Honor Thy Creditors Beforan Thy Shareholders: Are the Profits of Chinese State-Owned Enterprises Real?

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Summary

The Chinese state owned enterprises (SOEs) have become quite profitable in recent years. As the largest shareholder, the state has not asked SOEs to pay dividends in the past. Therefore, some have suggested that the state should ask SOEs to pay dividends. Indeed, the Chinese government has adopted this policy advice and started to demand dividend payment starting from 2008.

While we do not question the soundness of the dividend policy, the point we raise is whether those profits are real if all costs owned by SOEs are properly accounted for. Among others, we are interested in investigating whether the profits of SOEs would still be as large as they claim if they were to pay a market interest rate. Using a representative sample of corporate China, we find that the costs of financing for SOEs are significantly lower than those for non-SOE companies after controlling for some fundamental factors for profitability and individual firm characteristics. In addition, our estimates show that if SOEs were to pay a market interest rate, their existing profits would be entirely wiped out. Our findings suggest that SOEs are still benefiting from credit subsidies and they are not yet subject to the market interest rates. In an environment where credit rights are not fully respected, dividend policy, though important, should come second and not first.