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West China Management Cases

Canada-China University Industry Partnership Program (CCUIPP)



北京大学出版社
PEKING UNIVERSITY PRESS



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PREFACE

The Canada-China University Industry Partnership Program (CCUIPP) was a cooperative project involving the Chinese Ministry of Education, the Faculty of Management of McGill University and the Canadian Association of Graduate Management Schools. It was established under an agreement between the Canadian International Development Agency (CIDA) and China's Ministry of Foreign Trade and Economic Co-operation. The financial support for CCUIPP was provided primarily by CIDA and in part by the academic institutions and industries that participated in the activities. The goal of the project was to promote economic reform in the telecommunications, financial services and energy sectors. It achieved this goal through improving management methods, promoting Canadian and Chinese university-industry partnerships and networks and strengthening the capacities of universities to serve the management needs of these sectors. The main components of the project were university-industry partnerships and national activities including applied research, conferences, workshops and case writing.

In the early days of the project, the activities were centered in Shanghai, Wuhan and Xiamen. However in the last two years a major effort was made to extend the project to the universities and industry of Western China. This was achieved by linking the three initial universities, Huazhong University of Science and Technology, Shanghai Jiaotong University and Xiamen University with schools in the west. Together, each partnership worked with companies in Western China to research and write the business cases contained in this text. Their work was supported by workshops on case writing and case review sessions provided by the project. Each partnership also benefited from the support of a Canadian academic advisor. This initiative will provide both students and academic researchers in Canada and China a unique inside view of the major problems of Western Chi-



nese companies in a wide range of industries.

An activity such as this requires the contribution and participation of many organizations and individuals including academics, administrators and managers. Although it is not possible to recognize every contribution some should be acknowledged. The project would particularly wish to thank those companies that opened their doors to the researchers and were so generous with their time and data. As well, on the Chinese side, Jin Wei, Shanghai Jiaotong University, Jianqiao Liao, Huazhong University of Science and Technology, and Shen Yi Feng, Xiamen University played an important role in organizing and conducting the research. They were given significant support from Ilan Vertinsky, the University of British Columbia, Rejean Dupre, Concordia University, and Taieb Hafsi of Hautes Etudes Commerciales. Sylvain St. Amand, Executive Director of the Centre for International Management Studies at McGill, played an important role in the development of the extension to the project and to its implementation. We hope that the results of their efforts will provide an important addition to university research and teaching programs.

Wallace Crowston

Project Director

The Centre for International Management Studies

McGill University

August, 2004



CONTENTS

Chongqing Department Store Co., Ltd.	(1)
Taiji Group Co., Ltd.	(18)
Sichuan Claster Aircraft Engine Maintenance Co., Ltd.	(58)
The Compensation Plan of JingLong Co., Ltd.	(78)
Strategic Choices of Bluesky Co.	(102)
Minsheng Co.	(129)
MG Dairy Company	(162)
Honghe (Red River) Cigarette Factory	(185)
CRSB Materials Supply Corporation	(195)
A Comprehensive Analysis of Consumption Custom and Market Research	
—Northwest Branch Paper Mills, Inc.	(209)
The No.1 Dairy Business of Xinjiang	
— “MT Company”	(217)
Sichuan Feihong Bearing Co., Ltd.	(230)
CIMS Engineering of the Southwest Diesel Factory	(246)
Expanding Strategy of Chengdu Tanyutou Investment Co., Ltd.	(265)

Chongqing Department Store Co., Ltd.*

Yifeng Shen

(Xiamen University)

Xing Liu

(Chongqing University)

Yali Tang

(Chongqing University)

Min Xiao

(Xiamen University)

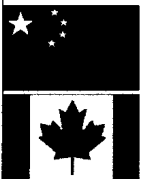
Yuanyan Wu

(Xiamen University)

The Company

The garden atop the headquarters Mansion of Chongqing Department Store Co., Ltd. (hereinafter referred to as Chongqing Department Store) commands a clear view of Chongqing Liberation Monument dozens of meters away — a landmark structure of Chongqing Municipality. With the

* This case is sponsored by CCUIPP. Some data have been disguised solely as basis for class discussion and the case is not intend to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.



swift changes of the world, the Liberation Monument has lost some of the political significance that it carries; however, its status as the center of Chongqing Municipality has remained intact. In the vicinity of the Liberation Monument now stand rows upon rows of skyscrapers around which pedestrians rub their shoulders in this booming town, reflecting the importance of Chongqing as the hub of business, transportation and culture in China's southwest region. Originally named Jiangzhou and later renamed Bazhou or Chuzhou, Chongqing adopted the name of Yuzhou during the reign of Emperor Wendi of the Sui Dynasty in 581 AD; hence the abbreviation of Yu for Chongqing. In 1189 AD, Emperor Guangzong of the Song Dynasty ascended the throne, calling it an occasion of "double festivities" and upgraded the apanage to Chongqing Prefecture; hence the name of Chongqing (meaning "double festivities"). Located on the upper reaches of the Yangtze River, Chongqing is an important juncture in the Yangtze River economic zone and the central and China western economic zone and a super-large city integrating commerce, industry, communications and culture. With abundant resources, ample energy, convenient transportation facilities, rich human resources, strong consumer spending and brilliant market prospects, Chongqing has become a leading business and trade center in the southwestern region and is rapidly emerging as a key area in China's accelerated development of the economy in the central and western areas, as well as a hot destination of overseas investment and investment by China's more prosperous eastern region in the hinterland. Furthermore, as the core city in the Three Gorges reservoir area, Chongqing serves as the port of distribution for materials and personnel for the Three Gorges Project.

The headquarters building of Chongqing Department Store is located at the heart of Yuzhong District, the most dynamic and vibrant downtown area of Chongqing (see Figure 1). Founded on May 1, 1950 on the basis on its antecedent, Gem Tongxing Industries Co., Ltd., which was a leading business in the southwest region, Chongqing Department Store became the first state-owned department store following the liberation of Chongqing in November 1949. In the 1950—60s, Chongqing Department Store, with the mottos of "strenuous efforts, hard work, cost-efficient





Figure 1 Location of Chongqing Department Store Co., Ltd

operation, civilized trading and quality service," was a huge success story. In 1959, Chongqing Department Store was represented at the All-China Heroes Assembly and was honored as one of the "100 red flags" of the nation and became a showcase of the commercial sector of the city. In 1974, it was listed by the then Ministry of Commerce as one of the top 10 departments stores of the nation. Following the 3rd plenary session of the 11th Congress of the Chinese Communist Party, the company embarked on a series of reforms. Through a decade of reforms, Chongqing Department Store has successfully reconsolidated its strengths and overhauled its operating system, eventually allowing it to triple its sales revenues and to tremendously improve its social and economic benefits; as a result, it has developed into the largest integrated department store in Chongqing in terms of size of operations and has been fondly dubbed by residents in this mountainous city a "window" on the industrial products market of Chongqing. In 1990, it was listed by the State Bureau of Statistics as one of the 26 best-performing stores in China and designated by the All-China Labor Union as a corporate recipient of the May 1 Labor Medal. In 1992, it was awarded the prestigious title of an outstanding collective and received the May 1 Labor Certificate of Merit; in the same year, it was included by the then Ministry of Commerce on the list of the nation's top 100 retailers and top 100 best-performing stores; it was the only store in the southwestern re-



gion to win the two tiles at the same title. At present, its core business covers general merchandise, hardware, electric appliances, sundry goods for everyday use, furniture, metering and measuring devices, labor protective equipment, artware (including gold and silver jewelries), grains, oil and their products, non-staple food, other food, and retails of tobacco and wine; its sideline includes paints, general machinery, chemical products, chemical raw materials (not including hazardous substances), building materials, commodities catering to overseas Chinese and state-controlled commodities. Major business modes of the company include retails, wholesales, commissioned purchase and commissioned sales.

In 1992, as the Chinese economy commenced an extensive transformation from the system of a planned economy to the system of the market economy, the interests of the central government and local governments underwent readjustments; Chongqing Department Store, with no exception, embarked on the ruthless course of going public. June of the same year, approved by the File No. 51 of Chongqing Committee of Economic System Reform (1992), Chongqing Department Store, as sole sponsor, was authorized to issue stocks by private placement. And its original operating assets with an appraisal value of RMB 543.582 millions yuan was converted into 420 million state-owned shares and the remaining was entered into capital surplus account. In addition, the company issued 48 million shares held by legal institution and 30 million shares held by employee at the price of 1.5 yuan per share by private placement, 117 million yuan altogether. The total number of shares of the company was 120 million.

July 2, 1996, 30 million shares held by employee and some held by legal institution were listed and traded in Shanghai Stock Exchange. The relevant information of this issuance in 1996 were as follows:

- (1) Stock type: Common stock
- (2) Par value: RMB 1.00 /share
- (3) Issuing price: RMB 1.50/ share
- (4) Underwriting period: From June 25, 1992 to July 10, 1992
- (5) Number of subscribers: 11583, 9091 of whom held at least 1000

shares.



- (6) Target Subscribers: Employees and legal institution
- (7) Principal underwriter: Chongqing Security Company
- (8) Participating underwriters: China Security Co. LTD, China Southern Security Co. LTD and Chongqing Security Company
- (9) Stock registration institution: SSCCRC Shanghai Security Company of Central Registration & Clearing
- (10) Issuance date: July 2, 1996
- (11) Stock code: 600729
- (12) Listing place: Shanghai Stock Exchange

"We're in a twilight industry; the general merchandise sector is characterized by cut-throat competition; if we fail to stay a step ahead of our competitors, we will soon end up like the ancient town of Ciqikou." Mr. Zhang, Chief Accountant of Chongqing Department Store, was frank about the situation. Outside of the window of his spacious office a number of new department stores are rapidly rising above the ground, including the Metropolitan Plaza, Time Square, Pacific Department Store and New Chongqing Plaza. Thanks to a popular novel entitled *The Red Rock*, many people are aware of Ciqikou, a place name. In the novel, a communist party member under the alias Hua Zhiliang was imprisoned in Zhazi Cave but managed to cheat the guard and escape from prison by disguising as a lunatic. He boarded a ship at the ancient ferry of Ciqikou and eventually reached the revolutionary base north of the Jialing River. Ciqikou, an ancient town with a history of a millennium, was once a hustling and bustling place where "huge throngs of people rubber shoulders with one another during the daytime and thousands of lamps turned the town into a sea of light at nightfall". However, "fortune comes and goes"; when the pier was relocated to Hanyu Road in 1958, Ciqikou lost its status as a distribution port and transit center, and business activities in the town suffered a rapid decline. The present-day Ciqikou attracts only tourists in an aesthetic mood. On an afternoon in the depth of winter, in the flowing music of Sichuan bamboo instrument, a stroll along the lanes paved with flagstones, a saunter around the classic, elegant, winding neighborhoods, narrow alleys and architectures of the Ming and Qing dynasties, an appreciation of



the traditional handicrafts such as embroidery. A long and steep stone ladder steps towards the river, and this stone ladder was screened in a famous film “Zhou Yi’s train” in the year of 2002. And a trip to the temple fair may trigger nostalgic feelings for the bygone glory, and more importantly, and an overwhelming emotional stirring for the evanescence of the worldly affairs.

Since its transformation to a joint-stock limited liability company, Chongqing Department Store has proactively implemented the strategic guidelines of “consolidating the core business, developing sidelines, promoting multiple modes and expanding the market share”. In September of 1993, approved by the board of directors and voted by the shareholders’

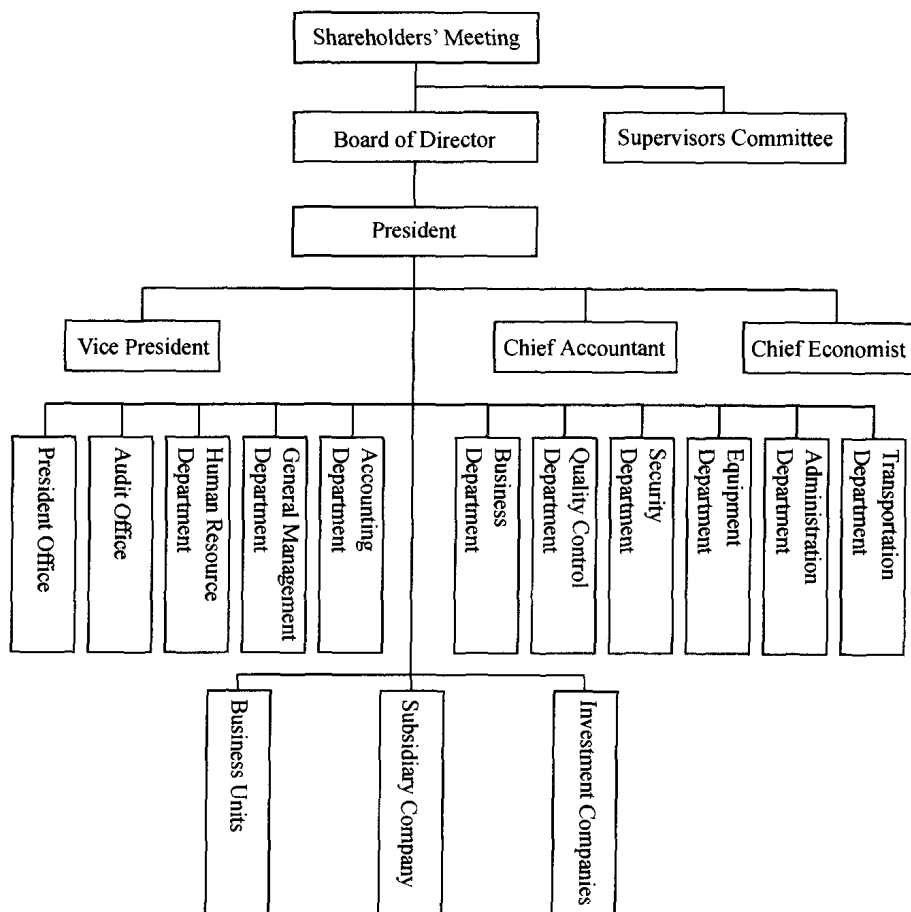


Figure 2 Chongqing Department Store's Organization Structure

meeting, Chongqing Department Store signed the merge agreement with Chongqing Women & Children's Store in the way of bearing the latter's debts. In December a year later, the company reached the merge agreement with Chongqing Children's Clothes Factory by way of buying and bearing its debt. Chongqing Electronic Equipment Manufacturer at the end of 1997. Besides, branches of Chongqing Department Store bloomed up in the adjacent areas. The company began its expansion with the investment on Beibei Store and Chongqing Baihui Food Supermarket — the largest professional food supermarket throughout the whole country. Then Jiangbei Store and Jiulong Store in 1996; Nanfeng Store and Shuangqiao Store in 1997; Shapingba Store in 1998; Changshou County Store, Bishan Store and Hechuan Store, beyond the territory of Chongqing, in 2000; and Yongchuan Store Wanzhou Store Tongliang Store in 2001. Besides stores, its investment also involved other sectors, such as Longxi County Bases in Jiangbei District, Chongbai Hotel, Baifa Real Estate Agency, Baisheng Automobile Trading Company, Baijia Advertising Agency, Baitong Shipping Office, Chongqing Dengkan Mouth Cares Company Ltd. and Chongbai Food Development Co, Ltd., and etc..

Capital Structure

"It's beyond all doubts that we need bulk of funds to back up our swift development. The plight confronting Chongqing Department Store was the shortage in capital " Treasurer Zhang said without preamble. Then, he continued to enumerate for us the investments over the years 1993—2000, "It is expect that by the end of 2001 company will have arranged for a total investment of 757 million yuan, plus the paid cash dividend of 283 million yuan, the cash outflow came to 8.89 times that raised in 1992."

"Then, there is a phenomenon, we feel very strange. During the years 1996—2000, company's financial statements exhibited an always zero balance in the items of long-terms debt and long-term bonds. The account indicated that actually this long-term loan had come from the merge



agreement by bearing the debt of Chongqing Electronic Equipment Manufacturer, with an interest rate of 5.04%. Subject to the Chongqing Merger Regulation, Chongqing Department Store was not necessary to pay the interest since 1998. The principal of debt would be paid back within 5 to 7 years. Hence, Chongqing Department Store was actually carrying out zero long-term liability policy. Additionally, Chongqing Department Store was one of the public companies that kept declaring and paying dividends every year. Alone in the years 1998—2000, Chongqing Department Store declared and paid cash dividend of 0.25yuan, 0.33 yuan, 0.27 yuan per share respectively, totally 103 million yuan. Whether so, we can reckon it as an attempt to keep a specific capital structure.”

“From the financial statements of last three years, one might observe that the company kept its debt-asset ratio at about 60%. The company depended more on the investment returns, retained earnings, trade credit, and etc. to finance its new projects.” Treasurer Zhang continued, “compared with our peers who were of an average debt-asset ratio of 50%, we were in a disadvantageous edge, but this was out of our control”.

“Why not consider right offerings? Not only could it raise the funds wanted, but also improved the capital structure.” on the way to Chaotianmen Pier. I burst out this question, feeling unwise afterward. It seemed as the first choice to many MBA students! “A further knowledge about the company’s ownership structure would benefit our analysis.” Independent director of Chongqing Department Store, Meng replied calmly. Our car sped along the Jialing River. In the depth of winter, the Jialing River was in the dry season of February, laying bare vast stretches of the sandbank, rocky shoal and riverbed; even the water line on the mossy embankment was visible. The Jialing River flowed northwestwards to Chongqing, traversing Beibei District, Yubei District, Shapingba District, Jiangbei District and Yuzhong District on the way, and making three turns before eventually flowing from west to east into the trunk stream of the Yangtze River at Chaotianmen Pier. “The capital structure policy of one company is nevertheless decided by its ownership structure. Ownership structure is dominating over the company.” Our colleague from Chongqing University



make a good comment. On a certain afternoon of the winter, we stood together at Chaotianmen Pier, looking at the flowing Jialing River and the tranquil approaching Yangtze River water. Under the hazy sky, the two rivers converge into a boundless stretch of water as part of the Yangtze River that flows eastwards.

Right Offering and Ownership Structure

“Dating from the transformation, the company’s ownership structure has been dominating the capital structure. In the bright and spacious office, Treasurer Zhang continued speaking with assurance.”

“In June of 1992, Chongqing Department Store, as a sole sponsor, transformed into a corporation. And its original operating assets was converted into 420 million government-owned shares, held by Chongqing Huamao State-owned Assets Management Company Ltd. (hereinafter referred to as Chongqing Huamao), the subordinate of Chongqing Trade Committee, accounting for 35 % of total shares. Till then, Chongqing Huamao became the major large shareholder of Chongqing Department Store. The Yuzhong District subbranch of Chongqing Construction Bank of China, the Yuzhong District subbranch of Chongqing Agricultural Bank of China and Chongqing Silver Bridge Trade Service held 1.67 % respectively, as the second large shareholder. When listed in July 1996, the company converted 30 million shares held by employee into tradable A share common stocks, no change occurred to the total number of shares, Chongqing Huamao still the major large shareholder. On April 1997, the 1996 annual shareholders’ meetings approved to distribute stock dividends at the rate of 7:10, rising the total number to 204 million. Meanwhile, based on this number of shares, the company launched its first right offering plan. The share distribution quota was 10:3 with right offering price setting between 5—8 yuan. All moneys from this right offering would be directed to the development of chain stores and convenient stores in Chongqing area. State Ministry of Finance gave a written approval, “NMF Release No.6 (1998)”, on the company’s application for the right offerings, valid within half a year. Where-





as Chongqing Huamao, the major large shareholder played a negative role in the course of Chongqing Department Store first right offering. The arguments of both sides focused on the asset assessment of Chongqing Friendship company Ltd. (hereinafter referred to as Chongqing Friendship), a subordinate of Chongqing Trade Committee.

In March of 1999, Chongqing Department Store and Chongqing Huamao reached an agreement entitled "An Agreement on Trust State Owned Assets of Chongqing Friendship to Chongqing Department Store". In this agreement, it was quite clear that the state-owned assets of Chongqing Friendship were destined as cash-equivalence paid for pending right offering. However, the assets valuation of Chongqing Friendship was performed by Chongqing Auditing Office, solely responsible for Chongqing Huamao, Chongqing Department Store demurred at the auditing result which appeared quite beyond reasonable.

January 2000, the Chongqing Trade Committee. declared the discontinuation of the Trustee Agreement by CTC Document No. 5 [2001], without any notification. In consequence, it terminated the company first effort on the right offering. When the proposal raised again in the Shareholder's meeting, because large number of minority stockholders were absent and Chongqing Huamao exerted the right of waiver, it was voted down. Zhang seemed reluctant to recall the past, stand up and placed some documents in front of us from his huge but tidy bookcase.

"It was in the same year that Chongqing Huamao transferred its shares to Chongqing Bridge Limited company(hereinafter referred to as Chongqing Bridge)?" we changed a topic. "Exactly," Zhang affirmed, "the right number was 34.68 million state-owned shares. After the transaction, Chongqing Huamao held 18% of the company's shares, Chongqing Bridge owned 17.17% and Southwestern Security Company managed to get 1.25% of shares. Abstracting from the truth that Chongqing Bridge and Southwestern Security Company were actually dominated by Chongqing National Investment Company, one might fall into the trap of arguing that Chongqing National Investment became the major large shareholder of Chongqing Department Store."