Strategic Transformation of Diversified Development of Large Energy State-owned Enterprises in China

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Keywords: Diversification, SOEs, Strategic Transformation.

Abstract. In China, large energy SOEs are generally engaged in diversified business, and it is urgent to study their business transformation strategies under the diversified business framework. Based on the three key factors of “what to do, how to do it, how to manage it”, there are three feasible modes of the development strategy of diversified for the SOEs, namely the internal expansion “wheel”, the open “wheel” and the open “track”, and further propose the corresponding transformation path.

Introduction

In China, large energy SOEs are almost all diversified. Zhu Jiang (1999) believes that diversification can reduce business risks and the large fluctuations in profit levels. Xie Peihong et al. (2008) believe that because China's economy is still in a period of transition, transaction costs are high, and the business environment faced by enterprises is highly uncertain, leading to a strong driving force for diversified businesses. Chen Xinyuan et al. (2007) pointed out. Even SOEs can only lead to diversification if they are only considered for political and social goals. As can be judged, diversification will still become an important development model for large enterprises.

For China's energy SOEs, there are certain practical constraints on the development of diversification. First, monopolistic business is a strategic business that the central government must vigorously develop. Secondly, SOEs are required to develop strategic emerging industries. Finally, monopolistic business also needs to strengthen business attributes, making more economic benefits. Therefore, under the special constraints, the development of diversified business of energy SOEs in China is a problem worthy of further study.

Key Factor Analysis

To study the diversified business strategy of China's large energy SOEs, the core is to answer three key questions, namely: What to do? How to do it? How to manage?

Key Factor 1: What to Do?

The core business of energy SOEs is monopolistic business, which is strategically important to the national economy and national security, and cannot be abandoned. Therefore, its diversified business are divided into two types:

Strong Synergistic Business. The business has a close relationship with the monopoly business in the industrial chain, it has the dual functions of supporting monopoly business and profit creation. The range of such services is relatively limited.

Weak Synergistic Business. The business has a weak relationship with the monopoly business in the industrial chain, it is purely a profit creation orientation.

Key Factor 2: How to Do It?

When a company enters a business area, it generally includes two methods:

Self-built. The company relies on its own resources to set up a new company to engage in new business. The advantage of this approach is that it can make full use of existing resources and be proactive. The shortcoming is the lack of scarce resources such as technicians. It is difficult to break
through the inherent limitations of thinking and institutional constraints, and the startup business faces many risks of cultivation.

**Mergers and Acquisitions.** It chooses to directly acquire a company engaged in the business in the market, thereby indirectly entering the business field. The advantage of this method is that it is beneficial to make full use of the high-quality resources of the society, reduce the initial risk, realize the rapid entry and eliminate potential competitors. The disadvantage is that there is a risk of M&A. Whether the success depends on the company's vision and capital strength, and negotiations with the innovation team or shareholders may also fail.

**Key Factor 3: How to Manage?**

There are three main types of control methods:

**Operational Control.** The group is involved in the day-to-day operations of its holding subsidiaries, subcompany only responsible for executing decisions.

**Strategic Control.** Maintaining the independent operation of the holding subsidiaries, carrying out strategic control over the holding companies to serve the overall strategy of the group.

**Financial Control.** It is the fundamental purpose to maintain the independent operation of the holding or share-holding subsidiaries, to maximize profits through capital operation. It does not involve the production and operation of enterprises.

**Diversified Business Development Strategy**

Based on rationality and scientific considerations, in the long run, there are three feasible solutions for the diversified business development strategy of energy SOEs, namely the internal expansion “wheel” scheme, the open “wheel” strategic scheme and the open “track” scheme.

**Option 1: The Internal Expansion "Wheel"**

The main feature is that, in terms of business layout, surrounding the traditional monopoly business, it is only engaged in competitive business with strong synergies; it adopts self-construction in the development mode, that is “starting from scratch” In the control method, take strategic control (Figure 1).

![Figure 1. Schematic diagram of the internal expansion "wheel".](image)

**Option 2: The Open "Wheel"**

The characteristic is that, in the business layout, only competitive business with strong synergy is engaged, in the development mode, both self-built and M&A methods are adopted. in the form of management and control, strategic control is implemented. However, in the process of M&A new business, only carry out shareholding and financial control as the initial condition is not mature. Once the conditions are mature, additional investment will be continued to achieve holding and strategic control.
Option 3: The Open “Track”

The characteristic of this kind of scheme is that in the business layout, the business with strong or weak coordination with the monopolistic business is involved. In terms of development methods, self-construction or mergers and acquisitions are adopted for strong synergistic businesses, and mergers and acquisitions are adopted for cooperative weak businesses. In terms of management and control methods, strategic management is adopted for strong synergistic business; financial management and control is implemented for collaborative weak business, and the capital operation principle of “low buy and high sell” is followed. However, for the strong synergistic business, in the process of merger and acquisition, when the initial conditions are not mature, only shareholding and financial control can be carried out; once the conditions are mature, additional investment will be continued to achieve holding and strategic control.

Each of the three schemes has its own advantages and disadvantages. It cannot directly compare horizontally. It is closely related to the development stage of the enterprise and the corresponding boundary conditions. It should be judged according to the boundary conditions when selecting.
Table 1. Comparison and Selection of Strategic Plan for Diversified Business Development of large energy State-owned Enterprises.

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Advantages and disadvantages (importance)</th>
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<tbody>
<tr>
<td>The internal expansion &quot;wheel&quot;</td>
<td>Advantages: similar to the current development model, the transition is easy (strong). Disadvantages: ① subjected to the limited resources of the enterprise, the expansion speed is slow (strong). ② high risk of failure in the initial period (strong). ③ passive when dealing with competitors (general). ④ lack of profitable &quot;hematopoietic&quot; business (general).</td>
</tr>
<tr>
<td>the Open &quot;wheel&quot;</td>
<td>Advantages: ① rapid expansion by M&amp;A (strong). ② through M&amp;A, obtain scarce resources (strong). ③ eliminate competitors in the initial stage through M&amp;A (strong). ④ similar to the current development model, the transition is easy (general). Disadvantages: lack of profitable &quot;hematopoietic&quot; business (strong).</td>
</tr>
<tr>
<td>the open &quot;track&quot;</td>
<td>Advantages: ① rapid expansion by M&amp;A (strong). ② through M&amp;A, obtain scarce resources (strong). ③ collaborative weak business can contribute profits (strong). ④ eliminate competitors in the initial stage by M&amp;A (strong). ⑤ Low cost and quick exit from collaborative weak business (strong). Disadvantages: ① policy may continuously restrict the development of synergistic weak business (strong). ② policy may restrict the implementation of capital operations in the company on policy (strong).</td>
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Strategic Transformation Path for Diversified Business Development

The strategic transformation of diversified SOEs' diversified business needs to implement a "step-by-step" strategy. First, the medium-term internal expansion "wheel". In the long-term, the transition to the open "track" mode. The final transition to the open "wheel" mode. However, each transition needs to meet certain boundary conditions, and strategic transformation measures are needed.

Mid-term Transition: An internal Expansion "Wheel" Mode

The boundary conditions are that the reform of the state-owned assets management system has made significant progress, and the policy of monopolizing state-owned enterprises engaged in competitive business has been loosened. The transformation measures are to divest synergistic weak business, reform the existing management and control model, set up an investment platform for sub-business segments, implement strategic management and control; implement market-oriented transformation, and advance toward the goal of building a modern enterprise system.

Long-term Transition: An Open "Track" Model

The boundary condition is that the policy allows monopoly of state-owned enterprises to engage in non-related competitive business, allowing restructuring into investment companies and capital operations. The transformation initiative is to set up an investment company consisting of venture capital, industrial funds, etc. to adapt to different stages of growth of the enterprise, and to form a capital operation platform for capital operation of the cooperative weak business.

Final Mode: An Open "Wheel" Mode

The boundary condition is that a new industrial revolution has taken place and a huge breakthrough has been made in the development of strategic emerging industries. The transformation initiative is to divest synergistic weak business, focus on synergistic business, and build a business "ecosystem" around monopolistic business.

Main Conclusions

It is an inevitable trend for large energy SOEs to implement diversified business strategy transformation. This paper proposes three feasible diversified business strategy models, namely, the internal expansion "wheels", the open "wheel" and the open "track", focusing on the three key
factors of “what to do, how to do it, how to manage it”. Furthermore, it proposes the strategic transformation path of diversified business of energy state-owned enterprises in China, namely: the transition to the internal expansion “wheel” mode in medium-term, the transition to the open “track” mode in the long-term, and finally the transition to the open “wheel” mode.

Acknowledgement

This paper was financially supported by the State Grid Corporation headquarters science and technology project “Corporate business classification evaluation method and development potential analysis research adapted to state-owned enterprise reform” (Project No.: XM2017020014660).

References

