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Transformation of a Chinese State-Owned Enterprise

Guangzhou Metro Corporation

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Established in 1992, Guangzhou Metro Corporation is a Chinese urban rail transit state-owned enterprise (SOE) under the government of Guangzhou, one of the largest cities in China. With registered capital of RMB 6.28 billion and assets of RMB 22.4 billion as of the end of 2005, Guangzhou Metro is responsible for the development and operations of Guangzhou's mass transit system. The company also operates a diversified range of ancillary businesses, such as advertising, property development, telecommunications, and consulting services.

Guangzhou Metro can offer lessons about the successful construction of a transportation infrastructure project; more important, however, the company is an example of how a previously poorly performing SOE with a dubious reputation can be transformed into arguably the best-run mass transit company in China. Through the implementation of the transformation program put together jointly by the Guangzhou Metro and Booz Allen Hamilton project team in 1999, the transformation is widely regarded as one of China's most successful SOE change programs. Today, Guangzhou Metro has more than 6,700 employees, with 161 senior managers and 494 in middle management. Two of its major lines—Line 1 and Line 2—are fully operational, with a total length of 36.6 kilometers and an average rider volume of 470,000 trips per day. Ongoing construction

includes Line 3, Line 4, Line 5, the new airport line, the trial section of the Guangzhou-Foshan line, and the branching of Line 2 and Line 8.

Guangzhou Metro's transformation blueprint cuts across most of the key dimensions of the company, including business strategy, corporate governance, corporate portfolio rationalization, business and management processes, organization structure (with emphasis on the relationship between the headquarters and the subsidiaries), and culture. The project team also addressed one of the most critical issues Guangzhou Metro faced at that time—the relationship between the enterprise and the government. As an SOE, Guangzhou Metro was originally started within a planned economy environment in which some 15 different government organizations, such as the Construction Commission, Planning Commission, Finance Bureau, Audit Bureau, Personnel Bureau, and the like, were assigned to interface with the enterprise. Each government organization was responsible for directing or overseeing part of the operations of the enterprise, but there was no clear definition of who was responsible or accountable for the protection and enhancement of the overall value of the enterprise (and its asset owner), nor were corporate governance or empowerment to the enterprise management clearly defined.

Recognizing the Need for Change

In 1999, when Line 1 had just commenced operation, Guangzhou Metro was plagued by fraud scandals committed by the company's then senior management

team. Lu Guanglin, the new leader of the management team at that time, knew that it would take a lot more than just launching an advertising and public relations campaign to transform Guangzhou Metro into an effective company and to reestablish people's (and the government's) confidence in it. The company was plagued with many problems that were prevalent in Chinese SOEs, such as a lack of formal management processes and an insufficient system of checks and balances. Lu recognized that in order to overcome the stigma, a true transformation was needed. He wanted to make Guangzhou Metro a "modern and outstanding enterprise." The challenge, however, was to convince the government and the employees that there were indeed fundamental problems with the system and that it could be resolved only through implementing step changes, not just incremental improvements.

Lu faced great resistance within the organization when he decided to retain a global management consulting firm to lead the transformation program. A number of local management specialists and well-known Chinese academics criticized him for "worshiping Western ideas," implying that he did not trust the Chinese specialists. Lu had a different perspective. "While there were specialists and technical consultants who could help solve the technical problems for the company, Guangzhou Metro needed fresh perspectives, modern ideas, and a more systematic approach to a complete transformation of the corporation," he said. Lu believed that if Guangzhou Metro was to become a well-run enterprise, what was needed was to apply Western "medicine" appropriately and carefully to its Chinese "body." The idea was for the entire Guangzhou Metro team to put their hearts and souls into the transformation process and to move forward. It required a concerted effort, and Lu promised that no one would be left behind. In return, they would need to give the transformation effort their best shot.

A Carefully Considered Transformation Plan

Having determined its objectives, Guangzhou Metro, in conjunction with Booz Allen Hamilton, began the process of an in-depth organizational transformation in 1999. In developing the transformation plan, Booz Allen identified the following seven major tasks in its scope of work:

- Recommend the optimal structure for the company in relation to the government and its subsidiaries. Evaluate the feasibility of the government's transfer of authorization to Guangzhou Metro for the construction and operation of the metro lines.
- Conduct a comprehensive assessment of the current management positions at Guangzhou Metro and deliver an assessment report.
- Develop a five-year strategic development plan (2000–2005) for Guangzhou Metro, specifying key implementation steps.
- Develop an overall transformation plan for Guangzhou Metro, addressing management philosophy issues, organizational structure, division of responsibilities, management structure, a human resources system, a distribution system, core processes, and corporate culture.
- Analyze the financial performance of the company's metro operations and its other operational businesses and provide a forecast.
- Review and analyze the different approaches with which Guangzhou Metro could raise capital in the capital markets, including the viability of a public listing and the steps required to achieve that.
- Propose a management system and policies that are aligned with Guangzhou Metro's five-year strategic development plan.

Before implementing the transformation plan, it was important to have a complete diagnostic of the overall situation, incorporating the following key areas:

- **Organizational Structure**—Review the organizational setup, work division, and management system and flow, and evaluate the advantages and disadvantages of the organizational structure.
- **Construction Management**—Identify gaps in the management flow for construction projects. Study the purchasing and bidding processes, and scrutinize the management reporting system of construction projects.
- **Operations**—Examine resource allocation and logistical arrangements for achieving Guangzhou

Metro's key objectives: "Safety, speed, timeliness, and comfort."

- **Governance**—Investigate the feasibility of establishing a new governance model in which the government and the enterprise management redefine their relationship through a new contractual arrangement so that the enterprise can operate its assets according to some predefined principles and criteria, and benchmark governance models of other local and foreign mass transit enterprises.
- **Human Resources**—Review the existing personnel and reward systems, analyzing both the advantages and disadvantages; simultaneously, conduct cultural workshops to secure the opinions and ideas of employees about existing organization, personnel, and culture.
- **Financial Management**—Evaluate the current financial management structure and process flow, and analyze the gaps in financial control, monitoring, and process efficiency.
- **Financial Performance**—Review financial statements of the company and conduct preliminary financial analysis to understand key drivers for revenue and growth, along with key risk areas. Analyze the existing business development and planning processes and benchmark the operational and financial performance of the company against world-class metro operators to identify potential areas of improvement.
- **Affiliated Businesses**—Identify the scope of business for the subsidiary companies, and study the potential financial contribution of these businesses to Guangzhou Metro.

In the second half of the project's development stage, Booz Allen first helped Guangzhou Metro to detail its vision, mission, and focus. After consolidating all the findings from the first phase, the strategic development plan for the next five years was formulated and a conceptual framework for the longer term was outlined:

- A near-term strategic plan focusing on refinement and preparation for the major transformation (2000–2001);

- A medium-term strategic plan covering the years of rapid growth (2002–2005); and
- A conceptual framework for the longer term, which focuses on developing and further strengthening the company (2006–2010).

Booz Allen recommended that Guangzhou Metro and its owner (the Guangzhou government) should adopt a new relationship based on a clear contractual arrangement between the two and the establishment of a new governance model whereby a Board of Directors would be established to protect the interests of the asset owner and to provide checks and balances with management, while management would be fully empowered to run the company. Successful examples of this arrangement are plentiful: The Hong Kong Mass Transit Railways Corporation (MTRC) and the Airport Authority Hong Kong (AAHK) are prime examples of well-run statutory bodies that are formed based on this concept whereby the enterprise management is authorized to operate the organization based on "prudent commercial principles."

Transformation in Progress

Massive organizational change is always challenging for any company and Guangzhou Metro undertook this initiative during a particularly taxing period in its corporate history.

While operating the newly constructed Line 1, the company was tasked with building the new Line 2 under a much tighter timetable. The company's resources were limited, and many management problems arising from rapid growth had yet to be resolved. According to a research study on the corporate life cycle of Guangzhou Metro, more significant changes were forthcoming. The company desperately needed more structured and systematic management controls suitable for its evolving business needs; it had to adjust or change its internal culture accordingly. Lu later recalled, "We combined advanced and mature management theories, particularly Western theories, with practical China realities giving us a unified and effective solution."

Implementing the transformation plan was a multistep process. First, the company streamlined its organizational structure, addressing head-office alignment issues and the details of redesigning management processes.

Next, it revamped the employee-compensation system, setting up an appropriate performance-appraisal system and implementing a new incentive system that would be more aligned with desired behavior and performance. In a traditional Chinese SOE, the employees' compensation scheme was very rigid and was dictated by the government. With the transformation, Guangzhou Metro was able to seek the government's approval of better allocating its compensation to its employees based on merit. This was not ideal, but clearly a major step forward.

Guangzhou Metro then proceeded to build its core capabilities and developed a learning culture. Simultaneously, it addressed workflow improvements by instituting management-process reengineering and rationally structuring the company's internal communication system to enable a more efficient exchange of information. Not least, the company worked on creating a new culture based on an appropriate set of values.

Reaping the Rewards of the Transformation

Since its transformation, Guangzhou Metro has been consistently delivering strong performance. It has been expanding its tracks at a rate of 36 kilometers per year, with a target total length of 255 kilometers for seven metro lines by the year 2010. It has achieved many technical "firsts" in China and has received strong feedback and recognition from both industry peers and passengers. In addition, by embracing "safety, speed, timeliness, and comfort" as its key objectives, it has carefully reorganized its operations, raised its operations and service standards, and delivered safe and reliable transportation services to its customers. It has achieved remarkable results in metro system development and operations management and received praise from industry peers for its high level of performance.

Initial benefits of the transformation plan were highly visible when the construction of Line 1, which happened prior to the transformation, was compared with the construction of Line 2, which followed the implementation of Guangzhou Metro's new initiatives. While the construction cost for Line 1, an 18-kilometer line, was RMB 12.26 billion, the cost for Line 2, also an 18-kilometer line, was reduced to RMB 8.85 billion. Even though both lines were the same distance and had the same transport capacity, Line 2 boasted more advanced equipment and was launched with better services. Overall, the entire Line 2 came in under budget by RMB 1.7 billion against the initial budget of RMB 10.6 billion.

Lu credited the positive results of Line 2 construction to the transformation. "Under the transformation, the management team was able to drive productivity, deliver profits, and develop future talents. The construction time was shortened by two years and the cost per kilometer was reduced by almost RMB 200 million." Furthermore, since 1999, Guangzhou Metro has not experienced any corruption or fraud. It has clearly established its reputation and trust with the government and the community.

Despite the immediate benefits, the transformation was a long journey. According to Liang Qiaoming, Deputy General Manager of Guangzhou Metro, "Someone had originally suggested that it would take one year for the change to be implemented. I personally thought that it would take at least three years to implement any transformation with long-term impact. In reality, the transformation plan was confirmed in 2000, but the company didn't get to a solid platform until 2003, and it wasn't until early 2005 that a modern corporate system was put in place."

The transformation process required real commitment from the management team. Reflecting on the experience, Lu concluded that while setting up the policies was relatively straightforward, integrating the policies into processes and daily activities and ensuring that the company's management philosophy and objectives were truly reflected in daily behavior was difficult. He recommends that companies embarking on

transformation should ensure proper communication and feedback channels so that the management team can work closely together. “This is what enabled Guangzhou Metro to deliver across such a broad scope and under such strong pressures from a RMB 10 billion investment,” he said. “Having gone through the five-year transformation based on sound management theory and best practices, Guangzhou Metro has indeed experienced a tremendous and fundamental change and is now a much healthier organization.”

Guangzhou Metro is clearly still in the process of change. More work needs to be done in defining the governance of Guangzhou Metro. As a result of the transformation, Guangzhou Metro has better defined the working processes with the various government organizations. However, the new governance model developed by Booz Allen is still awaiting the government’s approval. Today, Guangzhou Metro still does not have a Board of Directors, and it does not have fully delegated authority from the government and must still report directly to the various government organizations on many of its major decisions.

What’s Different with Chinese SOE Transformation?

The transformation of Guangzhou Metro has shed some light on what is different (or not so different) with Chinese SOEs’ transformation relative to enterprises in other, Western, economies. Guangzhou Metro has proved that even an SOE that was formed under a planned economy can be successful, to a large extent, if people put their minds to it. The success of the Guangzhou Metro was due in no small part to the strong leadership of Lu Guanglin, who had a vision of what needed to be done and the commitment and courage to do it, as well as a very strong supporting senior management team led by Liang Qiaoming. Lu and Liang were fully committed to making the change for the overall benefit of the enterprise and its asset owner and they saw there was no other alternative but to go for this transformation. At a critical juncture of the project, when Booz Allen was asked to present interim findings to a group of representatives from the government organizations and a few academics from local universities (who were acting as advisors), some of the participants at the meeting expressed concern

about the scale and pace of the reform. Lu stood up and gave a compelling speech to all the participants confirming how important the transformation was for Guangzhou Metro (and for the government) and how committed he and the senior management team were in driving forward the change. After the speech, everyone was fully committed and there were no doubts cast upon the recommendations.

However, there were constraints in the Chinese system that prevented a complete transformation. The unwillingness of the government to redefine its relationship with Guangzhou Metro based on a contractual relationship and a delegation of authority concept denied management the room to further accelerate the company into a real “modern and outstanding enterprise.” In addition, the government still controlled the appointment of senior executives of the enterprise, as well as the overall amount of compensation that the enterprise could pay its employees. (The enterprise was allowed to allocate the money, given the total sum.) As a result, compensation levels at Guangzhou Metro might fall behind the market, especially for critical positions, when considering the Western multinationals and Chinese private companies.

The Guangzhou Metro team, at virtually every level of the organization, was extremely open and receptive to the “new” business and management ideas and tools. The dozen people who were primarily responsible for implementing the transformation were extremely dedicated to its success; after the plan was put in place, many of them were reassigned (mostly promoted) to other positions of responsibility and were champions of change within the organization. In comparison with their Western counterparts, they might not possess the same experience and tools, but their interest levels and commitment made a difference.

The real change of Guangzhou Metro was the metamorphosis of the organization from a “rule of man” with no checks and balances to a “rule of law” under a management team, with the checks and balances already built in as part of the new systems and processes. The former situation was quite prevalent in traditional Chinese culture and it

often manifests in local enterprises, in particular, SOEs formed under a planned economy. However, this style of organization could be a real detriment to the development of a company in a market economy. Many Chinese companies will have to undergo a transformation like Guangzhou Metro's if they aspire to become high-performing organizations.

Transformation Strategy Going Forward

In recent years, both the external environment and internal management conditions have changed a great deal. In order to meet the requirements of

the company's rapid development and to maintain sustainable growth, Guangzhou Metro has had to deepen the reform of its management system, organization structure, human resource management, core system and processes, and business management models.

The Guangzhou Metro transformation project provides a concrete example of how an SOE and management consultants can work together to address complex business and organizational issues, even under the constraints of state ownership, a traditional mindset, and old baggage from an unstructured system.

Also contributing were Helen Or and Sue Chan.

What Booz Allen Brings

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for more than 90 years. Providing consulting services in strategy, operations, organization and change, and information technology, Booz Allen is the one firm that helps clients solve their toughest problems, working by their side to help them achieve their missions. Booz Allen is committed to delivering results that endure.

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