incentive program for management etc. As previously stated, Sheng Fang Da launched its Management Buyout process simply because its management consider it is a feasible way of its employee benefit program.

The second stage of Management Buyout in United States is the acquisition process. Standard Two Stage Auction Process in designed to eliminate the situation when corporate executives get emotional involved in a deal and end up overpaying for a target company.

Management Buyout in China usually employed a less direct way to process the transaction. Management teams do not directly acquire shares; rather they acquire shares through an independent investment company, such as a trust company and security investment company. The Investment Company usually is fully owned by the management team. For example, Aomeidi and Dong Ting Shui Zhi both formed Investment Limited Liability Corporation prior to buyout process.

The reason that management usually does not purchase stocks directly through secondary market or through auction process is because the purchasing prices would be much higher this way. Most companies completed its Management Buyout process through negotiation with state government because state government usually has majority ownership of the company. Based on currently legal system, Employee Stock Holding Company is a preferred buyer in Management Buyout process. However, most Employee Shareholder Holding Companies are only organized and regulated at local government level. Therefore, in the second stage, public companies' focus is seeking for the support from local government and permission for its Management Buyout.

In the last stage of buyout, a key idea of financial acquirers is the "acquisition competence", according to which they can specialize and develop capabilities in redesigning and enforcing highly powered incentive and control systems, thereby achieving systematic value creation through enhanced utilization of existing resources as well as development of new ones, without the exposure to the costs of post-acquisition integration processes. Therefore, the last stage of Management Buyout is to restructure the targeted company in its financial structure, in order to maximize the utilization of its financial resource.

Management Buyout in China mostly has not done much after its completion. Instead of focusing on improving operating efficiency, many companies' management start worry about their personal debts and start paying higher dividends.

Valuation

Valuation is the core techniques for investment bankers. However, most Management Buyout in China lack of systematic approach in valuation. Most management buyout employed negotiated price, or book value price.

Fair market value is defined by Internal Revenue Services as "the price at which a property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of the facts." In the majority of purchase decisions the fair market value of the good or service being sold has been determined over numerous transactions. This is also true, in a macroeconomic sense, with regard to pricing acquisition transactions. However, in a transaction involving a business, the market value of the target is often not well defined, principally because the market can be very thin, with only a handful of potential buyers. It is difficult to determine the market value of a company for several reasons. Value depends on who a prospective buyer is and what knowledge the buyer possesses. Furthermore, value also depends on the process that will be used to realize value. Finally, valuation is difficult because each company is one of a kind. During Leveraged Buyout, Management Buyout sometimes is considered as a side program for financial capitalist to squeeze the cash out of the target company to pay for the debt. The support of management team will be an important factor to accomplish this target. Therefore, financial buyer provided management team an incentive program.

In United States, whether an acquisition makes economic sense depends on the expected cash flows of the target company. U.S. companies have policies that steer them away from any acquisition that would dilute earnings or would create goodwill on their books. These policies exemplify corporate America's often criticized focus on quarterly earnings instead of long-term value creation. Cash flows do not just depend on earnings levels. Capital expenditures and changes in working capital investment are equally important cash flow variables that must be scrutinized. Successful Leveraged Buyout firms have always spent an extensive amount of time reviewing capital expenditure plans, pruning gold-plated corporate budgets down to essential economic projects. The market values of all the target's assets, especially unwanted or unneeded assets, is critical information to properly analyze a deal. Book value and replacement value are irrelevant in analyzing such assets.

In most Management Buyouts in China, book value has been considered benchmark for setting purchasing price. From management's perspective, Management Buyout is a way to compensate them as they were underpaid for a long time; therefore, the price for Management Buyout should be very favorable to the management. In fact, in Te Bian Dian Gong's (600089) Management Buyout transaction, the book value was 3.36 Yuan per share, earning per share was 0.18 Yuan, return on assets was 5.54%. The company used two different prices in Management Buyout transactions, 1.24 Yuan per share and 3.1 Yuan per share. The underpaid portion of management compensation was priced at 2.12 Yuan per share and 0.26 per share each.

The reason management can acquire state-owned shares at such a low price is because of current state-owned enterprises control mechanism. Though these enterprises are state owned, local government is fully authorized to approve Management Buyout transaction as well as its valuation. As long as local government does not allow outside parties or independent agencies to control and monitor the valuation process, management can use most favorable price they chose. Due to conflict interest between local and state government, low purchasing price has caused state government and small investors losing equity.

Economist Mr. Zhang Shu Guang suggest that allow the public investors enter Management Buyout or Leveraged Buyout transactions will allow the valuation judged by the market, not by the management or local government. If outside investors were allowed enter bidding process, the valuation would much accurate than it is right now.

Exit Strategy

Management Buyout in United States focused on short term profitability rather than long term profitability. As long as the target company meets the required return, the company will either be sold or go public. Possible exit strategies in United States include (i) initial public offering, which allows management to sell stocks to public, (ii) re-capitalization, which allows equity holders to realize return by taking a sizable dividend, and (iii) outright or partial sale to another strategic or financial buyer. Management has very clear strategies for exit.

In China, the company will not go private after Management Buyout; therefore there is no need for going public again. The potential exit strategy for management could be either realize return by taking sizable dividend, or sell to another strategic or financial buyer.

CHAPTER SEVEN

CONCLUSIONS

The original purpose of Management Buyout could be either improve its resource allocation or optimize its management structure, or both. These benefits can be realized through reducing agency cost, motivate management, and formulate comprehensive management monitoring system. However, Management Buyout is not the only solution for these issues. And there are many problems Management Buyout cannot solve. Though Management Buyout in China seems like a promising solution for reducing state-owned shares, it didn't solve the fundamental problem of agency cost. There are many factors can cause failure of Management Buyout in China.

At first, Management Buyout needs strong regulatory framework to support and regulate its activities, which is what China's economic environment lacks. Increasing management ownership is a double-edge sword. On the one hand, it will improve efficiency, reducing the waste and motivate management team; on the other hand, it cause issues in "control the votes", which might reduce the efficiency in long run. In many cases, corporate raid is beneficial to the company. The threat of being taken over will force the management to be more diligent with their performance. However, when management had certain amount of votes, it can easily protect its position. The rest shareholders' decision would be hard to execute. Moreover, many state-owned companies in China don't have a necessary "ready" condition for Management Buyouts: a health and effective modern corporate governance system. Because the shareholders' interest is represented by the state government, it is a tendency that "everybody's interest" becomes "nobody's interest." Therefore, without sufficient internal control and monitoring system, management could easily take over the total control of the company, and management can even utilize the company's resource for its own benefits.

Second, companies taking Management Buyout usually requires strong debt capacity. This can be a great challenge for state-owned companies, which usually already had high debt ratio.

Third, traditional Management Buyout usually focused on short-term oriented results. Targets of Management Buyout usually have improvement room in cost reduction, improve profitability etc. Most state-owned companies are good targets for Management Buyout. However, if the potential in cost reduction and improve profitability have been fully discovered, technical improvement and continues improvements will be the determinant factors. Therefore, through Management Buyout, state-owned companies can be benefited only to certain stage. And it eventually relies on technology, production, continues improvement and other management themes.

Fourth, Management Buyout will improve management structure, improve corporate governance and reduce state-owned shares only if companies focused on improving operational efficiency, financial performance, and reducing agency cost after the successful Management Buyout. But in many cases, management focuses on reducing personal debt.

Fifth, under current political background, reducing stated-owned shares is an important reason for the popularity of Management Buyout. The Regulation and Policies of Merger and Acquisition were revised many times in order to support Merger and Acquisition activities. However, the barriers on the transactions and flexibility of transferring the shares of state-owned companies to private investors still unbreakable.

Sixth, domestic capital market is not ready for Management Buyout. The difficulty of acquiring the reliable source of capital for Management Buyout prevents many potential buyouts.

In summary, through study the results of Management Buyout in China and the factors caused its failure, the obvious differences can be recognized between Management Buyout in China and United States. First, Management Buyout in China is purposely reducing state-owned corporate shares, and Management Buyout in United States is to improve the ownership structure and capital structure in order to achieve greater operational performance. Second, Management Buyout in China usually achieves "control in fact" rather than total control. Management Buyout in United States usually realized total control. Third, the company in China has less debt after buyout than it is in United States because management contributed their personal funds for Management Buyout. Last, Management Buyout in China usually completed through negotiation with government, Management Buyout in United States usually operated through public bidding approach.

APPENDIX

TABLES

Table

Sheng Fang Da

Sheng Fang Da (000055)

Date	Open	High	Low	Close	Volume
19990129	18.17	18.49	16.72	**16.91**	34,951
19990209	16.91	16.93	15.05	**15.46**	9,028
19990331	15.5	17.1	14.3	**15.79**	76,894
19990430	15.8	16.5	12.88	**13.8**	31,887
19990531	13.75	18.11	12.4	**16.62**	198,483
19990630	16.98	22.7	16.3	**21.68**	372,725
19990730	20.8	20.8	17.1	**17.84**	147,742
19990831	18	18.43	13.81	**15**	88,568
19990930	15.02	16.79	14.61	**14.8**	77,393
19991029	15.13	15.13	13.9	**14.68**	17,511
19991130	14.55	15.17	14.17	**14.77**	26,714
19991230	14.78	15.31	13.81	**14.03**	36,134
20000128	14.09	15.83	13.8	**14.01**	76,109
20000228	14.1	17.8	14.1	**16.11**	127,948
20000331	16.1	20	15.28	**20**	252,582
20000428	20.72	22	17.81	**18.16**	192,389
20000531	17.8	19.08	15.55	**18.21**	113,309
20000630	18.28	18.7	16.5	**18.43**	101,657
20000731	18.7	19.87	18.1	**18.41**	109,619
20000831	18.41	19.56	17.5	**17.54**	64,709
20000929	17.6	17.62	16.2	**17.18**	21,937
20001031	17.18	18.78	17	**17.95**	37,125
20001130	17.6	19.5	17.6	**17.95**	94,689
20001229	17.95	20.18	17.4	**20.17**	129,661
20010119	20.29	22.2	19.79	**20.56**	143,404
20010228	20.56	20.78	15.3	**16.49**	57,993
20010330	16.42	17.78	15.81	**17.17**	56,443
20010430	17	18.88	16.95	**17.66**	95,402
20010531	17.75	18.4	17.28	**17.45**	35,140
20010629	**17.45**	**19.9**	**17**	**18.93**	**141,977**
20010731	18.9	19.23	16	**16.12**	56,757
20010831	16	16.8	13.79	**14.13**	40,617
20010928	14.1	14.88	13.52	**14.17**	15,547
20011031	14.01	14.15	11.57	**12.96**	16,515

Sheng Fang Da (000055)

Date	Open	High	Low	Close	Volume
20011130	13	14.05	11.3	**13.8**	28,092
20011231	13.98	14.4	13	**13.41**	104,045
20020131	13.39	13.5	9.8	**11.19**	61,378
20020228	11.18	11.82	10.96	**11.46**	27,282
20020329	11.4	13.3	10.91	**12.19**	124,858
20020430	12.19	13	11.5	**12.71**	46,410
20020531	12.7	12.9	11.08	**11.24**	27,428
20020628	11.12	14.18	10.68	**12.96**	102,930
20020731	12.93	13.18	11.75	**11.82**	37,748
20020830	11.93	12.1	11.38	**11.79**	24,024
20020930	11.87	12.28	11.18	**11.36**	29,469
20021031	11.4	11.43	9.51	**9.9**	56,603
20021128	9.8	10.44	7.7	**8.19**	43,753
20021230	8.48	11.2	7.81	**9.74**	432,102
20030131	9.52	12.48	9.22	**11.1**	379,484
20030228	11.29	11.62	10.52	**10.64**	95,541
20030331	10.61	11.79	9.47	**10**	64,483
20030501	10.05	10.87	7.9	**8.12**	122,583

Buyout date: Jun 2001

Correlation Coefficient	0.80959
Price % change after buyout within one month	-14.8%
Price % change after buyout to now	-57.1%
EPS % change one year after buyout	-208%

Aomedi

Aomedi (000527)

Date	Open	High	Low	Close	Volume
19990129	6.75	8.2	6.45	**7.67**	528,080
19990209	7.64	7.65	7.08	**7.54**	91,118
19990331	7.68	8.45	7.5	**7.68**	636,946
19990430	7.68	7.89	7	**7.1**	316,575
19990531	7.1	8.42	6.46	**7.9**	631,435
19990630	7.9	14.1	7.63	**12.99**	2,169,495
19990730	12.3	15.27	11.69	**12.89**	1,583,236
19990831	13	14.18	10.95	**11.28**	624,833
19990930	11.33	11.98	10.7	**11.26**	321,407
19991029	11.25	11.25	10.08	**10.43**	161,688
19991130	10.35	11.39	10.11	**10.8**	249,846
19991230	10.8	11.15	10.2	**10.51**	175,454
20000128	10.5	12.7	10.5	**12.27**	989,441
20000229	12.7	14.85	11.88	**13.18**	1,273,660
20000331	13.26	16.17	12	**15.07**	3,234,785
20000428	15.01	15.2	13.5	**14.06**	833,685
20000531	14.2	15.82	12.7	**14.94**	1,404,078
20000630	15	15.55	14.1	**14.96**	851,665
20000731	14.9	15.9	13.14	**15.05**	814,708
20000831	15.1	15.48	13.9	**14.03**	640,121
20000929	14	14.2	12.65	**12.87**	252,035
20001031	12.95	13.22	12.39	**12.49**	150,142
20001129	12.49	14.38	12.48	**14**	502,957
20001229	14	14.27	12.5	**13.39**	224,459
20010119	**13.39**	**13.79**	**12.85**	**13.09**	**200,097**
20010228	13.19	13.28	11.91	**12.41**	164,695
20010330	12.4	14.3	12.3	**13.71**	476,673
20010430	13.72	13.8	12.58	**13.24**	320,788
20010531	13	13.42	12.69	**12.73**	205,911
20010629	12.73	13.3	12.68	**12.75**	213,576
20010731	12.78	13.18	10.28	**10.3**	164,086
20010831	10.35	11.18	10.03	**10.52**	168,800
20010928	10.52	10.83	10	**10.08**	93,142
20011031	10.2	10.2	8.71	**9.42**	125,044
20011130	9.5	9.75	8.71	**9.58**	113,054

Aomedi (000527)

Date	Open	High	Low	Close	Volume
20011231	9.6	10.86	9.6	**10.12**	278,310
20020131	10.12	10.19	8.72	**9.74**	215,561
20020228	9.7	10.06	9.57	**9.86**	83,618
20020329	9.88	11.17	9.52	**9.65**	409,739
20020430	9.55	9.93	9.19	**9.53**	153,618
20020531	9.5	9.54	8.28	**8.32**	124,576
20020628	8.3	9.85	7.9	**9.6**	346,381
20020731	9.6	9.68	8.78	**8.8**	140,189
20020830	8.85	9	8.46	**8.7**	100,752
20020930	8.7	8.85	8.24	**8.28**	62,552
20021031	8.26	8.38	7.9	**8.07**	51,843
20021128	8.05	8.36	6.95	**7.3**	92,153
20021230	7.32	7.43	6.77	**6.78**	100,685
20030131	6.73	7.58	6.58	**7.36**	242,205
20030228	7.22	7.48	7.17	**7.19**	148,170
20030331	7.2	7.28	6.64	**6.91**	101,926
20030501	6.94	7.78	6.65	**6.8**	484,553

Buyout date Jan 2001	
Correlation Coefficient	0.93688
Price % change after buyout within one month	-5.1%
Price % change after buyout to now	-48.1%
EPS % change one year after buyout	-40%

Sheng Li Gu Feng

Sheng Li Gu Feng (000407)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
19990129	13.5	14.91	13.27	**13.46**	26,221
19990209	13.45	13.5	12.3	**12.6**	10,555
19990331	12.68	13.68	11.26	**12.61**	45,541
19990430	12.65	13.35	11.6	**11.89**	42,824
19990531	11.89	13.8	11.38	**12.9**	75,761
19990630	12.9	18.62	12.3	**17.34**	399,720
19990730	16.2	18	13.65	**13.82**	207,288
19990831	13.8	15.68	13.78	**14.55**	113,157
19990930	14.5	15.28	13.96	**14.28**	78,677
19991029	14.33	14.8	13.3	**14.52**	29,724
19991130	14.5	15.18	14	**14.82**	77,794
19991230	14.82	15.6	14.1	**14.46**	76,135
20000128	14.4	17.5	14.4	**16.91**	288,827
20000228	17.65	18.28	15.16	**15.3**	237,089
20000331	15.19	17.28	15	**16.2**	326,394
20000428	16.2	18.63	16	**16.96**	300,673
20000531	17.15	17.15	15.33	**16.33**	102,403
20000630	16.33	18.75	16.1	**18.22**	349,330
20000731	18.1	19.9	17	**17.21**	333,301
20000831	17.25	17.95	16.5	**17.09**	119,997
20000929	16.99	17.34	16.01	**16.6**	43,166
20001031	16.6	17	14.2	**15.7**	81,826
20001130	15.75	16.59	15.51	**15.95**	101,022
20001229	15.96	17.37	15.65	**16.91**	258,298
20010119	17.21	17.8	16.74	**17.79**	146,185
20010228	17.8	18	16.28	**17.72**	159,740
20010330	17.75	18.61	17.59	**18.14**	224,649
20010430	18.15	18.99	17.81	**18.28**	183,989
20010531	18.3	19.5	17.51	**17.71**	189,234
20010629	17.7	18.23	16.82	**17.45**	212,318
20010731	17.5	17.88	15.08	**15.13**	78,380
20010831	15.35	15.6	13.71	**14.46**	98,163
20010928	14.44	15	13.8	**14.2**	50,557
20011031	14.08	14.21	11.66	**12.88**	80,755
20011130	12.88	13.76	11.9	**13.73**	119,669

Sheng Li Gu Feng (000407)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
20011231	13.76	14.3	13.21	**13.8**	133,370
20020131	13.88	15.48	12.4	**14.6**	222,587
20020228	14.61	15.78	14.48	**15.07**	210,302
20020329	15.1	16.07	14.71	**14.85**	300,136
20020430	14.98	15.6	13.58	**14.29**	111,095
20020531	14.3	14.5	13	**13.33**	81,717
20020628	13.23	15.81	13	**14.87**	230,952
20020731	14.74	15.39	14.47	**14.47**	50,405
20020830	14.73	14.99	14.31	**14.79**	53,757
20020930	**14.65**	**14.9**	**13.9**	**14**	**47,120**
20021031	14.06	14.06	13.05	**13.56**	54,341
20021128	13.56	14.09	12.53	**13.09**	55,131
20021230	13.2	13.37	12.34	**12.37**	34,279
20030131	12.1	13.3	12	**13.26**	97,698
20030228	12.95	13.32	12.81	**13.11**	44,734
20030331	13.07	13.86	13.07	**13.67**	108,668
20030501	13.75	15.37	13.43	**14.5**	326,976

Buyout date: Sep 2002	
Correlation Coefficient	0.89541
Price % change after buyout within one month	-3.1%
Price % change after buyout to now	3.6%
EPS % change one year after buyout	-30%

Dong Ting Shui Zhi

Dong Ting Shui Zhi (600257)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
20000630	18.15	22.28	18.15	**20.97**	551,526
20000731	20.73	22.9	20.15	**20.84**	235,903
20000831	20.8	22.8	20.4	**21.81**	194,460
20000929	21.63	24.53	21.4	**22.29**	343,737
20001031	22.42	24.28	21.58	**23.07**	103,334
20001130	23	25.15	22.78	**23.42**	138,550
20001229	23.42	26.58	23.4	**26**	131,351
20010119	26.3	27.5	24.1	**25**	71,036
20010228	25	25	22.48	**23.2**	49,008
20010330	23.3	25.42	23	**25**	53,414
20010430	25	25.69	24.2	**24.36**	64,319
20010531	24.28	26.68	24.21	**26.65**	84,293
20010629	26.82	28.95	25.98	**27.55**	127,521
20010731	27.58	27.95	23.4	**23.58**	62,452
20010831	23.6	24.97	22	**22.39**	44,914
20010928	22.3	23.44	20.45	**20.63**	25,787
20011031	20.8	20.83	16.5	**18.91**	46,010
20011130	19.24	19.38	16.75	**19.38**	33,473
20011231	19.38	19.75	17.51	**19.33**	31,616
20020131	19.34	20.17	14.31	**16.53**	85,339
20020228	16.56	17.26	15.9	**17**	23,612
20020329	16.92	18.61	16.55	**16.6**	65,089
20020430	16.55	18.1	16.4	**17.97**	33,028
20020531	17.99	18	16	**16.41**	15,032
20020628	16.3	18.32	15.81	**17.53**	43,925
20020731	17.4	18.05	17.08	**17.35**	31,794
20020830	17.47	18.68	17.22	**18**	33,113
20020930	18	18.38	17.04	**17.09**	42,987
20021031	**17**	**17.15**	**15.82**	**15.84**	**27,104**
20021128	15.83	16.44	13.82	**14.86**	34,940
20021230	15.1	15.88	14.24	**14.36**	51,037
20030131	14.1	15.7	13.18	**15.5**	70,336
20030228	15.57	15.94	15.02	**15.63**	42,954
20030331	15.7	16.54	15.48	**15.83**	39,624
20030501	15.76	16.1	13.8	**13.93**	74,926

Dong Ting Shui Zhi (600257)					
Date	Open	High	Low	Close	Volume

Buyout date: Oct 2002		
Correlation Coefficient	0.89986	
Price % change after buyout within one month		-6.2%
Price % change after buyout to now		-12.1%
EPS % change one year after buyout		5%

Fu Shu Gu Feng

Fu Shu Gu Feng (000973)					
Date	Open	High	Low	Close	Volume
20000531	15.9	15.9	15.02	**15.51**	137,306
20000630	15.5	15.58	14.6	**14.8**	169,005
20000731	14.8	15.29	14.26	**14.74**	101,639
20000831	14.76	15.7	14.36	**14.89**	161,454
20000929	14.85	15.32	13.88	**14.19**	50,747
20001031	14.19	15.09	14.01	**14.62**	34,248
20001130	14.62	15.67	14.53	**15.2**	111,375
20001229	15.23	15.61	14.5	**15.17**	76,710
20010119	15.2	16.1	14.87	**15.27**	122,966
20010228	14.88	15.05	14.2	**14.7**	39,892
20010330	14.73	15.39	14.7	**15.33**	63,568
20010430	15.44	15.8	14.5	**15.06**	82,844
20010531	15.16	16.83	15	**16.74**	223,276
20010629	16.8	17.84	16.42	**16.82**	199,496
20010731	16.8	16.86	14.99	**15.09**	104,109
20010831	15.33	17.4	15.13	**15.8**	234,843
20010928	15.79	16	13.81	**13.96**	54,658
20011031	13.99	14	11.01	**12.95**	76,220
20011130	12.9	13.32	11.26	**13.31**	46,760
20011231	13.29	13.4	12.08	**12.88**	35,665
20020131	12.95	12.95	8.95	**11.26**	67,573
20020228	11.38	11.68	10.8	**11.2**	25,676
20020329	11.18	13.05	10.66	**12.13**	98,289
20020430	12.05	12.51	11.7	**12.34**	41,937
20020531	12.35	12.35	9.3	**9.6**	228,525
20020628	9.58	12.09	9.32	**11.07**	407,543
20020731	11.11	11.48	10.7	**10.7**	104,976
20020830	10.95	11.05	10.35	**10.77**	64,504
20020930	**10.7**	**10.89**	**10**	**10.09**	**36,114**
20021031	10	10.06	9.32	**9.46**	21,899
20021128	9.62	10.14	8.5	**8.94**	52,908
20021230	8.98	9.19	8.02	**8.25**	61,744
20030131	8.1	8.92	7.86	**8.8**	56,524
20030228	8.75	9.18	8.61	**9.06**	62,729
20030331	9.09	9.23	8	**8.45**	49,571

Fu Shu Gu Feng (000973)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
20030501	8.47	9.31	8.1	**8.22**	257,039
Buyout date: Sep 2002					
Correlation Coefficient				0.87493	
Price % change after buyout within one month					-6.2%
Price % change after buyout to now					-18.5%
EPS % change one year after buyout					41%

Te Bian Dian Gong

Te Bian Dian Gong (600089)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
19990129	13.5	15.2	13.21	**14.78**	66,231
19990209	14.66	14.66	13.9	**13.95**	8,383
19990331	13.95	17.06	13	**15.89**	187,240
19990430	15.6	19.98	15.2	**18.35**	200,615
19990531	18.19	19.46	17.1	**19.4**	266,651
19990630	19.5	27.83	19.3	**23.77**	591,403
19990730	22.82	37.7	21.39	**30.48**	392,968
19990831	30.2	30.2	24.5	**25.18**	216,436
19990930	25.15	28.3	24.18	**25.29**	187,582
19991029	25.11	25.19	20.5	**23.45**	61,715
19991130	23.45	23.45	21	**22.37**	81,550
19991230	22.4	23.3	21	**22.8**	50,044
20000128	22.6	26.3	22.1	**25.7**	208,226
20000229	26.48	29	23.6	**25.85**	663,714
20000331	25.5	34.88	24.8	**32.9**	1,208,457
20000428	33.2	34	19.18	**20.44**	618,845
20000531	20.6	20.78	17.38	**19.8**	226,244
20000630	19.8	20.39	18	**18.97**	230,955
20000731	18.9	19.5	18.25	**18.8**	153,806
20000831	18.81	20.98	18.49	**18.76**	413,912
20000929	18.61	19	17.41	**17.76**	96,745
20001031	17.8	18.22	16.68	**17.02**	82,251
20001130	17	18.12	16.8	**16.94**	156,200
20001229	16.95	17.1	16.5	**16.96**	87,578
20010119	16.96	17.48	16.68	**16.9**	64,665
20010228	16.9	16.9	14.38	**14.88**	59,907
20010330	14.9	15.89	14.61	**15.42**	93,563
20010430	15.42	15.81	14.8	**14.82**	99,827
20010531	14.82	15.54	14.5	**15.1**	85,470
20010629	15.12	15.73	14.85	**15.33**	93,527
20010731	15.35	15.8	14.09	**14.1**	77,912
20010831	14.01	14.58	12.45	**12.58**	35,627
20010928	12.5	13.38	11.55	**11.65**	29,701
20011031	11.68	11.8	9.12	**10.9**	48,625
20011130	10.78	11.58	9.65	**11.41**	62,439

Te Bian Dian Gong (600089)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
20011231	11.45	11.78	10.08	**10.43**	44,340
20020131	10.46	10.46	8.1	**9.35**	49,582
20020228	9.34	9.87	9.2	**9.27**	20,020
20020329	9.27	11.38	9.09	**10.29**	151,049
20020430	**10.19**	**10.67**	**9.8**	**10.5**	**97,047**
20020531	10.65	10.65	8.82	**8.93**	37,622
20020628	8.8	10.4	8.6	**10.32**	77,353
20020731	10.32	10.82	10.1	**10.15**	91,867
20020830	10.15	10.45	9.75	**10.29**	31,174
20020930	10.29	10.29	9.06	**9.68**	14,929
20021031	9.7	9.7	8.99	**9.11**	11,751
20021128	9.02	9.4	7.51	**7.94**	23,351
20021230	8.25	8.88	7.7	**8.04**	86,701
20030131	7.8	9.25	7.6	**8.69**	44,425
20030228	8.66	8.95	8.4	**8.69**	54,014
20030331	8.7	8.79	7.9	**8.53**	64,330
20030501	8.52	9	8.01	**8.24**	136,922

Buyout Date: Apr 2002

Correlation Coefficient	0.53406
Price % change after buyout within one month	-15.0%
Price % change after buyout to now	-21.5%
EPS % change one year after buyout	0%

Yu Tong Bus

Yu Tong Bus (600066)					
Date	**Open**	**High**	**Low**	**Close**	**Volume**
19990129	13.5	14.91	13.27	**13.46**	26,221
19990209	13.45	13.5	12.3	**12.6**	10,555
19990331	12.68	13.68	11.26	**12.61**	45,541
19990430	12.65	13.35	11.6	**11.89**	42,824
19990531	11.89	13.8	11.38	**12.9**	75,761
19990630	12.9	18.62	12.3	**17.34**	399,720
19990730	16.2	18	13.65	**13.82**	207,288
19990831	13.8	15.68	13.78	**14.55**	113,157
19990930	14.5	15.28	13.96	**14.28**	78,677
19991029	14.33	14.8	13.3	**14.52**	29,724
19991130	14.5	15.18	14	**14.82**	77,794
19991230	14.82	15.6	14.1	**14.46**	76,135
20000128	14.4	17.5	14.4	**16.91**	288,827
20000228	17.65	18.28	15.16	**15.3**	237,089
20000331	15.19	17.28	15	**16.2**	326,394
20000428	16.2	18.63	16	**16.96**	300,673
20000531	17.15	17.15	15.33	**16.33**	102,403
20000630	16.33	18.75	16.1	**18.22**	349,330
20000731	18.1	19.9	17	**17.21**	333,301
20000831	17.25	17.95	16.5	**17.09**	119,997
20000929	16.99	17.34	16.01	**16.6**	43,166
20001031	16.6	17	14.2	**15.7**	81,826
20001130	15.75	16.59	15.51	**15.95**	101,022
20001229	15.96	17.37	15.65	**16.91**	258,298
20010119	17.21	17.8	16.74	**17.79**	146,185
20010228	17.8	18	16.28	**17.72**	159,740
20010330	17.75	18.61	17.59	**18.14**	224,649
20010430	18.15	18.99	17.81	**18.28**	183,989
20010531	18.3	19.5	17.51	**17.71**	189,234
20010629	**17.7**	**18.23**	**16.82**	**17.45**	**212,318**
20010731	17.5	17.88	15.08	**15.13**	78,380
20010831	15.35	15.6	13.71	**14.46**	98,163
20010928	14.44	15	13.8	**14.2**	50,557
20011031	14.08	14.21	11.66	**12.88**	80,755
20011130	12.88	13.76	11.9	**13.73**	119,669

Yu Tong Bus (600066)					
Date	Open	High	Low	Close	Volume
20011231	13.76	14.3	13.21	**13.8**	133,370
20020131	13.88	15.48	12.4	**14.6**	222,587
20020228	14.61	15.78	14.48	**15.07**	210,302
20020329	15.1	16.07	14.71	**14.85**	300,136
20020430	14.98	15.6	13.58	**14.29**	111,095
20020531	14.3	14.5	13	**13.33**	81,717
20020628	13.23	15.81	13	**14.87**	230,952
20020731	14.74	15.39	14.47	**14.47**	50,405
20020830	14.73	14.99	14.31	**14.79**	53,757
20020930	14.65	14.9	13.9	**14**	47,120
20021031	14.06	14.06	13.05	**13.56**	54,341
20021128	13.56	14.09	12.53	**13.09**	55,131
20021230	13.2	13.37	12.34	**12.37**	34,279
20030131	12.1	13.3	12	**13.26**	97,698
20030228	12.95	13.32	12.81	**13.11**	44,734
20030331	13.07	13.86	13.07	**13.67**	108,668
20030501	13.75	15.37	13.43	**14.5**	326,976
Buyout date: Jun 2001					
Correlation Coefficient				0.89541	
Price % change after buyout within one month					-13.3%
Price % change after buyout to now					-16.9%
EPS % change one year after buyout					9%

Sheng Zhen Index

Sheng zhen Index

Date	Open	High	Low	Close	Volume
19990129	2,945.23	2,987.26	2,823.62	**2,920.39**	80,853,809
19990209	2,917.94	2,942.33	2,705.54	**2,755.30**	17,721,163
19990331	2,760.55	2,949.29	2,744.16	**2,872.15**	117,309,397
19990430	2,870.09	2,987.41	2,739.62	**2,793.45**	160,580,087
19990531	2,793.20	3,352.55	2,521.08	**3,270.34**	208,208,090
19990630	3,277.05	4,896.04	3,239.04	**4,702.77**	508,601,799
19990730	4,669.77	4,669.77	3,628.55	**4,045.35**	315,567,248
19990831	4,075.14	4,225.33	3,861.15	**4,154.20**	190,487,726
19990930	4,158.02	4,318.04	3,951.09	**3,967.08**	122,218,341
19991029	3,963.07	3,967.27	3,598.74	**3,742.01**	94,053,153
19991130	3,742.62	3,811.32	3,525.76	**3,533.98**	121,865,057
19991230	3,530.03	3,632.05	3,284.79	**3,369.61**	71,661,017
20000128	3,374.11	3,952.41	3,360.21	**3,952.41**	249,265,475
20000229	4,102.65	4,685.48	4,039.87	**4,484.16**	333,163,195
20000331	4,468.97	4,635.67	4,100.78	**4,532.31**	483,522,956
20000428	4,523.90	4,685.38	4,381.85	**4,683.17**	310,891,774
20000531	4,708.53	4,736.72	4,275.86	**4,643.15**	220,673,030
20000630	4,665.01	4,875.05	4,665.00	**4,830.67**	211,336,900
20000731	4,806.47	4,905.51	4,697.96	**4,894.13**	0
20000831	4,900.54	5,062.29	4,707.05	**4,826.30**	0
20000929	4,800.59	4,842.36	4,424.01	**4,524.70**	0
20001031	4,534.85	4,654.71	4,448.20	**4,573.22**	0
20001130	4,573.23	5,011.03	4,572.60	**4,829.99**	113,259,415
20001229	4,836.63	4,869.91	4,652.22	**4,752.75**	222,765,942
20010119	4,756.18	4,849.25	4,610.27	**4,743.36**	151,616,741
20010228	4,754.24	4,764.64	4,318.52	**4,453.14**	111,597,310
20010330	4,455.15	5,037.51	4,455.15	**4,965.98**	325,769,041
20010430	4,976.97	5,091.45	4,765.01	**4,802.59**	359,387,275
20010531	4,810.90	4,929.26	4,784.89	**4,857.46**	255,969,052
20010629	4,862.19	4,874.79	4,632.20	**4,716.89**	246,532,078
20010731	4,720.37	4,733.32	4,043.80	**4,059.00**	195,700,294
20010831	4,069.10	4,177.95	3,782.53	**3,860.21**	162,623,951
20010928	3,861.97	3,993.22	3,468.96	**3,498.62**	159,775,817
20011031	3,490.27	3,615.15	3,124.57	**3,438.52**	160,800,293
20011130	3,445.95	3,514.03	3,146.75	**3,513.75**	52,623,548

Sheng zhen Index

Date	Open	High	Low	Close	Volume
20011231	3,521.27	3,613.71	3,245.50	**3,325.66**	13,434,297
20020131	3,319.20	3,319.25	2,661.90	**2,982.69**	14,280,970
20020228	2,987.67	3,104.37	2,944.26	**3,029.49**	8,427,251
20020329	3,022.35	3,393.44	2,969.81	**3,173.90**	31,283,039
20020430	3,161.10	3,275.91	3,082.33	**3,253.46**	16,290,352
20020531	3,255.02	3,267.01	3,014.67	**3,037.00**	12,590,455
20020628	3,028.03	3,575.87	2,948.71	**3,551.33**	31,143,658
20020731	3,556.53	3,586.06	3,396.67	**3,406.54**	23,322,080
20020830	3,434.49	3,499.68	3,358.57	**3,436.84**	12,119,872
20020930	3,438.18	3,465.07	3,236.22	**3,243.93**	10,431,728
20021031	3,227.46	3,227.46	2,989.78	**3,036.18**	8,961,368
20021128	3,035.84	3,189.14	2,757.70	**2,876.89**	16,693,118
20021230	2,919.09	2,938.85	2,744.65	**2,771.02**	15,354,965
20030131	2,743.21	3,069.12	2,673.25	**3,051.22**	23,657,128
20030228	3,045.01	3,082.36	2,980.86	**3,054.33**	15,895,984
20030331	3,058.27	3,100.97	2,954.08	**3,097.28**	16,727,938
20030501	3,105.28	3,525.87	3,092.63	**3,260.75**	62,373,030

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