

What are the Corporate Governance Challenges for Family
Businesses? A Comparison of the United Kingdom and China

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List of Abbreviations

CBRC – China Banking Regulatory Commission
CEO – Chief Executive Officer
CGI – OECD Principles of Corporate Governance Index
CIC – Community Interest Company
CIO – Charitable Incorporated Organisation
CCP/CPC – Communist Party of China
CSR – Corporate Social Responsibility
FRSSE - Financial Reporting Standard for Smaller Entities
GDP – Gross Domestic Product
IBC – Imperial Bank of China
IFB – Institute of Family Business
IMF – International Monetary Fund
LLC – Limited Liability Company
LLP – Limited Liability Partnership
LTD – Private Limited Company
MOBM – Market Oriented Block Holder Model
NBS – the National Bureau of Statistics of the People’s Republic of China
NPC – National People’s Congress
OECD - Organisation for Economic Co-operation and Development
PLC – Public Limited Company
PRC – People’s Republic of China
SBS – The Department for Business Innovation and Skills *Small Business Survey*
SMEs – Small and Medium-Sized Enterprises
SOEs – Stated-owned Enterprises
SPC – The Supreme People’s Court
TVOEs – Township and Village-owned Enterprises
UK – The United Kingdom
US/U.S. – The United States of America
WTO – The World Trade Organisation

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Abstract

The family business is ubiquitous. Its prevalence in the various forms of capitalisms that exist is a clear indication of its importance. Even throughout China's history and now within its version of a modern socialist market, the family business has proven to be a foundation of societies.

In the United Kingdom (UK), family businesses have been successful and had steady growth thanks to a conducive macro-environment that consisted of a democratic political system, an advanced legal system and a Western social-cultural context. In contrast, China has a socialist and centralised political system. It has an inadequate legal framework for its private-sector and is set in a social-cultural context that has strong Confucian underpinnings. Such a macro-environment presented family businesses with immense challenges.

Many of the challenges faced by family businesses in advanced Western countries have been addressed through a now healthy and functioning corporate governance framework. Such frameworks are well studied and established in countries such as the UK. China on the other hand, only began its corporate governance reform in the 1990s, mainly focusing on SOEs, and borrowing corporate governance literature from other developed countries.

This thesis undertakes a comparative study of corporate governance challenges faced by family business within the macro-environments of China and the UK. A number of challenges faced by family businesses in China are analysed and shown to be intricately related, and so a holistic approach is recommended to find further solutions. By adapting and transplanting Western corporate governance mechanisms, it is possible that challenges can be overcome at an organisational level, despite the macroeconomic differences. Changes to the political and legal systems at a central government level are also proposed to improve the situation for family businesses over the long run

Chapter 1 Introduction

1.1 Research Background

Whilst capitalism literature broadly recognises different types of capitalism such as the Anglo-American system; the communitarian system of countries such as Germany; and the family orientated capitalism of countries like Italy; in all of them family businesses play an important role.¹ The same has been true for China throughout most of its history and, even in the modern socialist market economy with Chinese characteristics, family businesses have played an important role.²

China's economy started to rapidly grow since Deng Xiaoping's "open up" policy in 1978, the economy grew with an annual GDP growth rate averaging over 8 per cent since the 1980s.³ Thereafter, China has experienced a fast-growing period for decades, and became a member of the World Trade Organisation (WTO) in December 2001. This certainly brought more trade with other members in the WTO. The membership of the WTO boosted China's economy prior to the worldwide financial crisis.⁴ China's economy grew with an average

¹ Hall P A, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (OUP 2001). Hanckle B, *Debating Varieties of Capitalism* (OUP 2009). Hampden-Turner C and Trompenaars F, *The Seven Cultures of Capitalism* (Judy Piatkus (Publishers) Ltd 1994).

² Von Glahn R, *The Economic History of China: From Antiquity to the Nineteenth Century* (CUP 2016).

³ Brown D H and MacBean A, "China's macro environment and enterprise challenges" in Brown D H and MacBean A (eds.) *Challenges for China's Development: An enterprise perspective* (Routledge 2005).

⁴ World Trade Organization, "International Trade Statistics 2015" https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf (accessed 21 September 2016).

growth rate of over 6 per cent annually whilst most of the developed countries suffered from the effects of the 2008 financial crisis. Since the financial crisis, China has continued to maintain the annual GDP growth rate at 6 per cent which enabling it to develop strong trading relationships with many countries. The strong economic growth attracted investment from foreign businesses in China since the 1980s. These foreign businesses have achieved significant goals in China. Then with the financial crisis, and the latest referendum of Brexit, investors in China took opportunities to invest overseas, especially in Europe. Taking an example of the investments in to the United Kingdom (UK) market, sizeable investments have appeared in sports, tourism, culture and entertainment industries. A large number of these investments were made by Chinese Stated-Owned Enterprises (SOEs) and successful and large private enterprises. These events reflect recent developments in China's economy in general, and the changes that China's economy is experiencing. One of the biggest changes in China is a shift of emphasis from manufacturing for other countries to creating and innovating for itself. China's policy is to move towards developing a more diverse and innovative economy.

As commented by the Innovation Policy Platform, "China's growth pattern is currently changing, with a reduction in the rate of growth and an attempt to rebalance the economy from exports and investment towards private consumption..."⁵ However, due to the unique nature of China's long history, its cultural influences, and political upheavals in the twentieth century, China has developed a named socialist economy with Chinese characteristic. Therefore,

⁵ The Innovation Policy Platform, World Bank & OECD, "China", <https://www.innovationpolicyplatform.org/content/china> (accessed 20 September 2016).

enterprises in China face a number of challenges specific to its political and cultural context. Chinese SOEs have great support from Chinese governments and banks. In contrast, SMEs do not, and subsequently face challenges in China's macro environment. Most of the SMEs in China are privately owned businesses, which are family organised.

Family businesses have increasingly received attention from academic and business advisors during recent decades. Such businesses contain unique conflicts stemming from the involvements of families and businesses at the same time when compared with other business forms. Studies of family business are relatively recent (circa four decades). The field has developed within several disciplines and avenues of research including: history, economics, management studies, law, sociology and psychology.

This research explores and compares the corporate governance challenges for family businesses in the context of the UK and China. This combination study explores the challenges with regards to family businesses from several perspectives, which usually are looked at individually in the literature. The connections between these challenges affect family businesses in more important ways than expected. Examining from a comprehensive level offers a more complete analysis towards challenges for family business.

Family businesses across the world face a series of challenges in a variety of areas ranging from management issues to negotiating legal regulations, and from raising finance to adapting to political changes. Even across cultures, these

challenges are correlated and overlapping, suggesting that a solution to a specific challenge would have limited scope for success. By exploring and comparing family businesses and macro environments in both China and the UK, this thesis highlights the importance of doing an integrated analysis and argues that the characteristics and theories of the family business in both countries overlap. This potentially allows for theories of family business and corporate governance in the UK to be transplanted into a Chinese context subject to the general problems associated with legal transplantation.

1.2 Research Objectives

1.2.1 Research Objective - China

The growing influence that China is exerting on other parts of the world is being increasingly reported by the media. China has become a centre of opportunities, challenges and problems in the globalized world of the 21st century. Recently in practice, many family offices have appeared in China, which highlights the influence of Western business operations. However, the literature and theories relating to family businesses in the context of China are relatively limited as there is little research and examination on the part of Chinese scholars. For instance, there is not, as yet, an integrated study of the existing challenges of family businesses in China.

1.2.2 Research Objective – A Combined Research of Several Aspects

Existing research on the family business and its challenges are concentrated to individual field of study in the UK including: (i) looking into the family business from the perspective of social sciences, such as psychology analysis in the process of family business succession, long and successful family businesses' history analysis in historical study, and (ii) corporate governance theories – agency theory, life cycle theory, performance *et cetera* and conflicts in family businesses from the perspective of management science studies. However, there is rarely a research that combines all relevant challenges that family businesses face in social contexts, which makes this research novel. This thesis examines the challenges through disciplines of law, governance, history, politics, social science and management in an integrated manner. Using the lens of life cycle theory in family business study, this thesis hopes to integrate the challenges in corporate governance in a social context, a political environment, a legal framework, and management issues that family businesses are experiencing, or will experience.

In the UK, existing policies, laws, regulations and support from the government are at a variety organisational levels. They are all designed and serve to aid SMEs. However, policies in China, China's legal framework and economic environment are often dictated from the top down. Introducing crucial differences that cannot be overlooked is needed in analysing family business in China. Indeed, China's every aspect highlights the lack of formal support that SMEs have in comparison to the UK. Therefore, it is necessary to analyse

challenges for family businesses in a combined/integrated manner as examining individual aspects alone will only lead to omitting other issues in relation to family businesses. In this thesis, the author chooses historical, legal, managerial and social aspects to lay out the corporate governance challenges for family businesses in contexts. Furthermore, this thesis aims to contribute a dynamic perspective for future studies in family business and corporate governance, and to raise attention for law makers and legislative framework, and calling for legal reform or guidance of policies to focus more on small and medium-sized family business.

Through analysis in varied fields of study, it is possible to transplant some Western corporate governance mechanisms to the social and legal contexts in China. Compared with the UK, research on Chinese family businesses is sparse. Many studies have remained at the early stage of introducing the field of research in a Western context, or translating Western studies. Transplanting is not strange to China, particularly with legal frameworks. However, in family business studies, transplanting corporate governance mechanisms is a novel venture. The research of family businesses in China is very much at a theoretical stage and there is even less guidance in applying family business theories in practice. The context of China is also considered to be unique, so it is hard to imagine governance mechanisms of family businesses applied to small to medium-sized family firms in practice. This thesis analyses political environment, law, culture and history, to raise the possibility of applying certain mechanisms to a Chinese family businesses in China's context. Ultimately, this thesis suggests that it is possible to implement corporate governance mechanisms in

Chinese family businesses from organisational level. It further raises the expectation for future studies in developing and applying mechanisms properly in both contexts.

1.2.3 Research Objective – Family Businesses

Family business study is a relatively new research field, which is just over four decades in the Western context. A lot of research has been conducted in various fields that related to family businesses. The study of family business has not flourished in China. Significant more research conducted on large corporations and Chinese SOEs. In comparison with the relative sparsity of family business study in China, Western scholars have examined the family business in a more systematic way and through the prism of many theories.⁶ Family business has been considered to be the bedrock of the economy for many countries, and it remains be recognised as being important in China. However, their implementation is an issue. Corporate governance mechanisms in the context of family business are not widely applied in practice in Chinese context except those which already exist in relation to public quoted companies under the existing Chinese corporate governance system. Mostly, it is the large sized family businesses which apply corporate governance mechanisms. The Chinese family business study and theories are not seen as an important guidance by practitioners either. Hopefully, with the influence of Western

⁶ Nordqvist M, Melin L, Waldkirch M and Kumeto G (eds.) *Theoretical Perspectives on Family Businesses* (Edward Elgar 2015).

education and recent development of economic policies, family business study will be gain ground in the near future in China.

1.3 Methodology

1.3.1 Social-Legal Methodology

The thesis aims to discover the challenges faced by family businesses. The UK and China have very different legal systems, political environments, economic contexts and social contexts. Family businesses in China have experienced many challenges in the fields of social science, management, politics and law. However, there is not enough awareness nor are there sufficient solutions to address the challenges at an organisational level.

Under these circumstances, the author chooses the socio-legal research methodology to conduct the research. The reasons are: (i) family business study has been examined within several disciplines, including history and social science. The law is one of the disciplines that regulates corporation types. It does not regulate family business particularly, but rather through general corporation types in companies in corporate law and commercial law. (ii) The challenges that family businesses face in legal framework are connected closely to the political, social and economic environment in both contexts. Therefore, the examination of the corporate governance challenges for family firms takes the research beyond the confines of the legal system. (iii) There is a gap between the existing research of family business and Law itself in the proposed

context of China. It is important to have an external perspective – through managerial and social contexts to examine existing law in China and identify the gap, further to raise the needs of reform in law, or propose alternative solutions in applying policies or regulations at a lower regulatory level. Therefore, it is proposed to not apply a Doctrinal research methodology due to the family businesses' complex involvements with related disciplines. It is however crucial to examine the social contexts, political environments, economic backgrounds *et cetera*, and so a law in context research methodology is adopted.

Analytical and descriptive methods are used to conduct this social-legal research. The existing challenges for family businesses in various fields in the UK and China will be described and analysed in order to explore the important issues and propose potential solutions to current problems. Investigations into the corporate governance challenges for family businesses comparing China to the UK will be carried out by utilising the theoretical research method. The thesis raises and describes the existing challenges in a combination of fields and relates its challenges to the Chinese context.

In contrast with the empirical tested method, the theoretical method adopted to answer the research question could contribute to family business studies and legal research. There is a limited amount of family business research available from the external perspective of legal studies, and there are few studies looking at legal reform through research on family businesses (especially small and medium-sized family businesses) in the extant literature. This research has taken a theoretical approach due to the need to do cross-field analysis. Empirical

research in family business studies is often very specific and focuses on a particular attribute of family business. It would be difficult to gather sufficient sample data from family businesses in China that would yield significant empirical results, and therefore makes an empirical analysis beyond the scope and resources of this study. However, with more resources and support, it might be possible to conduct a quantitative analysis on specific aspects of small and medium-sized family businesses in future.

1.3.2 Comparative Law Research Approach

Another research approach applied in this thesis is that of comparative law. Simone Glanert argued the different views of whether comparative law is a method or a methodology.⁷ He stated that the comparatists consider comparative law as a “methodological endeavour”, but often comparative law is regarded as a method.⁸ Since there is no unified definition in literature, this research does not state comparative law as a method or methodology but a research approach.

Since part of this thesis looks at the possibility of transplanting Western corporate governance mechanisms in family business studies into another completely different context, it is important to apply a comparative approach to explore one social context and legal system, and to compare it with another

⁷ Glanert S, “Method?” in Monateri P G (ed.) *Methods of Comparative Law* (Edward Elgar 2012).

⁸ Ibid. 3.

context and legal system. Therefore, regardless of whether comparative law research is a method or methodology, it is useful for this research.

As stated by M. Van Hoecke, “When one tries to improve one’s own legal system, be it as a legislator or as a scholar, it has become obvious to look at the other side of the borders.”⁹ This is why this research chooses comparative law to analyse transplantation. The comparison between different law frameworks in two completely different jurisdictions is to understand and learn from one, then apply or reform the other in legal research; it is the foundation of transplantation.

Comparative law was viewed as a “tool” to learn and understand law from the end of the nineteenth century by some scholars, such as Raymond Saleilles from France¹⁰ and this method expanded to the whole Europe. Comparative law facilitates learning and understanding laws that exist in other countries, being able to evaluate one’s own law and legal systems and improve the ones’ own.¹¹ M. Van Hoecke suggested using comparative law as an approach to study legal system across borders, as “...importing rules and solutions from abroad may not work because of a difference in context. Hence, a more thorough contextual approach may be required”¹². Accordingly, this thesis uses detailed analysis and description of existing contexts to show the uniqueness and similarities of

⁹ Van Hoecke M, "Methodology of comparative legal research · law and method · Recht en methode in onderzoek en onderwijs," (2015) 12 (3) *Law and Method*.

¹⁰ Saleilles R, "Droit civil et droit compare", *Revue inter. enseignement* 1911, 22, in Van Hoecke M, supra n 9, 2.

¹¹ Glenn H P, "The Aims of Comparative Law" in Smits J M, (ed.) *Elgar Encyclopedia of Comparative Law* (Edward Elgar 2006), 57-65, in Van Hoecke M, supra n 9, 2.

¹² Van Hoecke M, supra n 9, 3.

contexts, further to learn corporate governance mechanisms from Western context and transplant solutions to the Chinese context.

Language in comparing legal systems matters too. As is often the case, the majority of researchers compared their research objects in their own language. For instance, a number of researchers compared common law systems that are mainly in their own language.¹³ It is easy to compare and learn about similar legal systems since the countries have common ground on their social contexts and other aspects.¹⁴ However, as M. Van Hoecke pointed out that, research conducted in this way is limited.¹⁵ With globalisation and developments in language, many studies and legislation are brought in varied languages and to different countries. But the limitation of those translation works is that the scale and scope of law is not wide enough to gain accurate results. To conduct appropriate comparative research, the author compares a common law system with a civil law system in two official languages, aiming to gain the correct background in legislation, to introduce their social contexts and legislations in a more specific manner. Further, to gain knowledge and find potential solutions to solve challenges that family businesses face.

To understand the modern shape of legal systems with different languages and social contexts, it is important to know the development of each country and the current status of each state. Therefore, historical contexts and development shall also be studied. According to M. Van Hoecke, since the 19th century,

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Ibid.

“...many authors on comparative law emphasize also the importance of taking into account the socio-economic and historical context of the law when carrying out comparative legal research.”¹⁶ Hence, the historical perspective in this thesis provides a viewpoint to learn how the differences in the two legal systems were shaped by their history and development, while the comparative law analysis offers insight in to Chinese contexts allowing exploration of possible legal reforms at national and organisational levels.

1.4 The Structure of This Research

The thesis is organised as 7 chapters. Each chapter deals with different challenges that family businesses face in a modern legal framework, paying consideration to their management and social environments. Chapter 2 examines the historical development of family business and corporate governance frameworks, comparing both jurisdictions, and follows a recent trend of analysing family businesses from a historical perspective. This will also highlight the importance of both legal and non- legal factors. The chapter emphasises the importance of family business studies in particular fields, which builds the foundation for later chapters of the thesis. This historical comparison can be used to help predict the future of their development bearing in mind the sometimes helpful approach of path dependency.

Chapter 3 introduces and compares the legal frameworks in China with the British. The Chinese Civil Law system has changed in the past decade and legal

¹⁶ Ibid.

reform is catching up with changes to the economy and political systems. Analysing the changes made to the Chinese legal framework and comparing them with UK law will help predict legislative changes for family business development. Analysing the UK corporate governance system will also help to predict family business practices in China.

Chapter 4 analyses details and theories of corporate governance together with its mechanisms to explore their use in family businesses. Corporate governance mechanisms are applied directly to family businesses in many Western countries, especially ones where family businesses are well-established. These mechanisms may solve similar issues in the Chinese context, though complications introduced by China's macro environment make these businesses more difficult to control and maintain through a governance model. Chinese family businesses have their own unique business operation and traditional Confucian traditions prevent businesses from operating in quite the same way as Western ones. Consequently, some part of the chapter is spent examining existing Western mechanisms of corporate governance with the intention of adapting them to their own circumstances for implanting. Finally, by comparing company law in both jurisdictions, insight is gained into how corporate governance related rules work for Western family businesses and how they can be applied to Chinese family businesses in future.

Chapter 5 examines family business literature together with theories that exist in major countries including the United States (US), UK, and China. The main theory, called life cycle theory is covered in depth, and formalises a notion of

business development cycles. Chinese family business studies from some distinguished scholars are looked at, covering succession research and developing cycles.

Finally, Chapter 6 looks at the social challenges for family businesses in China, with a focus on “guanxi”. Guanxi is a complex net of relationships connecting people, and it forms the foundation of numerous businesses deals within China, potentially having been exported to many other countries too. Guanxi and trust are inseparable, and it can therefore be regarded as a barrier for controlling businesses through a legal framework. There are theories and research on trust, but there are relatively few theories and literature on guanxi itself. The chapter explores this area and looks at key issues such as ownership, concluding that this kind of challenge is best solved with suitable and customized mechanisms within family businesses.

Securing financing for family businesses in China is also a critical issue. SMEs have had difficulties in financing. The shadow banking is an alternative way for firms but comes with huge risks. Although shadow banking is not a main theme to this research, the financing issue is often crucial for family businesses, therefore, the discussion is kept brief in Chapter 6. To avoid damages caused by shadow banking, some of the communist party members have suggested to provide legal and safe sources such as banks to help with the financing of SMEs.

Chapter 2 Historical Analysis and Literature Review

2.1 The Significance of Business History

The paramount scholar in the arena of business history, deemed the “founding father”¹⁷ was Chandler, who developed findings based on individual cases in both global and comparative contexts. The research that historians achieved was gained from existing cases, either from oral or written sources. Chandler also raised the importance of individual case analysis from which to develop generalizations, in order to build further frameworks and theories in this field. He raised this assertion to outline the generalization and concepts that come from individual cases in a particular business context and period that can be applied to other periods and places. Therefore, this can be used in other periods as a tool to predict future trends and build new theories.

Although it may be difficult to generalize individual cases in the field of family businesses, the characteristics, history and management theory are distinctly different. Nevertheless, generalizations are subsequently becoming a leading approach in the study of family businesses. In addition, as Colli emphasised, “this search of generalization is what makes historical research different from pure descriptive archeological effort, which is necessary as the basis of the discipline (as said, based on primary sources), but is hardly complete in itself. Rather it is a step beyond the mere collection of facts. Moreover, it is this search

¹⁷ Colli A, “Business history in family business studies: from neglect to cooperation?” (2011) 1 (1), *Journal of Family Business Management*, 14-25.

for generalization that can make historical analysis appealing for other scholars who build theories about business firms and organisations.”¹⁸ This statement indicates that developing markets mirror those of advanced markets, more particularly, corporate governance mechanisms from the UK and transplant to China with Chinese characteristics is possible.

2.2 The Study of Business History – a Combination of History (including Legal Developments) and Business Study

The function of business history research is highly commended. It has been developed slowly as an independent field from economic history as more business historians confirmed such findings.¹⁹ Moreover, it contributes a lot to management studies, specifically the family businesses.

As Colli pointed out, the signpost for business history research was the publication in 2008 – the Handbook of Business History. Thus, we can say that the business history research is still in the early stage of development, although it has never been as a new discipline, it has always been a subject in economic history but waited to be discovered and developed.²⁰ Also as Norman S. B. Gras, the first professor of business history in the world, wrote that “every particular study has some reference to a general pattern of behavior or development. In each instance, we should learn how the particular firm being studied fits into the larger whole. It may be that the study will illustrate the

¹⁸ Ibid. 16.

¹⁹ Ibid.

²⁰ Ibid.

general; or it may qualify or redefine the general; indeed, it may actually point to errors in previous concepts”.²¹ To conclude, many business historians started to look at the research of business history as a separate research field and believed that researching business history would enhance theoretical development. The examination of the culture of a country, as well as its historical development helps to illuminate its general background in a comparative context. For instance, a country like China, with just less than five thousand years of history, it is important to understand its culture and development. This also raises issues in terms of path dependency theory as a determinant of corporate governance.²²

Many historians are not from the discipline of business history, but from other fields such as marketing, and finance.²³ Therefore, there are a number of arguments about the function of business history: First, history is a longitudinal approach; Secondly, history represents scenarios without seeing them as new; Thirdly, historical study is useful in the context of international business and long-term economic growth research.²⁴ Moreover, Peter Buckley concluded that subjects like business history or history in general, can be useful in building theories. Afterwards, Richard Whittington, another management scholar, held

²¹ Gras N S B, “Are you writing a business history”, (1944) 18 (4) *Bulletin of the Business Historical Society*, 73-110, 104.

²² Bebchuk L and Roe M J, “Towards a Theory of Path Dependency in Corporate Ownership and Governance” (1999) 52, *Stanford Law Review*, 127-170.

²³ Colli A, supra n 17, 16.

²⁴ Ibid. Buckley P, “Business history and international business”, (2009) 51 (3), *Business History*, 307-33. Jones G and Khanna T, “Bringing history (back) into international business”, (2006) 37 (4), *Journal of International Business Studies*, 453-68. Also, the important work of Acemoglu D and Robinson J A, *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (Profile Books 2013).

similar supportive opinions. Colli also pointed out the close relationships between business history and management.²⁵

2.3 The Study of Business History and Family Businesses

Family business is a very important focus of study because family businesses are ubiquitous worldwide. It contains the elements of family and business, as well as the characteristics of family involvement with and in the business. Moreover, the culture, as well as the values of family business, need time to develop. In many jurisdictions, large numbers of corporate giants started their lives as small family businesses. Therefore, family business can be a crucial element in the study of business history. For instance, the succession issue is a part of family business theories and important in management studies, it also exists in the business and family history and is even reflected in case law examples of minority shareholder protection. This is one example of the close relationships between business history, management studies and legal/governance issues in family controlled companies. Other related theories, such as “family firm life cycle theory”, also reflects the relationship stated above.²⁶

Another example of the close relationship is management ownership, which is also one of the most crucial issues in the field of family business. The governance mechanisms are often critical for business performance and

²⁵ Colli A, supra n 17.

²⁶ Ibid. 18.

management. One advantage of doing research through the lens of historical studies is that family businesses would understand their governance mechanisms in real world terms through experience and practice and provide evidence for others with regards to corporate governance methods and their underlying theories.²⁷

Business historians often take the view that the best approach on studying family businesses is comparative research. Indeed, culture and values differ from country to country and region to region impacting family business. Therefore, conducting research by comparing different contexts is crucial.²⁸ Colli discussed that history studies do not only provide the evidence and theories for developing family firms, but also provide an understanding of the culture and value of them. It is important to perform a comparative study for the reasons: 1) We need to understand the society, history, culture as well as ideology of the families that own the businesses at a horizontal level, in order to generalize the concepts and develop theories. He stated that the culture is not only the culture that family businesses are located in, but also the culture that families form and bring to the businesses. He further concluded, this culture is the advantages of the firms, which can make the firms be competitive in the general environment;²⁹ 2) Generalizing the concepts and theories are helpful to plan strategy, as well as improve performance *et cetera* for family businesses in a global context. For instance, many family businesses consider or plan to be family businesses in the long term. This has been raised and recognized as one of the toughest

²⁷ Colli A, supra n 17.

²⁸ Ibid.

²⁹ Ibid.

choices, as well as one of the most important ones, which is highlighted in Carlock and Ward's study.³⁰ In this effect, conducting a comparative study, further to generalizing the concepts and theories also provides family businesses with a demanding suggestion, namely. 3) Transplant the advanced theories and practice to other certain contexts. Colli concluded that generally in the 19th century, Western family business practice was subject to their contextual culture, it affected their governance and succession issues.³¹ From my perspective, conducting comparative studies in family business and their governance practices is a potential route to breaking down the cultural and national barriers, to generalize existing successful cases, as well as providing guidelines for success in general.

Furthermore, the study of family businesses has attracted business historians since the 1990s and it has become the favourite arena for business historians.³² As stated by Colli, a huge amount of research towards family businesses has extended to international and comparative perspective regardless whether or not academics and experts have familiarity with foreign contexts.³³ For instance, Spanish scholars Paloma Fernández Pérez, Nuria Pulgand and German scholar Hartmut Berghoff, all actively did research on Spanish family businesses and German family businesses concerning the nature, structure, competitive advantages and main features in their 2004, 2007 and 2006 studies. Some

³⁰ Carlock R S and Ward J L, *Strategic Planning for the Family Business - Parallel Planning to Unify the Family and Business* (PALGRAVE 2001).

³¹ Colli A, supra n 17, 20.

³² Jones G and Rose M B, "Family capitalism" (1993) 35 (4) *Business History*, 1-16.
Rose MB, *Family Business* (Elgar 1995).

Colli A and Rose M B, "Family business" in Jones G and Zeitlin J, (eds.) *Handbook* (OUP 2008), 194-218.

³³ Colli A, supra n 17, 18.

based on the cases of single countries and some based on the comparative contexts.³⁴ Nevertheless, the trend of the research in this field from national to international has proceeded apace.

Although business history has advantages in the study of family business, business historians find that it is very difficult to be accurate, due to the relative lack of sources. First hand material and detailed analysis is important. However, it is very rare to obtain the documents from business families, since they see their documents as part of the family secret and privacy. Therefore, access to the records and documents is a problem. This is not only necessary for writing the business history, but also for the research of corporate governance, other management studies, as well as legal research. For instance, in the research of comparing family-owned firms with public companies and in the new modern developed or developing countries, scholars look at the records that can be accurate and accessible.³⁵ Where companies have commissioned corporate histories these often provide a very useful starting point.³⁶

Historical study is not only beneficial for family businesses, but also for all organisations.³⁷ Such an approach can give insights into many different

³⁴ Colli A, Pérez P F and Rose M B, "National determinants of family firm development? Family firms in Britain, Spain, and Italy in the nineteenth and twentieth centuries", (2003) 4 (1) *Enterprise and Society*, 28-64. Colli A and Rose M B, "Family firms in comparative perspective", in Amatory F and Jones G (eds.), *Business History Around the World* (CUP 2003), 339-52.

³⁵ The reason that author chooses to do thesis and library based research is because the lack of the accurate sources and data. It is a limitation for this field in worldwide, especially in China. Although with the huge markets and continually developing economy, the transparency still needs to be solved, in this effect, it requires the legislative development and persistence on pursuing "rule by law" in a long term. However, with the needs of the legal frameworks, the policies that government develops, it is possible to achieve the goal. Colli A, supra n 17, 20.

³⁶ For example, Wilson C, *The History of Unilever* (Vols I-III) (Cassell and Company 1954-57).

³⁷ Ibid.

aspects, for example, human capital and network of organisations. As stressed by Jones and Khanna, it includes but is not limited to “resources, competences, identity, knowledge and reputation building”³⁸. These aspects of “immaterial capital” apply to other organisations apart from family businesses, especially in China.

2.4 The Study of Business History and Development in the UK and China

In terms of Chinese business and legal development, Chinese business history helps to offer insights since legal reform is associated with economic reform. It is important to examine the history of a country, in order to understand family businesses in its national setting.

2.4.1 Business History in the UK

The history of the family business in the UK is a varied one. By medieval times guilds and companies formed by charter for the regulation first of general trading activities in the towns and later of specific trades and skills. Members of guilds traded on their own behalf and their businesses were largely family orientated.

The objective of guilds was to regulate and control a particular branch of trade rather than to create any form of corporate trading association. England was

³⁸ Defined as “valued objects and qualities [y] that have been passed down from previous generations” (The New Oxford American Dictionary) in Colli A, supra n 17, 20.

slow to adopt Arabic numerals and double entry book keeping. This impacted on the development of both partnership and corporate law development. In England, the modern trading “company” has its origins more in canon law and historical institutions than in legal theory. The guilds were much more significant regulators of trade than states and rulers at this time – which is exactly why the nation-states eventually crushed them. The suppression of many guilds occurred along with that of the monasteries during the reign of Henry VIII. Even before the suppression of guilds the migration of landless peasants had led to small workshops, owned and managed by the more prosperous master craftsmen displacing the old guild organisations especially in cases where a measure of mass production for sale was economically feasible.³⁹

During the age of mercantilism, the development of the joint stock company proceeded apace with not only chartered corporate bodies but many without charters or statute. The South Sea Bubble saga and resulting legislation led to various forms of unincorporated joint stock companies and the further development of partnership law eventually codified in the Partnership Act 1890.⁴⁰ In the 19th Century the first Companies legislation was enacted. From a historical perspective, the corporations in the UK initially were public joint stock

³⁹ Hadden T, *Company Law and Capitalism* (2nd edn. Weidenfeld and Nicolson 1977) Chapter 1. For a consideration of the social-cultural, political, religious and historical influences on the development of medieval Coventry’s guilds and governance see Kasabov E and Sundaram U, “An Institutional account of governance structures in early modern business history: the Coventry business history” (2014) 56 (4) *Business History*, 592-622.

⁴⁰ This aspect has been examined in detail in a number of books and articles, for example: Dubois A B, *The English Business Company after the Bubble Act 1720-1800* (The Commonwealth Fund 1938). Butler H N, “General Incorporation in Nineteenth Century England: Interaction of Common Law and Legislative Process” (1986) 6 (1) *International Review of Law and Economics*, 169. Bubb R, “Choosing the Partnership: English Business Organization Law During the Industrial Revolution” (2015) 38 *Seattle University Law Review*, 337-60.

companies as the Companies Acts presume them to be, then smaller companies took advantage of the legislation and increasingly used incorporation under the Joint Stock Companies Act 1856 to operate many forms of businesses.⁴¹ Indeed as pointed out by Dignam and Lowry, had the House of Lords in *Salomon v Salomon*⁴² been able refer to the parliamentary reports (Hansard) they would have found that the requirement of seven members had been chosen to avoid its use by very small businesses.⁴³ As Harris argued that, professionals who designed the Articles of Association did so in a flexible contractual way. Private and often smaller companies could adapt articles accordingly. Many articles of association had their roots in the terms of partnership agreements and trust deeds.⁴⁴ This is one reason that the norm of corporations is the “contract” in the UK as well as the US.⁴⁵ However, in the context of the UK the idea of self-ordering of both the private and public corporate regimes has been challenged.⁴⁶ In the Common Law system, *Salomon v Salomon*⁴⁷ and the Companies Act 1907 sanctioned the concept of the private company.⁴⁸ Moreover, scholars emphasised that often founding families in businesses existing a century or more ago have withdrawn from an active role in corporate governance. From the comparative study perspective,

⁴¹ Harris R, “The Private Origins of the Private Company: Britain 1862-1907” (2009) available at SSRN: <http://ssrn.com/abstract=1613206> (accessed 03 September 2010).

⁴² [1897] AC 22, HL.

⁴³ Dignam A and Lowry J, *Company Law* (8th edn, OUP 2014) at para 2.23. It was not until the decision in *Peppar v Hart* [1993] AC 593 that the courts were able to take into account Parliamentary reports.

⁴⁴ *Ibid.*

⁴⁵ Wells H, “The Rise of the Close Corporation and the Making of Corporation Law”, (2008) 5, *Berkeley Business Law Journal*, Temple University Legal Studies Research Paper No. 2008-65, available at SSRN: <http://ssrn.com/abstract=1119280> (accessed 02 September 2010).

⁴⁶ Moore M T, “Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism” (2014) 34 (4) *Oxford Journal of Legal Studies*, 693-728.

⁴⁷ *Salomon v Salomon*, supra n 42.

⁴⁸ Johnson P, *Making the Market: Victorian Origins of Corporate Capitalism* (Cambridge Studies in Economic History – Second Series) (CUP 2010).

Franks, Mayer, and Rossi found that there was no difference between the companies set up in 1900 and 1960, as well as the growth of ownership.⁴⁹ They concluded that “the forces that made founding families withdraw from corporate governance in the modern UK also operated a century ago”.⁵⁰

Chapman’s work on the nature of British merchants up to 1914 identifies how they developed into diversified business groups which he rather amorphously termed “investment groups”. He argued that their main function was financial and that they were primarily a device to maintain the growth and power of the family (or families) that contribute the particular business.⁵¹ In her original work on free standing companies Wilkins noted their lack of managerial hierarchies suggesting that they were fated for extinction over the long term.⁵² Chandler’s model also seeks to explain why Britain fell behind the US in the development of capital intensive manufacturing industries, particularly in the late 19th Century. In particular, Chandler pointed to the growth of large manufacturing firms managed by professional managers able to invest in mass manufacture and marketing. This “managerial capitalism” he contrasted with the “personal capitalism” preferred by the British in the form of atomistic firms owned and managed by families.⁵³ Chapman applied Chandler’s critique in his study of

⁴⁹ Franks J, Mayer C and Rossi S, “Spending Less time with the Family: The Decline of Family Ownership in the United Kingdom” (2005) NBER Chapters, <http://www.nber.org/papers/w10628> (accessed 23 September 2016) in Morck R K (ed.) *A History of Corporate Governance Around The World* (The University of Chicago Press 2005), 581-611.

⁵⁰ Morck R K and Steier L, “The Global History of Corporate Governance: An Introduction”, in Morck R K, supra n 49, 24-25.

⁵¹ Chapman S, *Merchant Enterprise in Britain* (CUP 1992).

⁵² Wilkins M, “The Free-Standing Company, 1870-1914: An Important Type of British Foreign Direct Investment” (1988) 41 *Economic History Review*, 259-85. Wilkins M and Schroeter H (eds.) *The Free Standing Company in the World Economy 1830-1996* (OUP 1998).

⁵³ Chandler A D, *Scale and Scope: The Dynamics of Industrial Capitalism* (Harvard University Press 1994).

managerial competence in his “investment groups” He showed that his investment groups sometimes attained a formidable size running contrary to the Chandler’s view. However, in other ways he confirmed other aspects of Chandler’s view. For example, he was critical of the continuing influence of the family and the retention of the partnership form. These he argued often led to nepotism and failure. However, the importance of family control in Britain in terms of relative decline may have been over emphasised.⁵⁴ Chandler himself went some way to conceding this point at a colloquium on *Scale and Scope* admitting that the critical difference between British, German and US firms was not the size of family holdings rather it was the stubborn continued practice of centralized decision making whereas their German and US counterparts were willing to cede authority to sophisticated managerial hierarchies.⁵⁵

Taking up the study of merchants Jones found that whilst joint stock companies were taken up for diversification, the partnership form remained widely used by many of the parent firms in the inter-war period and beyond.⁵⁶ During the post-war period waves of mergers culminating in the mid-1960s resulted in Britain’s economy becoming the most concentrated “big business” economy in Europe. As part of this process family influence and “personal capitalism” rapidly declined and was largely swept away. Public companies were increasingly used

⁵⁴ Church R, “The Limitations of the Personal Paradigm” (1990) 64 *Business History*, 703, 706. Jones G “Great Britain: Big Business Management and Competitiveness in Twentieth-Century Britain” in Chandler A D, Amatori F and Hikino T (eds.) *Big Business and the Wealth of Nations* (CUP 1997), 102, 108.

⁵⁵ Chandler A D, “Response to the Contributors to the Review Colloquium on *Scale and Scope*” (1990) 64 *Business History Review*, 736, 747. For a review of the research on “Personal capitalism” in Britain, Cheffins B R, *Corporate Ownership and Control: British Business Transformed* (OUP 2008), 11-17, 24 and 221-4.

⁵⁶ Jones G, *Merchants to Multinationals: British Trading Companies in the Nineteenth and Twentieth Centuries* (OUP 2000), 52.

to access capital even where the ultimate parent company remained family controlled. The requirement of the 1948 Companies Act that private companies had to disclose their financial details partly influenced this move.⁵⁷ This did little to facilitate active monitoring as the provisions reflected a number of compromises, including a directors' and industry lobby for reduced disclosure on the grounds of commercial secrecy.⁵⁸

By the 1980s the multinational enterprises which were the successors of the eighteenth and nineteenth century British trading companies were alive and active as complex international business enterprises. Within two decades many ceased to exist, some had focused on becoming chemical or food companies and distribution networks. Many had ceased to be British owned. According to Jones it was the British capital markets that proved to be the final arbiter of the fate of many British trading companies. These capital markets had enabled the growth of the diversified trading company prior to 1914 but with the declining price of shares in the publicly quoted companies in the 1990s the capital markets proved to be the nemesis of the diversified trading companies. By way of contrast it was the family control of Hong Kong based firms such as Jardine Matheson and Swires that ensured their survival.⁵⁹

Whilst some of the largest trading companies had no family influence Jones concluded that family influence was a striking feature in the management of

⁵⁷ Ibid, in Chapter 5. Companies Act 1948, ss 147-158.

⁵⁸ Maltby J, "Was the 1948 Companies Act a Response to a National Crisis" (2000) 5 *Accounting History*, 31-60. Toms S and Wright M, "Divergence and Convergence within Anglo-American Corporate Governance Systems; Evidence from the US and UK, 1950-2000" (2005) 47 (2) *Business History*, 267, 275.

⁵⁹ Jones, supra n 56, 341-2.

most trading companies. Indeed, provided family control could be combined with sufficient “outside” capital to provide for growth, Jones concluded that there was little evidence that family control was a disadvantage for trading companies. Family control provided an element of continuity to firms that engage in risky businesses and allowed them to “reinvent” themselves. Sustained ownership by a family could enhance their firm’s reputation for probity, competence and durability which were and remain an important “soft asset” for trading companies. Family ownership was an important factor after 1945 in the continued independence of firms. Of those trading/merchant firms that made the transition from family to managerial businesses few were successful in the longer term. When families sold their shares it often triggered a period of shareholder instability leading to acquisition or dissolution.⁶⁰

Manufacturing was also subject to mergers and nationalization. The US tendency to large divisionalised companies was only half-heartedly followed in the UK and the economies of scale achieved were less efficient. Many smaller innovative companies (often with an element of family block holding) were merged from the aero and car manufacturers to the chemical industry.⁶¹ At the same time the post war heavy taxation system, particularly in relation to close companies, with a correspondingly lighter regime for institutional investors encouraged many block holders to sell to the institutional investors, including pension funds.⁶² This further diluted family ownership of larger SMEs in the UK.

⁶⁰ Ibid. 352.

⁶¹ Toms S and Wright M, *supra* n 58.

⁶² Cheffins B R and Bank S A, “Corporate Ownership and Control in the UK: The Tax Dimension” (2007) 70 (5) *Modern Law Review*, 778-811. Foreman-Peck J and Hannah L “Some consequences of the early twentieth century British divorce of ownership from control” (2013) 55 (4) *Business History*, 543-564. Higgins D, Toms S and Filatotchev I, “Ownership,

According to Franks, Meyer and Rossi the landscape of corporate Britain had briefly resembled that of continental Europe during the 1950s and early 1960s. The development of an unregulated takeover market with the potential of acquiring control through the purchase of partial share stakes and discriminatory offers caused companies to respond in a number of ways. They introduced dual-class shares and voting rights restrictions. Pyramid structures also developed as companies sought protection under the umbrella of others. However, both institutional investors and the London Stock Exchange (LSE) were concerned with the interference that managements' ability to entrench itself behind takeover defenses and withdrawal of institutions' voting rights had on the takeover process. Their opposition steadily led to the demise of dual-class shares and the introduction of the Takeover Code in 1967.⁶³

However, efficiencies of the larger combines were increasingly questioned and the result was a move towards a more tax efficient regime for demerging and management buyouts.⁶⁴ An important factor influencing the growth of management buyouts in the UK from 1981 was the relaxation of the law regarding financial assistance in the purchase of a company's own shares.⁶⁵ This made it easier for buy-out financiers to take security. The period after 1980 saw the re-emergence of flexible specialization and the resurgence of the

financial strategy and performance the Lancashire cotton textile industry, 1918-1938" (2015) 57 (1) *Business History*, 97-121.

⁶³ Franks J, Meyer C and Rossi S, *supra* n 49.

⁶⁴ For a consideration of the tax regime and methods of demerging see Lawton P, "Demergers: An Assessment" (1984) 5 *Company Lawyer*, 17. In terms of corporate divestment demergers were far less successful and popular than the management buyout.

⁶⁵ The relaxation of the financial assistance rules helped management buyouts but not demergers where often a notional loan was required to equate values between the part being demerged and the part being retained, for example *Brady v Brady* [1989] AC 755 (HL). It was not until the Companies Act 2006 provisions that this problem was largely solve in the context of demergers.

smaller firm in Britain. In the UK, there had traditionally been a much closer link than in the US between the buy-out and venture capital markets.⁶⁶ The influence of works like Schumacher's *Small is Beautiful*⁶⁷ and the growing recognition of the importance of small and family business was on the march and increasingly recognized as important by law reform bodies and politicians. This culminated in the "think small first" policy behind the Companies Act 2006.

According to Toms and Wright the lack of opportunity to develop large scale industries forced British capital abroad. This left domestic entrepreneurs dependent on alliance and network style capitalism. They suggest that the British tended to perform badly when half-heartedly and partially importing US models of concentrated industry, productivity and managerial capitalism during the 1950s and 1960s. As a consequence of this, British firms were relatively well placed to exploit the return to shareholder capitalism in the 1980s.⁶⁸ As a result of these various and complex forces (often external determinants of corporate governance) and the evolution of their interaction, the UK is not a typical country in terms of its corporate landscape. Unlike most countries, it does not have concentrated ownership nor does it have pyramid structures (one method by which families retain control)⁶⁹. As a result, family ownership is of limited significance in traded and quoted companies whereas in most countries it is

⁶⁶ Toms and Wright, supra n 58, 279. Wright M, Thompson S and Burrows A, "Corporate Governance: The Role of Venture Capitalists and Buy-outs" in Keasey K, Thompson S and Wright M (eds.) *Corporate Governance: Accountability, Enterprise and International Comparisons* (John Wiley & Sons 2005).

⁶⁷ Schumacher E F, *Small is Beautiful: A Study of Economics as if People Mattered* (Random House 2011).

⁶⁸ Toms and Wright supra n 58, 285.

⁶⁹ For a consideration of how families maintain control of quite extensive business groups, Morck R and Yeung B, "Enterprise models: freestanding firms versus family pyramids" in Neal L and Williamson J G, *The Cambridge History of Capitalism (Vol II)* (CUP 2014), 201-229.

quite extensive if not dominant. In addition, the UK is the only country with anything like a true market for corporate control. In many other countries, a market for corporate control is either stymied by anti-takeover mechanisms or is largely non-existent.⁷⁰ Relatively recently, some aspects of these features of the UK corporate landscape, have been further accentuated by the activities of private equity and hedge funds.⁷¹

The Institute of Family Business report in 2011 indicated the importance of the family business sector to the UK economy as a whole. That report indicates that there were circa 3 million family businesses in the UK, or two in three of all private sector firms. They provided 40% of all private sector jobs, a 35% of all private sector turnover. Family businesses were estimated to have contributed £81.7 billion to the UK Exchequer (14% of total government revenues) in 2010. At that time, almost 2 million family firms were estimated to be sole traders (66%), incorporate companies (24%) and partnerships (10%) made up the rest. The 2011 report did however note a small decline in the number of family firms. During the recession caused by the financial crisis of 2008 demand for credit rose but family firms were more successful in obtaining external finance and appeared to be less vulnerable to corporate dissolutions, possibly a reflection of stronger balance-sheet fundamentals prior to the recession. However, most of the loan capital was for operating costs rather than investment.⁷²

⁷⁰ Franks J, Meyer C and Rossi S, *supra* n 49, 582 and 606.

⁷¹ Toms S, Wilson N and Wright M, "The evolution of private equity: corporate restructuring in the UK, c. 1945-2010" (2015) 57 (5), *Business History*, 736-768.

⁷² Institute for Family Business Report, "The UK Family Business Sector: Working to grow the UK economy", (2011) *Oxford Economics*, available at <http://www.lborolondon.ac.uk/media/wwwlborolondonacuk/downloads/research/enterprise-development/theukfamilybusinesssectornov2011.pdf> (accessed 14 September 2017).

In 2014 there were an estimate of 4.6 million family businesses in the UK, amounting to 87% of all private sector firms, up from 86% in 2013. They contributed an estimate £125 billion in tax in 2014 which was equivalent to 19% of all taxes collected by the UK Exchequer. Whilst most businesses were small firms (99.6%), medium-sized firms made up 0.3% of family firms. More than one in ten (10.9%) of large firms in the UK are family businesses. Family businesses employed an estimate 11.9 million people in the UK in 2014 (47% of all private sector employment). Family business remains very important if largely depending on the domestic market. However, Small Business Survey (SBS) definitional changes, survey sample changes and Oxford Economics methodological changes from year to year mean that the economic impact of family businesses is not perfectly comparable over time. Constant issues/problems in the reports include access to external finance (the need to raise external finance is often the main reason for dilution of family ownership). Access to external finance was often a critical impediment to success for family run businesses whilst the recent evidence on improvements in this regard is mixed. The issue of succession remains a challenge for many family firms. Institute of Family Business (IFB) reports almost 85,000 small and medium-sized family firms are likely to be sold or gifted to new owners each year before 2020 or 2021. Many have not prepared for the numerous difficult issues involved.⁷³

⁷³ Institute for Family Business Report, "The State of the Nation: The UK Family Business Sector 2015/16" (2016) *Oxford Economics*, available at <https://www.oxfordeconomics.com/recent-releases/state-of-the-nation> (accessed 14 September 2017).

The 2016 report on large family businesses in the UK also made some interesting and important points. The survey sample was comprised of the top 1000 companies (by turnover). The proportion of family businesses identified was 20.1% (using > 25% criterion for family shareholding). Just over half of these family businesses (10.8%) were UK family owned. The survey also indicated that UK family owned subsidiaries were more prevalent than subsidiaries owned by non-UK families. The proportion of family businesses in the top 200 companies was rather low at 8.3%. The largest number of family firms (27.8%) was found in the ranking 801-1000. Overall it was concluded that there may be a higher proportion of family-owned firms beyond the cut-off point of 1000. A total of 21 private equity owners were found within the 984 (of the top 1000 by turnover). Eight were identified as family businesses. Of these 4 were UK family owned. Family firms therefore have an important presence amongst the UK's largest firms (if not in terms of being quoted on the stock exchange). Survival rates of family firms in the top 1000 was also good.⁷⁴

2.4.2 China's Business History and Governance Factors

China has a long history in terms of trade and business activity. As the Roman, Pliny the Elder observed in the first century AD, "by the lowest reckoning, India, China and the Arabian Peninsula take from our empire 100 million sesterces

⁷⁴ Institute for Family Business Report, "UK Large Family Business Report 2016", RepGraph, (2016) available at [http://www.repgraph.co.uk/files/reports/UK%20Large%20Family%20Business%20Report%202016%20\(Website%20Final\).pdf](http://www.repgraph.co.uk/files/reports/UK%20Large%20Family%20Business%20Report%202016%20(Website%20Final).pdf) (accessed 14 September 2017). Franks J, Mayer C, Volpin P and Wagner H F, "The life cycle of family ownership: International evidence" (2012) 25 (6), *Review of Financial Studies*, 1675-1712.

every year – this is the sum which our luxuries and our women cost us”⁷⁵. Chinese silk accounted for a quite sizeable proportion of this sum. Indeed, over the centuries the trade via the “silk route” varied depending on the rise and fall of empires and the disruption or security that they brought with them.⁷⁶ From the earliest times trade via the silk-road and (from the 10th Century onwards) coastal and trade by sea⁷⁷ encouraged economic activity in terms of production, trade and banking systems (often in the form of credit associations and pawnbrokers until the 19th Century).⁷⁸

There have been a number of debates and hypotheses concerning the driving forces and major institutional drivers of economic development in China as well as the nature of business forms and networks. One area of contention is the relative importance of the roles of Smithian dynamics of market expansion and labour specialization and its interaction with the Schumpeterian dynamic of the opportunities presented by new technologies and the creative destruction thereby unleashed.⁷⁹ Throughout its history the Chinese state/government debated the extent to which it should engage in trade and commerce by say controlling salt and iron production and distribution and the extent to which it should leave it to merchants and the population at large to enrich themselves

⁷⁵ Pliny, *Natural History* Vol IV, books 12-16 Translated by Rackham H Loeb Classical Library 370 (Harvard University Press 1945), 63. McLaughlin R, *The Roman Empire and the Silk Routes: The Ancient World Economy & The Empires of Parthia, Central Asia & Han China*, (Pen & Sword History 2016), Chapters 1-3 and 14. Li L M, “Silks by Sea: Trade, Technology, and Enterprise in China and Japan” (1982) 56 (2), *The Business History Review*, 192-217.

⁷⁶ For an overview of the role of the silk road in Chinese economic history until relatively modern times, De La Vaissière E, “Trans-Asian trade, or the Silk Road deconstructed (antiquity, middle ages)” in Neal L and Williamson J G (dir.) *The Cambridge History of Capitalism Vol.1: The Rise of Capitalism: From Ancient Origins to 1848* (Vol I) (CUP 2014), 101-124.

⁷⁷ Von Glahn R, *supra* n 2, 1-10, Chapter 6.

⁷⁸ *Ibid.* 1-10, 150-51, 265-73, 336-45, 385-97.

⁷⁹ *Ibid.* 9.

through trade.⁸⁰ Nevertheless, the state influenced by Confucian and Neo-Confucian principles did not like to see individuals or groups becoming too powerful and rich by control of markets or excessive landholdings.⁸¹ This was justified in terms of the ruler's obligation to maintain harmony and frugality. Economic power independent of the state was viewed as ethically unacceptable, extravagant and punishable. Being lower than artisans or craftsmen in the Confucian hierarchy, and being unwilling to attract attention merchants sought to mask their wealth and thus seek to avoid official extractions and expropriations in a system which had no laws to provide redress.⁸²

With the family being the fundamental social and economic unit of Chinese society under Chinese law, business enterprises had no separate legal existence and remained wedded to the family institution. Property, for example, belonged to the household and not individuals. Business enterprises naturally took the form of family firms. Therefore, in order to pool capital and dilute risk from the Song Dynasty onwards various forms of partnership were created. According to Von Glahn because these arrangements lacked standing as legal entities they were governed by contracts.⁸³

A new boom in East-West trade was encouraged by the formation of the pan-Asian Empire of Chinggis and the revival of the overland trade network but the

⁸⁰ Wong R B, "China Before Capitalism" in Neal L and Williamson J G (eds.) *The Cambridge History of Capitalism* (Vol I) (CUP 2014), 125, 143-49.

⁸¹ Wong R B, supra n 80, and Whitley R, *Business Systems in East Asia: Firms, Markets and Societies* (Sage 1992), 93, 202.

⁸² Jacobs N, *The Origin of Modern Capitalism and Eastern Asia* (Hong Kong University Press 1958), 62. Whitley R, supra n 81, 93-94.

⁸³ Von Glahn R, supra n 2, 269.

incorporation of the Southern Song into the Yuan realm during a period when internecine conflict had erupted among rival Mongol Khanates once again re-orientated China's foreign trade towards the maritime world.⁸⁴ However, the rise of the Ming dynasty and the policies of the Hongwu emperor spurned the market economy developed since the Tang, Song and Yuan dynasties. His policies of social reform envisioned the restoration of a simple, village based agrarian society which rejected the extremes in wealth, ostentation and venality that had plagued the later Yuan dynasty. It would take a hundred years for markets to reassert themselves.⁸⁵

By 1500 the late imperial state possessed a complex range of policy options to influence economic activity. Behind these was the desire to raise revenues and support a stable social order. Whilst official policies fluctuated, two policy examples indicate the type of choices made. First the state could choose activist and interventionist approaches to control or direct economic activity. Examples include the regulation of mining and the exchange of vouchers for grain shipments for troops in the north. Secondly the state could monitor private sector efforts sometimes delegating responsibility or depend on others for the achievement of its goals. These approaches included market surveillance and reliance on elites for famine relief. In addition, and in between these two extremes of state control and an indirect monitoring there were many efforts to channel, redirect or limit private sector economic activity all influenced by Confucian and Neo-Confucian precepts.⁸⁶

⁸⁴ Von Glahn R, supra n 2, 283-284.

⁸⁵ Ibid. 385-394.

⁸⁶ Wong R B, supra n 80, 148.

In terms of business organisation, the Song-Yuan-Ming transition saw the development of what were initially localized corporate lineages. These were originally based on ritual practice and group solidarity rather than common economic interests. The development of lineage institutions and especially the development of corporate lineages, provided the opportunity and the means to transform the family firm into a quasi-corporate institution. Also, long distance traders who settled or stayed for some time in distant cities formed co-operative alliances with other merchants from their home areas. This not only facilitated long distance trade both within and beyond China but led to the creation of considerable trading empires by some groups, in particular the Shanxi and Huizhou merchants.

There also developed the concept of the “lineage trust” which was particularly useful in areas of economic activity requiring long term investment such as timber to which a more permanent quasi corporation like lineages were more suited. Whilst the purposes of lineage trusts were fundamentally ritual and moral ones such as sustaining the bonds of solidarity among kinsmen, maintaining the ancestral hall and gravesites, their resources were derived from the contributions of members. The members obtained income from their shares in such trusts but had no ownership rights and could not freely dispose of their shares. According to Faure the lineage trust was more akin to a holding corporation rather than a commercial partnership and their ritual character distinguished them from profit driven corporations⁸⁷. However, many lineage trusts exhibited a strong interest in profit maximization. Nevertheless, kinship

⁸⁷ Faure D, *China and Capitalism: A History of Business Enterprises in Modern China* (Hong Kong University Press 2006), 33-44 and 230.

and lineage bonds failed to shield lineage trusts from internecine conflicts. As McDermot observed, the main long-term problem faced by lineage trusts was the sustaining of control and cooperation among increasingly numerous and distantly related members.⁸⁸ This often led to some entrepreneurs venturing out independently without being encumbered by family ties and obligations.⁸⁹

During the later Ming and Qing, it became more common to form partnerships with multiple investors in order to pool resources and reduce risk. This also allowed these partnerships to extend the geographical range of their commercial activities. Whilst many of these, especially the *commenda* type of partnership, were often short lived other new types of partnership institutionalized the enterprise as a more permanent corporation independent of its individual investors. Conclusive evidence for the development of joint-share partnerships evolving beyond the constraints and limitations of the family firm is available from the sixteenth century onwards. This helped the longevity of such firms because dividing a partnership into shares enabled investors to withdraw without jeopardizing the firm's capital assets. It also allowed multiple heirs (note Imperial China's legal principle of equal inheritance) to preserve their individual stakes. This type of partnership also allowed for managers who provided only their expertise and labour but no capital. The buying and selling of shares had developed by the 18th Century but being largely dependent on personal relationships and contacts it did not lead to the development of a stock market.

⁸⁸ McDermott J P, *The making of a New Rural Order in South China (Vol I) Village, Land and Lineage in Huizhou 900-1600* (CUP 2013), 366-68.

⁸⁹ Von Glahn R, *supra* n 2, 301-306.

Partnerships (*hehuo*) could take a number of forms. These included first the *commenda* arrangement, secondly the joint-share partnership (*heben* or *hegu*) and thirdly the agency partnership. The *commenda* partnership usually only lasted for a single trading venture and took the form of one partner investing money whilst the active partner, in addition to his time, contributed his skills such as his knowledge of clients, shippers and brokers; his expertise in evaluating the quality and value of goods as well as his familiarity with trade routes and markets. Often profits were shared equally but since the investor took a greater risk by placing his capital at the disposal of the active partner he usually took the greater share of profit.⁹⁰ However, there was no strict legal definition of a partnership in Imperial China and no body of civil law to govern their organisations and activities. Contracts were often the basis of partnerships⁹¹. Magistrates would enforce customary commercial practices contained in contracts as long as they did not conflict with the provisions of statutory law. Only households (not individuals) were recognized by imperial law as bearers of property rights and having liability for debts.⁹² This could produce some areas of ambiguity and most disputes were settled by private mediation rather than law courts. As an example, bankruptcy operated outside the formal legal system

⁹⁰ Ibid. 336.

⁹¹ Contracts were important in imperial china for securing property rights and establishing business partnerships, Gardella R, "Contracting Business Partnerships in Late Qing and Republican China: Paradigms and Patterns", Kwan M B, "Custom, the Code, and Legal Practice: The Contracts of Changlu Salt Merchants in Late Imperial China" and Zelin M, "A Critique of Property rights in Pre-war China" in Zelin M, Ocko J K and Gardella R (eds.) *Contract and Property in Early Modern China* (Stanford University Press 2004), 327-47.

⁹² For the importance of property rights in Imperial china, see the case of Wang Zhen discussed in Brook T, *The Troubled Empire: China in the Yuan and Ming Dynasties* (Harvard University Press 2013), 156-160.

through customary forms of negotiation. The magistrate would only intervene to punish fraud or to compel parties to cooperate in mediation.⁹³

It is important to note that many firms had the potential to assume a permanent corporate existence. Examples include the Wanquantang medicine shop founded in Beijing at the turn of the 18th Century and which lasted for 250 years despite going through changes in partnership membership. Others include the Tongrentang medicine shop founded in 1702. This business, unlike the Wanquantang partnership granted dividend shares to its managerial personnel. In 1820 the original founding Yue family regained control. The Yutang processed foods company founded in 1779 had evolved from a family business into a multiple partnership relying on professional managers. In 1905 one of the two principal investors, whose family had been investors dating back to 1807, bought out his partner and the common investors and reestablished the firm as a family firm remaining as such until it was nationalized in 1956. These examples demonstrate the flexibility of the Chinese business partnership form of enterprise for it allowed firms to expand their capital and recruit expert managers. In doing so it enabled the firm to develop a permanent existence that was independent of the skills, financial condition and interests of the founders and their heirs. Even so, this sometimes allowed either the founding family to regain control or one of the investors to do so thus re-characterizing the firm as a family firm.⁹⁴

⁹³ Dykstra M, "Beyond the Shadow of the Law: Firm Insolvency, State Building, and the New Policy Bankruptcy Reform in Late Qing Chongqing", (2013) 8 (3) *Frontiers in Chinese History*, 406-33.

⁹⁴ Von Glahn R, *supra* n 2, 336-345 for these and other examples.

In the late Qing, a number of new banking and credit institutions developed which facilitated linkages between domestic markets and foreign trade, lowered the cost of credit and helped regulate commercial exchange. To a limited degree they borrowed from Western examples but in their essence, they largely consisted of adaptations of existing institutions which evolved to meet the diverse demands for commercial services. Early forms of these new types of financial institutions were the account agencies (*Zhangju*). These were chiefly located in Beijing and issued loans to commercial clients for up to one year. Whilst these were quite plentiful their individual operations remained quite small at roughly the size of a typical pawn brokerage in the capital. Native banks (*Qianzhuang*) were similar to account agencies but became active in foreign trade in the treaty port era. The demand for their services increased with the growth in foreign trade and since foreign firms had no access to the inland producers of silk and tea they relied increasingly on their “comprador” Chinese agents who established their own *qianzhuang*. This helped them to funnel finance from foreign firms to domestic clients. These institutions, in addition to accepting deposits, exchanging currency and making short term loans to merchants, issued various types of commercial paper similar to bills of exchange and promissory notes (*zhuangpiao*). In the second half of the 19th Century *qianzhuang* borrowed money from foreign firms using only their own notes as security which made them vulnerable to economic fluctuations so that financial crises in 1873 and 1883 bankrupted half of Shanghai’s *qianzhuang*. Success in the context of *qianzhuang* business relied very heavily on personal trust and connections. Native place ties based on familiarity underpinned the creditworthiness of partners, correspondents and clients sometimes dubbed

“fiduciary communities”.⁹⁵ Nevertheless the *qianzhuang* were essentially local institutions. The Ning-Shao banking network provided a substratum for the practice of account transfers thus enabling merchants to settle debts without resorting to the exchange of hard currency. These linked-firm forms of business organisation helped to disperse risk and develop intimate personal relationships with clients, which was especially fundamental in the finance industry. Again, family involvement could be central. The Fang family of Ningbo owned over forty *qianzhuang* including twenty-five in Shanghai.

Another form of banking institution was the *piaohao* bank, often called Shanxi banks. These initially focused on facilitating long- distance trade but eventually focused the majority of their business on government finance so that after 1870 the Shanxi banks handled 30% of total government revenues. This huge infusion of capital allowed them not only to offer personal loans, make advances to government agencies but also to broker loans from foreign banks for major infrastructure work such as railway construction. They therefore mobilized capital on a considerably greater scale than the more local *qianzhuang* banks. However, the dependence of the *piaohao* on business with the imperial government meant that their survival was increasingly dependent on the fiscal health of the Qing state. In 1897 the Imperial Bank of China (IBC) was founded in Shanghai and in 1905 the Da Qing (Great Qing) bank based in Beijing replaced the IBC. Amongst other objects it took over most of the remittances

⁹⁵ McElderry A L, “Securing Trust and Stability: Chinese Finance in the Late Nineteenth Century” in Brown R A (ed.) *Chinese Business Enterprise in Asia* (Routledge 1995) 27-44; Liu M J, Huang J, Chong A Y, Guan Z Z and Yannopoulou N, “Fellow-townsmanship as the mechanism for exploring and exploiting business opportunities: A Longitudinal reflection of the nineteenth century Ningbo entrepreneurs in Shanghai” (2015) 57 (6), *Business History*, 773-799.

from the *piaohao* banks. The fall of the Qing dynasty in 1911 forced the Da Qing to close its doors and within a few years almost half of the *piaohao* banks, including most of the largest ones had ceased to carry on business. As an institution, it largely disappeared. From amongst their managerial personnel came a considerable number of entrepreneurs who went on to found modern private banks in the early Republican era.⁹⁶

The Hanyeping Company, China's first modern industrial cartel, was formed from the amalgamation of three enterprises. According to Liu Yun, from a firm specific perspective, this pioneer trial by the Chinese scholar-bureaucrat elites resulted in failure largely because the firm failed to establish effective corporate governance. This institutional deficiency closely correlated with the over-stressing of the role of elites and a state led top-down approach taken by them.⁹⁷ Whilst government support was very important to the growth and survival of enterprises its deep and often heavy involvement sometimes had negative impacts which contributed to the eventual demise of some firms. One example is the China Merchants Steam Navigation Company. This prospered under the management of merchants but faltered when government officials gained control and management of its operations.⁹⁸

⁹⁶ For an overview of late Imperial Chinese financial institutions, Von Glahn R, *supra* n 2, 385-396. Cf. Wilson C and Yang F, "Shanxi Piaohao and Shanghai Qianzhuang: a comparison of the two main banking systems of nineteenth-century China" (2016) 58 (3), *Business History*, 433-453.

⁹⁷ Liu Y, "Revisiting Hanyeping Company (1889-1908): A case study of China's early industrialisation and corporate history" (2010) 52 (1), *Business History*, 62-73. Cf. Peng L and Brown A M, "A decade of hybrid reporting and accountabilities of the Hanyeping Company (1909-1919)" (2016) 58 (8), *Business History*, 1183-1209.

⁹⁸ Lai C, "The Qing State and Merchant Enterprise: The China Merchants Company 1872-1902" in Leonard J K and Watt J R (eds.) *To Achieve Security and Wealth: The Qing Imperial State and the Economy, 1644-1911* (Cornell University 1992), 139-155.

Relatively modern family business development from 1872 to 1949 has recently been studied by McWatters *et al.* focusing on manufacturing businesses from the establishment of the first modern, family run manufacturing business in 1872. They assert that Chinese family business has never been a homogenous form. Chinese family in other countries could be quite different from Chinese family businesses founded and operated in China. The context of colonialism, revolution, war, political turmoil and economic uncertainty provide a rich institutional context in which family firms were embedded.⁹⁹ Despite these challenging conditions studies by Chan indicate that Chinese textile firms, particularly in cotton spinning, were able to outperform their British counterparts despite the fact that the latter benefitted from more advance technology.¹⁰⁰ The successful Chinese family businesses were able to develop managerial techniques borrowed from abroad and, taking into account the unique cultural and societal environment in China, to develop new forms of organisation and management.¹⁰¹ On the other hand, particularly in the war free zone, being small was critical to family firms because it gave them flexibility and allowed them to effectively and efficiently manage their workforce. Whilst such firms could purchase advanced equipment they often suffered from a lack of skilled management. This often resulted in lower efficiency and a higher operating cost

⁹⁹ McWatters C S, Chen Q, Ding S J, Hou W X and Wu Z Y, "Family business development in mainland China from 1872 to 1949" (2016) 58 (3), *Business History*, 408-432.

¹⁰⁰ Zeitz P, "Do Local Institutions Affect All Foreign Investors in the Same Way? Evidence from the Interwar Chinese Textile Industry" (2013) 73 (1), *The Journal of Economic History*, 117-141.

¹⁰¹ Chan W K K, "Personal Styles, Cultural Values and Management: The Sincere and Wing on Companies in Shanghai and Hong Kong 1900-1941" (1996) 70 (2), *Business History Review*, 141-166; Cf. Godley A C and Hang H M, "Collective financing among Chinese entrepreneurs and department store retailing in China" (2016) 58 (3), *Business History*, 364-377.

which in part explains the competitive disadvantage that many Chinese family firm shad face relative to foreign companies.¹⁰²

The various examples of better practice considered by McWatters include having sons and daughters educated abroad, particularly in the West, but with an expectation that they will return to work in the family business, teams of brothers founding and working in the management of the family business and examples where the managers were not always the controlling shareholders. As Kirby¹⁰³ and Cochran¹⁰⁴ emphasise Chinese family business had its roots in networks of family and other social ties. The early 1904 company law of the dying days of the Qing dynasty was not a success because, according to Kirby, family business did not take to strangers being shareholders in the corporate business. The early Chinese company law aimed to create an improved legal environment for private business and was modeled on laws in Japan and Britain. Its effect was marred by lack of a regulatory effort to support a capital market and did not bring about significant changes to family businesses. The law failed to protect shareholders or curb managerial power. There was no specific regulation on company reporting resulting in vague accounting and a lack of transparency, allowing family firms to extract private benefits.¹⁰⁵ Self-regulation still dominated and guilds exercised authority in this regard. Guilds were the principal members of chambers of commerce and commercial disputes were

¹⁰² McWatters C S *et al.*, *supra* n 99.

¹⁰³ Kirby W C, "China Unincorporated: Company Law and Business Enterprise in Twentieth-century China" (1995) 54 (1), *The Journal of Asian Studies*, 43-63.

¹⁰⁴ Cochran S, *Encountering Chinese Networks: Western, Japanese and Chinese Corporations in China, 1880-1937* (University of California Press 2000) Note in particular chapter 7 on the China Match Company and Chapter 8 on Corporations and Networks.

¹⁰⁵ Goetzmann W and Köll E, "The History of Corporate Ownership in China: State Patronage, Company Legislation and the Issue of Control" in Morck R K, *supra* n 49.

resolved within the chambers. Business organisations, in particular family businesses, continued to rely on guilds to regulate their transactions despite the development of the company law which was revised in 1929.¹⁰⁶

Several family businesses grew considerably in China prior to 1949. Examples include the Rong family business, which as a symbol of Chinese family business and enterprise may have received support from banks that were also run by Chinese businessmen. Unfortunately, what was hoping to be a golden age after 1945 was marred by corrupt government. Members of the family were subject to extortion and abduction during the 1945-49 period being forced to pay significant sums of money in order to regain their freedom. Corruption therefore put a hold on the development of family business after the Sino-Japanese war.¹⁰⁷ Indeed during the late Qing period only a fraction of family businesses registered with the Chinese government fearing that to do so would result in loss of management control and family wealth.¹⁰⁸ A similar explanation has been put forward for the later low take up on the use of the corporations' laws in early twentieth century China.¹⁰⁹

After the founding of the People's Republic of China (PRC) in 1949, most economic activity fell within the remit of state-owned firms. Three decades later the introduction of the open-door policy led to the reemergence of family owned

¹⁰⁶ Zelin M, "Chinese Business Practice in the Late Imperial Period" (2013) 14 (4) *Enterprise and Society* 769-793. Zelin M, "The Firm in Early Modern China" (2009) 71 (3) *Journal of Economic Behavior & Organization*, 623 – 637.

¹⁰⁷ McWatters *et al.*, *supra* n 99, 421-422.

¹⁰⁸ Goetzmann W and Köll E, *supra* n 105.

¹⁰⁹ Bowen J R and Rose D C, "On the Absence of Privately Owned, Publicly Traded Corporations in China: The Kirby Puzzle" (1998) 57 (2) *The Journal of Asian Studies*, 442-452

and managed enterprises in the PRC. Their numbers grew dramatically. This was especially noticeable in the Special Economic Zones and coastal plains. In the early 1990s stock exchanges were established in Shanghai and Shenzhen. A number of family firms were listed, some of them being cross listed on foreign stock exchanges. Family firms have therefore experienced a renaissance in China.¹¹⁰

2.5 The Lessons of Business History

In both the UK and China business history shows the importance of family business in historical and modern context. Whilst the institutional, economic and political contexts vary resulting in a relatively unique corporate landscape in the UK and the resurgence of family businesses in China. The contribution of family business to the economies of both jurisdictions remains of considerable importance after 1990s. In the UK, the emphasis on “think small first” has not really succeeded in delivering noticeable benefits following the Companies Act 2006.¹¹¹ Indeed there have been calls for a greater variety of legal vehicles for carrying on business.¹¹² In China the historical record shows the importance of the family firm in carrying on entrepreneurial and business activities throughout

¹¹⁰ Pistrui D, Huang W, Oksoy D, Zhao J and Welsch H, “Entrepreneurship in China: Characteristics, Attributes, and Family Forces Shaping the Emerging Private Sector” (2001) 14 (2) *Family Business Review*, 141-152. Ding Y, Zhang H and Zhang J X, “The Financial and Operating Performance of Chinese Family-Owned Listed Firms” (2008) 48 (3) *Management International Review*, 297-318. Ding S J, Qu B Z and Zhang Z L, “Accounting Properties of Chinese Family Firms” (2011) 26 (4) *Journal of Accounting, Auditing and Finance*, 623-640. Kim Y and Gao F Y, “An Empirical Study Of Human Resource Management Practices in family Firms in China” (2010) 21 (12) *The International Journal of Human Resource Management*, 2095-2119. Lu Y and Tao Z G, “Contract Enforcement and Family Control of Business: Evidence from China” (2009) 37 (4) *Journal of Comparative Economics*, 597-609.

¹¹¹ Reisberg A, “Corporate Law in the UK After Recent Reforms: The Good, the Bad, and the Ugly” (2010) 63, *Current Legal Problems*, 315-374, at 332-336 and 362-363.

¹¹² Fisher G and Ormerod P, *Beyond the PLC* (Institute for the Study of Civil Society 2013).

its history. The importance of Confucian culture and the legal emphasis on family in that context had an important part to play.

Whilst it has been suggested that the recent upsurge in entrepreneurial activity in China is not a rebirth of an earlier tradition but may rather be attributed to reform an institutional change which have occurred post 1949 (before the introduction of economic reforms in 1978) and post the 1978 reforms. Atherton and Newman posit that these institutional reforms have been evolutionary adapting to as well as shaping emerging forms of economic activity. This includes entrepreneurship. They conclude that these developments produce “rule ambiguities” within the institutional framework that creates opportunities for entrepreneurs. At the same time these opportunities are vulnerable to continuing institutional change.¹¹³ However, in light of the historical context outlined above, the same comments could be made throughout China’s history to a greater or lesser extent in each period.

McWatters *et al.* also point out that the history of the family business from 1872-1949 might have important lessons for Chinese entrepreneurs at present. Just as in that period family firms have to compete with government, foreign firms and the consequences of “unequal” treaties a similar situation applies today. How the earlier firms coped and developed strategies to meet their challenges has lessons for family firms at present.¹¹⁴

¹¹³ Atherton A and Newman A, “The emergence of the private entrepreneur in reform era China: re-birth of an earlier tradition, or a more recent product of development and change?” (2016) 58 (3) *Business History*, 319-344.

¹¹⁴ McWatters C S *et al.*, *supra* n 99, 423-5.

The importance of the historical survey is that it shows the importance of family business in the context of both the UK and China. Although in the former, family control of large public corporations declined, in the latter family businesses have prospered in recent years and many are listed.

Chapter 3 Legal System and Legal Reform in China

3.1 Legal Reform in China and Its Relationship with Economic and Political Reform

Chinese legal reform has been tangled with economic reform and political reform in the last four decades. Zhu concluded, Chinese legal norms changed significantly and influenced by a series of changes, including “market economy, democratic politics, the harmonious society, ecological civilization, the construction of a legal system and globalization”¹¹⁵. The legal reform is basically a process of building the legal framework with socialist characteristics combined with socialist market economy characteristics. It is consistent with Central Communist Party’s (CCP, or Communist Party of China, “CPC”) goals in all meetings in the past four decades, with the aim of building a harmonious society and a unique Chinese market economy with socialist characteristics. In 1997, the CCP raised the mission of “formulating a socialist legal system with Chinese characteristics by the year 2010”¹¹⁶, it shows that legal reform of China has been planned by the central government, along with the economic and political reform. There are several scholars commented the legal reform and economic reform as influencing and reflecting the government’s monopoly on political power.¹¹⁷ Regardless it is right or wrong, as Zhu Jingwen stated, Chinese legal

¹¹⁵ Zhu J W, “The Socialist Legal System with Chinese Characteristics: Its Structure, Features and Trends”, (2011) 32 (3), *Social Sciences in China*, 87.

¹¹⁶ Zhu J W, *supra* n 115, 88.

¹¹⁷ Dicks A, “The Chinese Legal System: Reforms in The Balance”, (1989) 119, *The China Quarterly*, 540-576.

Chen Z W, “Capital markets and legal development: The China case”, (2003) 14, *China Economic Review*, 451-472.

system now is structured as a socialist legal system with Chinese characteristics, the Constitution is the core and various branches of law are the basis.¹¹⁸ To understand the legal reform process, it is necessary to learn how the legal reform started with the economic and political reforms.¹¹⁹ The examples of CCP reforms economy and law as political tasks can be found in Appendix 1.

China's economy has grown rapidly in the past four decades. Seeing the failure of Soviet Union, CCP realised China needs to go through a different socialist development. After the Cultural Revolution (1966-1976) completely destroyed legal institutions, government determined to change the situation. The new leadership under Deng Xiaoping from 1978, decided to create a unique and independent development for modern China – Open Door Policy (or opening up) – a big economic reform decision in China's economic history. The leadership was determined to change Mao Zedong's radicalism, and this was when the economic reform started. However, this economic reform was the result of

Ohnesorge J K M, "China's economic transition and the new legal origins literature", (2003) 14, *China Economic Review*, 485-493.

Ho D, Lau A and Young A, "Enterprise ownership and control in China: Governance with a Chinese twist", (2012) 55, *Business Horizons*, 575-582.

Potter P B, "The Chinese Legal System: Continuing Commitment to the Primacy of State Power", (1999) 159, *The China Quarterly*, 673-683.

¹¹⁸ Ibid.

¹¹⁹ Black E A and Bell G F (eds.) *Law and Legal Institutions in Asia* (CUP 2011), 10. An important difference between China's legal system and common law system, is that in China's socialist system, the Standing Committees of the National People's Congress reserves the power of legal interpretation. It has allowed the Supreme People's Court to issue various forms of judicial interpretations to assist in the application of law by provincial courts. "This may include replies to questions submitted by a lower court on which law and interpretation thereof should be applied in a case before the lower court." A common law system would not interpret like this. Meanwhile, academic writing or commentary is an indirect source, scholars may only be consulted where disputes are adjudicated or legislation is drafted. Although China is categorized into Civil Law system, this is not consistent with the civil law tradition, where academic writing or commentary shall be as a source of law. In the case of Japan, academic commentary is particularly strong.

political reform. In fact, the period of reform including economic, political and legal reforms can be generally divided into 1978-1989, 1989-2003, 2003-2012, 2012 onwards.¹²⁰

The first political reform came under Deng Xiaoping's leadership. Since 1978, Deng Xiaoping's aim was to bring stability to the party and party's governance.¹²¹ He raised the slogan of "Black Cats White Cat".¹²² New government officials were promoted and elderly officials retired.¹²³ It seemed to be a clearing house action, but it helped China to survive from what Soviet Union did not in the 1980s.¹²⁴ Along with this political reform, the economic reform started. In 1992, Deng Xiaoping visited the Special Economic Zones¹²⁵ and modernized industries. Deng Xiaoping believed that it was necessary to welcome and attract foreign investors to China and invest in China but also maintain China's socialism. Later in the year, Deng Xiaoping announced a "socialist market economy" is the key task for China in 1990s on the 14th National Communist Party Congress.

¹²⁰ Minzner C, "China after the reform era", (July 2015) 26 (3), *Journal of Democracy*, 129-143.

<https://search-proquest-com.ezproxy.lancs.ac.uk/docview/1697197441?accountid=11979> (accessed 28 July 2017).

¹²¹ Ibid.

¹²² Ibid. Slogan is "It does not matter if a cat is black or white, as long as it catches mice." It states that regardless which path China takes, as long as the country grows strong and people are happy.

¹²³ Ibid.

¹²⁴ Ibid.

¹²⁵ In 1979, four coastal economic zones were created as the symbols of attracting new foreign trade, and as the beginning of encouraging foreign investments. The four zones are in the cities of Shenzhen, Zhuhai, Shantou, and Xiamen. The development went well, so there were further 14 largest coastal cities opened in 1984, including Shanghai, Tianjin, Dalian, which are all major commercial cities now. The main purpose is to bring foreign firms that having advanced technology and investments to China, in order to fostering Chinese industries and economy in general. Hayter R and Sun S H, "Reflections on China's Open Policy Towards Foreign Direct Investment", (1998) 32 (1), *Regional Studies*, 1-16, <http://dx.doi.org/10.1080/00343409850123585> (accessed 17 November 2013).

The results of economic reform improved China rapidly, the agriculture sector developed, market incentives came into China, rural areas grew richer, and township and village enterprises started to grow strongly. With both political and economic reform proceeding apace, legal reform was an important goal during this period. Legal changes were made to adapt with economic development. In general, the regulations were more business and market oriented. In the mid-1980s, with the development of the joint ventures format becoming the most common model, the regulations of trading became less strict; and sole ownership by foreign investors in the Chinese market was legalized. Along with the foreign new models of business activities stimulated domestic commercial activators, relevant laws and regulations came into force, private entrepreneurs were hugely encouraged in the 1980s. By the time of late 1980s, rapid growing private business activities had become a wide range of providers who offered more options for the Chinese public than ever in its history.¹²⁶ Government bodies came out with hundreds of laws and regulations in a reasonably comprehensive manner, such as criminal law, civil law and commercial law.¹²⁷ Law became a profession again after Mao's rule.

¹²⁶ For the convenience, the important progresses in China are listed as below:
The Communist Party of China took over in 1949 – defeating the Nationalist Party in the civil war of China;
In the 1950s, the socialist transformation of the economy (during the period, many private businesses were taken over as part of the socialist progress);
In the 1960s and 1970s, the Cultural Revolution;
In 1989, Tiananmen Square event;
Around 1979 till present, abandoned the planned economy and developed the market economy and privatization (economy reform);
In 2001, PRC joined the WTO;
In 2008, Beijing Olympics Games was held successfully.

¹²⁷ Minzner C, supra n 120.

Economic reform in China is a double-edged sword, it brought opportunities for China as well as problems and challenges. Legal reform is one of the challenges. In terms of Company Law, the principles of foreign trade and managerial issues were new to China and there was a lack of regulation to cover all aspects; From other perspectives, more corruption and commercial crimes were committed under the attraction of making money, and mostly using connections and networks *guanxi* to obtain benefits for personal purposes.

After the ten years of huge changes in China, the CCP had a huge crisis in governing the country in 1989 because of the student democracy movement.¹²⁸ The crisis made the Party to further conduct political reform to maintain the CCP's governance and contain central power. The reform was continued but with a very comprehensive level of interference in business activities from the government. Deng Xiaoping's decisions of putting more elderly CCP leaders to retirement and pointed successors for the next decades gave China a chance to prevent what happened in Soviet Union.¹²⁹ Jiang Zemin took over the leadership in 1989 along with Deng Xiaoping's policies in politics helped to stabilize the Party's central control for almost two decades.¹³⁰

After 1990, the CCP stabilised the central control, but sought more control over all levels of local governments. Political stability boosted economy of China. Jiang Zemin and the leadership followed Deng Xiaoping's guidance to continually develop economy in building modern China. Further economic

¹²⁸ Ibid.

¹²⁹ Ibid.

¹³⁰ Ibid.

reform continued in 1992. Employment in more varied entities, private housing grew and less state control over these sectors.¹³¹ Graduates flooded into all type of enterprises and many joined private sector and foreign capital involved firms. Central government made legal reform to a very impressive level by 1999. The Company Act was established in 1993, which was the beginning of China's corporate governance. It was then amended in 1999 and more recently in 2014.

The Party continued to encourage economic development, further actions such as joining WTO in 2001 and allowing wealthy entrepreneurs to join the CCP in 2002 showed the flexibility and new trend of the Party's developing policies. However, in fact, the Party was trying to maintain its control by earning people's faith as the economy developed, by giving more power to the public and allowing a few legal channels for public to monitor local governments. For instance, members of the public could only complain about local government through *xinfang* departments (a division in government departments to deal with people's complaints against officials), courts (it is limited and courts mostly supported local government's reputation so the complaints could not be solved with justice or the results were biased) or village officials (elected officials mediate mainly to deal with conflicts in very low-level villages or towns)¹³². CCP developed law and litigation very much in 1990s including the Company Act in 1993. Furthermore, "rule of law" was raised by CCP as a new slogan in 1997. The central government later then amended Constitutional Law to add "rule of law" in 1999.

¹³¹ It used to be the state arranged employment for graduates after college, and state also arranged housing matter for public.

¹³² Minzner C, supra n 120.

By 2000, the economy continued to grow and more foreign social and cultural influences impacted in China. Many Media outlets changed from speaking for government to seeking more objective facts and truth as some Western media did. Reports of government officials abusing powers and consequential complaints from members of the public came to light. As a result, more people sought media exposure in terms of their filed complaints to government officials. The pressure from public exposure pushed central government to tighten its control over the media and restrict the flood of foreign cultural impacts over the Chinese public. For instance, China's government sought greater control over the internet and introduced its "Great Firewall of China" to control information from crossing borders.¹³³ However, the control did not help with the domestic situations much. Because of the political stabilizing process in the 1990s, many Han nation Chinese were sent to varied locations in China to maintain control of the CCP, which produced the further tension with Tibet and Xinjiang.¹³⁴ In 2008, a huge tragedy happened in the capital Urumqi.¹³⁵ The tragedy led to a massive arrest actions and severe legal punishments. In my opinion, that shook the control of CCP in the early 21st century and then government decided to develop West area such as Xinjiang and Tibet, including improving the financial situation locally and develop infrastructure programs to connect Western and Eastern China. At the same time, in Eastern China, the economy continued to grow, but the government's policies and regulations were falling behind the general business and economic environment. For instance, most of the economic development was situated in urban areas, whilst the township and village

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

enterprises which were an engine of economic development in the 1980s were facing decline, which seriously affected employment in rural areas. Meanwhile, government jobs attracted more graduates to join compared with the private sector in the last decade due to their stability and guanxi network building opportunities that brought more “grey income”. The situation in rural areas created the huge *Yi Min Chao* (migrant moving wave) to urban cities for work opportunities. Many rural areas only residents were the elderly and young children.

In the 1990s, the development of SOEs was dramatic in terms of their financial situation and political advantages. By the middle of 2000s, the central government set policies and publicly promoted SOEs to strengthen their position in competition with foreign companies.¹³⁶ However, the strong support and promotion led to corruption and overwhelming power for some SOEs managers and government officials. The situation in general was getting out of control and causing instability for CCP’s leadership in governing China. As a result, the CCP examined the situation carefully. Premier Wen Jiabao raised the development path in China in 2007, China was “unstable, unbalanced, uncoordinated, and ultimately unsustainable.”¹³⁷ Thereafter, the Party determined to alleviate poverty in rural areas, tried to balance the disparity in terms of economic development between Western and Eastern China and control/counter corruption to restore more order to economic and social development, and most importantly to strengthen CCP’s central power.

¹³⁶ Ibid.

¹³⁷ Ibid.

In the early second decade of 21st century, the political situation became more dramatic. Xi Jinping, the President, became the first president since Mao Zedong to control both military and political power at the same time. Since the commencement of his regime, the leadership changes within the CCP have been tremendous. Bo Xilai and Zhou Yongkang, for instance, were the high-profile cases in political changes after Xi Jinping's presidency. From central committee to local governments, all levels of government have been strictly investigated and watched since Xi Jinping's regime. While the political changes happened inside the governments, the economic growth was very important for China as the CCP wanted to maintain the double-digit growth but it fell to 7.7 per cent by 2012.¹³⁸ Unlike many other parts of the world suffering from the effects of the financial crisis in 2008, the government put considerably more investment into development programs particularly in infrastructure projects. In the meantime, the mismatch between economic development and the enactment of appropriately updated laws and regulations brought more challenges. After amending the Company Act in 2005, the other important amendment in Company Act happened in 2013, it seemed to be that China aimed to build a foundation for Chinese company law to better connect with the corporate world and opened the market economy to a higher level. The changes showed the purposes of releasing responsibilities from authorities but giving more power to shareholders and individuals instead. Although the changes of legal reform can be helpful, the potential risks and challenges exist. It is not impossible to regulate or guide legal entities by authorities in the future, but there

¹³⁸ Ibid.

is a need to have comprehensive levels of regulations and laws to solve the issues.

3.2 Challenges During Legal Reform – Legal Framework and Economy

China has developed to one of the largest emerging markets worldwide, and has greater political and cultural impact in the region.¹³⁹ Moreover, with developments in other parts of Asia the region has become a global player.¹⁴⁰ However, the developments such as the stock market and private ownership have not achieved complete acceptance by the Chinese public since 1990s,¹⁴¹ despite encouragement from government and financial institutions. Scholars such as Chen and Coffee demonstrated that in the early stage of economic reforming process, when the capital market first developed, the absence of legal frameworks in the area was obvious and lagging behind.¹⁴² The legal development was made after government and institutions realised the problems and tried to regulate economic activities in stock markets, although China did not have the correct and clear image about it. The judiciary did not have much experience about securities law (also corporate and commercial/business law generally) and this remains an ongoing issue today.¹⁴³ This situation is consistent with Coffee's hypothesis - the "crash-then-law".¹⁴⁴ It explains the

¹³⁹ Black E A and Bell G F, *supra* n 119, 1.

¹⁴⁰ *Ibid.*

¹⁴¹ Chen Z W, *supra* n 117, 451-472.

¹⁴² *Ibid.* Coffee J C J, "The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control", (2001) 111 (1), *Yale Law Journal*, 1-82.

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

legal development in China was pushed by the environment and the needs of having legal frameworks from relevant parties. Lawmakers started to realise the absence of the law in economic and financial area, as well as the urgent need to have a legal framework for practitioners. It is an example of the correlation between politics, economy and law sectors, as well as China's development tending to be one of "crash-then-law" in line with the hypothesis of Coffee. Understanding the process is an important way to discover and explore the legal development at present and in future.

As some academics explored, law does matter for economic and market development in the law and economics literature.¹⁴⁵ For instance, in 1990s the economy and finance pushed the development of the legal framework, thereafter, the law and regulations have been developed and helped the economic and financial development. In contrast, some academics held different opinions. For instance, Thakur raises a discussion of comparing China's situation and India's, demonstrating that law does not matter that much for the economic growth and market development, on the basis that India has a better institutional infrastructure.¹⁴⁶ The discussion is based on the theory of "law-then-growth".¹⁴⁷ Considering the situation in China, it is not like India which is the largest democratic country in the world, nor a "rule of law" country (the "rule of law" is very new for China and still set as a goal to achieve in long term), but it

¹⁴⁵ Chen Z W, supra n 117, 451-472.

¹⁴⁶ Ibid. Thakur R, "China is outperforming India", (7 January 2003), *International Herald Tribune*, 30.

¹⁴⁷ Chen Z W, supra n 117, 470.

has been developing more rapidly than India.¹⁴⁸ Another example, Indonesia, has also developed less rapidly under the “rule of law”.¹⁴⁹

As concluded by Black and Bell, it is hard to prove the link between the “rule of law” and some economic developments, although people know there is.¹⁵⁰ The “law and development” movement was the driving force for many Asian countries developing their legal systems, in the belief that it would aid the economic development of the region.¹⁵¹ In considering the link between law and economic development, it is the situation that a developing economy needs law and *vice versa* in my view. The situation of market development pushing legal changes also happened in the US.¹⁵² It is important to examine the economic development (in particular business development) and legal development, and *vice versa* in China’s case. Thus, it is necessary to look at the economic developments of China and how the legal reform and development has been since China’s “opening up”. Although law is not the drive for developing the economy, it is important for economy to continue grow once development has reached a reasonably complex level.¹⁵³ In China’s case, law was developed by political planning (planned by CCP) along with reform of the economy.

Accordingly, as scholars discuss from different perspectives and hold different opinions, the relationship between law and economy (as in which is the cause and effect) is not clear. For instance, as mentioned above, Coffee raised the

¹⁴⁸ Black E A and Bell G F, supra n 119.

¹⁴⁹ Ibid., 1.

¹⁵⁰ Ibid.

¹⁵¹ Ibid.

¹⁵² Chen Z W, supra n 117, 451-472.

¹⁵³ Black E A and Bell G F, supra n 119.

theory of Chinese legal system is shown as “crash-then-law” characteristic.¹⁵⁴ Chen agreed with Coffee’s theory and showed the consistence between the theory and China’s recent reform experience (mainly focused on the capital market experience) in the research.¹⁵⁵ Meanwhile, Chen pointed out that constituency of investors drove force behind such legal reform progress.¹⁵⁶

3.3 Chinese Legal System – The Socialist Characteristics of Chinese Legal System

Ancient Chinese laws could be generally divided into rites and punishments. In the words of the ancient philosopher Xunzi, “The fundamental principles of governance consist of rites and punishments.”¹⁵⁷

Since 18th and 19th centuries, the movement of diversifying the law to different groups occurred and as the initial and immature model of modern legal system, it developed to cover constitutional law, administrative law, criminal law, civil law, commercial law and civil and criminal procedural law. During the Republican period, government incorporated a law collection, named *Liu Fa Quan Shu* (The Complete Compendium of the Six Codes of Law)¹⁵⁸. This collection was made by the adoption that China made in accordance with the

¹⁵⁴ Coffee J C J, supra n 142, 1-82.

¹⁵⁵ Chen Z W, supra n 117, 451-472.

¹⁵⁶ Ibid.

¹⁵⁷ Xunzi “Governance” (成相). In *Collected Works of Xunzi* (荀子) in Zhu J W, supra n 115, 88.

¹⁵⁸ Ibid.

continental legal system, included constitutional law, civil law, commercial law, criminal law, and civil and criminal procedural law.¹⁵⁹

Entering to the 20th century, branches of law became more complex. The change happened with the various developments, such as social, cultural, economic, financial *et cetera*. The influences from state intervention and the political socialism society was happening in the legal field, further it caused changes in all branches of law. For instance, public law mixed and showed the nature of privatization, further to merge the private law and public law. Meanwhile, private law absorbed public law elements and was publicized.¹⁶⁰ The consequences are: 1) the laws are more diversified; 2) the need of more laws and regulations, which included the needs of private parties, such as shareholders and business investors; also including the need of keeping the political power from government. Under the circumstances of China, the business activities (private parties) and political interfere (government political interests) could not be separated as government (central government and local governments) tries to maintain political power and ensure the order of business activities. Thus, the branches of law show the interacted relations among each other. As Zhu concluded,

National interests, society's interests and private interests interpenetrate one another; public power and private rights influence each other; procedural and substantive law interact; and even international and national law are transformed into one another, so that a large number of new fields sharing the characteristics of different branches of law

¹⁵⁹ Ibid. 88-89.

¹⁶⁰ Ibid. 93.

have emerged. Classic examples of this are economic law, environmental law and social law.¹⁶¹

Nevertheless, taking civil and commercial law as the examples, commonly recognized as the private law field, they have been subject to interference by state power. By way of contrast, in Western countries, capitalism developed through various stages from relatively free markets to monopoly, then public law and private law separated from each other in the 19th century; in China, the separation appeared to happen during the period of economic transformation from planned to market economy.¹⁶²

3.4 Chinese Legal System – Socialist and Centralised Political Characteristics

Chinese legal system has the unique socialist characteristics along with the socialist characteristics economy, and law changes with the market economy. In Western countries, along with the long history of business, economic, finance and social cultural developments, the legal system has been developing through various degrees of sophistication for centuries. The new branches of law that emerged relatively recently in the Chinese legal system, such as economic law, social law and environmental law which have been taken shape in many Western countries for over a hundred years. In contrast, the PRC is merely in the sixth decade, and the Cultural Revolution completely damaged the economy and academic development of China especially its legal framework. Zhu

¹⁶¹ Ibid. 89.

¹⁶² Ibid. 93-94.

commented that one distinct differences between Western legal system and Chinese legal system (the socialist legal system with Chinese characteristics) is that: 1) Chinese legal system developed as the political missions for central government, it was planned by steps, one step at a time. 2) Chinese legal system was planned in advance by government, from the committee meetings that government held, and set as part of the overall tasks that government set every five years. Central government has been putting considerable effort into planning the legal reform and development.¹⁶³ Chinese legislation was planned from the very beginning of building the modern legal system – planned first then operated by steps. Thus, Chinese legal system with socialist and Chinese characteristics has been mainly dependant on the CCP.

As stated above, the planning and missions of legal reform process were conducted by National People's Congress (NPC), these political meetings have always been important and countries around the world watch these meetings closely when they are held. The NPC of the PRC, is the supreme body of the state power. The permanent body of NPC is the Standing Committee.¹⁶⁴ The NPC meeting are held as sessions once a year.¹⁶⁵ Only the NPC and its Standing Committee can enact and amend basic laws governing criminal offences, civil affairs, state organs and other matters, which means conducting changes in law.¹⁶⁶

¹⁶³ Ibid. 89.

¹⁶⁴ "STATE STRUCTURE OF THE PEOPLE'S REPUBLIC OF CHINA", The National People's Congress of the People's Republic of China website, http://www.npc.gov.cn/englishnpc/stateStructure/node_3826.htm (accessed 28 July 2017).

¹⁶⁵ "NATIONAL PEOPLE'S CONGRESS", The National People's Congress of the People's Republic of China website, http://www.npc.gov.cn/englishnpc/Organization/node_2846.htm (accessed 28 July 2017).

¹⁶⁶ "FUNCTIONS AND POWERS OF THE NATIONAL PEROPLE'S CONGRESS", The National People's Congress of the People's Republic of China website,

Since 1980s, after the Cultural Revolution, the Party has set series of missions to build up the socialist legal system with unique Chinese characteristics in all plans that Committee made. Deng Xiaoping raised the “Reform and Opening Up” policy and the government led China to a different role in the world stage. The government also raised the principles of “rule of law” at Plenary Session of CPC Meeting. This type of planning for legislation changes is not happening everywhere and anytime in history, but it does show that the differences China has in terms of legal reform from other countries in legislative history. As Zhu commented, “China’s legislative activities were carried out in a purposeful and planned way, greatly promoting the formation of the socialist legal system with Chinese characteristics.”¹⁶⁷ After meetings were held in 1980s, the reform of law and economy put into place and the leadership determinate to pursue economy changes and development. China entered into a period of exciting economic development, along with noticeable corruption and connections of bureaucrats and business individuals appeared (guanxi with government officials to gain personal favours and financial gains). During the period 1990 to 1999, China experienced rapid changes and economic reform especially following Deng Xiaoping’s much publicised trip in Southern China. The government established the “program of the national economy and society development decade” to develop the economy, progress institutional reform and establish a Socialist Market Economy System. This included fostering the establishment of private enterprises. By the end of 1990s, government saw economic reform and

http://www.npc.gov.cn/englishnpc/Organization/2007-11/15/content_1373013.htm (accessed 28 July 2017). “中华人民共和国国家机构体系” (The state organs of People’s Republic of China), The Central People’s Government of the People’s Republic of China website, http://www.gov.cn/misc/2005-08/28/content_27083.htm (accessed 28 July 2017).

¹⁶⁷ Zhu J W, supra n 115, 87-103.

progress with quite astonishing results. The government set the goal of establishing new rural towns to spread the benefit of development beyond the major coastal cities and towns, in order to further reform SOEs the modern enterprise system was introduced in 1999. China, then under the leadership of Zhu Rongji (the Premier of PRC then), continued the economic double-digit growth rate, set the “modernization, opening up and technological progress” as the basic goals. From 2001, the government raised the importance of developing economic and legal reform. In 2003, the initial step of building the socialist legal system was taking shape. The Party also called for a regulatory regime to foster private enterprises¹⁶⁸ and placed stress on the harmonious society and “building of democratic rule of law, justice, sincerity, amity, vitality, stability and order”¹⁶⁹. Since 2007, the task of improving the Chinese legal system had been emphasised. In 2008, the fundamental format of the Chinese socialist legal system was outlined by formal announcement by Wu Bangguo (Chinese chief legislator)¹⁷⁰ in the Central Committee. It appeared to be an important step in the history of the modern Chinese legal system’s development. The rural reform and development goals for rural reform by 2020 were also delivered by Hu Jintao, especially in agriculture sector and labour in agriculture sector. Thereafter, a series of laws and regulations came into force to foster the development of the agricultural sector of the economy. These developments

¹⁶⁸ CPC People official website, in Chinese language, 中国共产党历次全国代表大会数据库. <http://cpc.people.com.cn/GB/64162/64168/64569/> (accessed 17 November 2013). Jiang Zemin’s full report on the 16th CPC Central Committee meeting, which published by XinHua News, http://news.xinhuanet.com/ziliao/2002-11/17/content_693542.htm (accessed 17 November 2013).

¹⁶⁹ Ibid.

¹⁷⁰ Wu Bangguo (born July 1941) was a high-ranking politician in the PRC. He was the Chairman and Party secretary of the Standing Committee of the National People’s Congress, a position that makes him China’s chief legislator. He is also ranked second in official rankings of state and party leaders according to his qualifications in the Party.

indicate that legislative development and changes mostly follow on from the changing political goals and trends.

The current paramount leadership has been aiming to maintain and develop the economy and modernization of China since 2013. Furthermore, to improve the Party's work and government administration efforts to simplify and encourage a level of decentralization have been made. However, China is such a huge country and with multiple levels of government, from central, provincial, city, town and village difficulties arise in relation to policy implementation and, for example controlling the occurrence of corruption especially at the lower level of local governments. Therefore, decentralization is hard to implement. It may be argued that decentralization requires solid legal principles, administrative fiat and other regulatory support which implements and complies with the CPC's aim – "rule of law" – as it is variously understood in China. Indeed, China may need to transplant many regulations or laws from other countries and adapt them to meet its needs, but there are limitations on to what extent and to what level transplantation can work as with the two tier board system and the introduction of the independent non-executive director.¹⁷¹ In addition, as Ho *et al.* discussed, there must be a change in terms of control of the economy from the government if China is to successfully operate its decentralization.¹⁷² I think China will have to encourage or foster companies more than other aspects which goes along with the huge demand of growth in economy and government support. It has shown this through government's policies and goals set at each central meeting

¹⁷¹ Chen A, "The development theory of law and market in contemporary China" in Wang G and Wei Z (eds.), *Legal developments in China: Market economy and the law* (Sweet & Maxwell 1996), 3-20.

¹⁷² Ho D, Lau A and Young A, *supra* n 117.

in recent decades.

The difficulty in changing in this way is a big challenge in relation to government intervention. Ho and Xu stated, “the change will not be straightforward because the government currently has embedded interests in many Chinese companies”,¹⁷³ and Ho *et al.* concluded that a major change China has to make for decentralization and privatization is to remove the direct intervention that government has to SOEs.¹⁷⁴ Indeed government intervention in the SOEs has existed for a long time and there are issues in this matter. The reason that the government made the goal of decentralization is to continually be building the modern China, learning and transplanting the experiences that advanced countries which mostly are market economy have. It is uncertain as to what the current leadership will do to achieve the goal, releasing control over SOEs is difficult to imagine and the solution is unsure. However, it might be a good solution to implement the regulations that local governments put into practise during decentralization. However, it also means that lower level governments will have more power, therefore, the potential issues would be seen with the development, such as corruptions, or local governments would push local enterprises (regardless their size) on taxation to achieve better political performance. It will remain a challenge until China develops further on the legal reform and changes and what steps the government takes to decentralize remains very much uncertain.

¹⁷³ Ho S and Xu H, “Corporate governance in People’s Republic of China” in Keong L C (ed.), *Corporate governance: An Asia-Pacific critique* (Sweet & Maxwell 2002), 269-302.

¹⁷⁴ You J, *China’s enterprise reform: Changing state/society relations after Mao* (Routledge 1998).

The NPC meetings indicate how and what the planning is for the economic and legal reform along with maintaining the political organs. The political planning is a crucial governing aspect for China. Since 22th to 27th June 2017, at the 28th Session of the 12th NPC Standing Committee Meeting, Standing Committee members reviewed the amendment of promoting SMEs particularly through the taxation incentives. According to the meeting reports, summary and government published news, some committee members pointed out that taxation incentive is an important way of encouraging SMEs. Therefore, the draft after review added some benefits for small and micro enterprises such as tax deductions, corporate tax exemption and VAT etc.; Higher Education Institution graduates and former military officers who found small to micro enterprises could enjoy special taxation benefits or be relieved of certain charges; There are also benefits for technology start-ups to encourage technology innovation.¹⁷⁵

The main debates on the draft include the following factors:¹⁷⁶ First, Standing Committee members pointed out that there is lack of legal consequences in the draft for SMEs since the draft mainly focuses on encouragement but does not list legal responsibilities. It potentially causes lack of legal aid methods if the rights of SMEs are violated. Second, defining SMEs is a priority for the draft. There have been conflicted definitions of small to micro-sized enterprises in several departments of State Council already. Therefore, a unified definition of

¹⁷⁵ Chen Y (ed.) “中小企业促进法修订草案进入二审明确相关税收优惠措施” (Draft of Small and Medium-sized Enterprises Promotion Amendment Clarify Relevant Tax Incentives Measures) 2017年6月22日 (22nd June 2017) http://www.npc.gov.cn/npc/xinwen/lfgz/2017-06/23/content_2024079.htm (accessed 28 July 2017).

¹⁷⁶ Wang W, “中小企业促进法不能只有鼓励和促进”(It Needs More Than Just Encouragement and Promotion for Small and Medium-sized Enterprises Promotion Amendment), 2017年7月4日(4th July 2017), http://www.npc.gov.cn/npc/cwhhy/12jcw/2017-07/04/content_2025490.htm (accessed 3 August 2017).

small to micro-sized enterprises is needed in this draft. Third, whether the draft should be serving SMEs or small to micro-sized enterprises is under debate as well. Fourth, the monitoring bodies shall be clarified in the draft. There are varied government bodies in different provinces, which potentially cause confusions and conflicts in monitoring SMEs. Fifth, SMEs' funding problem. To help solving the funds problem, the draft added regulations of banking monitoring and supervising bodies should reasonably increase bad debts tolerance of small to micro-sized enterprises; Encourage and guide financial institutions to increase the funding amount and percentage; Large banks shall set special division to provide financial services to small to micro-sized enterprises. Some members hold doubtful opinions towards the draft as it seems to be impractical but only a formality. More details in how to implement is a challenge. Sixth, many members pointed out the needs of building a good legal environment for SMEs, and the importance of having systematic risk control mechanism for SMEs, such as mandatory legal counsels within the enterprises, establish mechanisms to review and monitor important activities, establish corporate contract management mechanisms, enhance legal training *et cetera*. There are many issues in need of review and corrected in the draft, and a lot of work and responsibilities from central government to local governments.¹⁷⁷

¹⁷⁷ Ibid.

3.5 Chinese Legal System and Corporate Governance in China

Salama and Putnam's research shows that the corporate financial outcomes are affected by the efficiency of governance mechanisms.¹⁷⁸ Their hypothesis was evidenced by the sample of annual observations from 2002 to 2006 of 5,985 firms, which proved that in the level of global diversification, the more efficient corporate governance mechanisms that companies have, the better financial outcomes and corporate investments that companies will achieve.¹⁷⁹ However, China has not operated corporate governance for a reasonably lengthy period, the laws and regulations are relatively recent and require professional practitioners and experience lawmakers in the field to monitor and improve the laws and regulations, as well as developing practice guidance. Improvements have been taking place, however, the challenges have not been overcome.

For one challenge of corporate governance in China is the legal system. The Party aims to build a legal system with Chinese socialist characteristics, combined with China's fast-growing economy in the context of its political environment and social/cultural customs. Bernhardt and Huang commented that Chinese law was much in the codes and model case records, thus scholars have examined China's laws for its unique Chinese characteristics.¹⁸⁰ However, not

¹⁷⁸ Salama F M and Putnam K, "The Impact of Corporate Governance on the Financial Outcomes of Global Diversification", (2013) 48, *The International Journal of Accounting*, 364-389.

¹⁷⁹ Ibid.

¹⁸⁰ The civil matters here as Bernhardt and Huang discussed, as the civil law regulated matters in contemporary Chinese law, "*minshi*" (民事), in contrast with "*xingshi*" (刑事), regulating the matters between equal private parties, or people's matters. The term had different scope of the matters: In the Republican civil code, followed by the general principles, there were four sections: obligations, ownership rights, family, and inheritance; In the Qing code, it was named as "minor matters" (*xishi*), which was similar to the Republican civil code term "people's matters". Mainly was included in the "household law", and in the categories of

much guidance or laws has been written about regulating the practical operations. The corporate governance is written in law but practice is not as operated in other advanced countries, the reason is often because China's laws are influenced by several factors, such as social and cultural ideology, historical development, custom *et cetera*.

In terms of operating the corporate governance properly by laws and the importance to the business activities in China, there is a major factor that we cannot omit – the social history impacts. The Chinese public have been used to obey the ruling authority for over two thousand years of history, it requires adaptations to the new and modern influences from democracy and freewill. With the new economic reform and legal reform, as well as fast changing social customs, there has been the development of more issues. The social and cultural impacts are the factors that need to be considered in operating efficient corporate governance in practice. Without considering these factors, corporate governance operation might be adapted in a way as an old Chinese idiom “上有政策 下有对策” (which the direct translation is “policies given from the higher level, a plan created from the lower level” saying that there must be a way to go around policies). What could happen is, people find the policies hard to adapt, then they might appear to act according to the laws because they have to, but not necessarily apply it in practice in the true spirit of the underlying policy. The corporate governance rules in China currently are transplanted from other

debt, markets, land and houses; marriage, succession and family divisions. The term was defined in a similar way in the Qing code and the Republican civil code. Bernhardt K and Huang P C C (eds.) “Civil Law in Qing and Republican China: The Issues” in *Civil Law in Qing and Republican China* (Stanford University Press 1994).

countries and combined with the Chinese Company Act, leading to a learning process in the context of Chinese culture and adaptation. Thus, from academic perspective, research on the experience and effectiveness of corporate governance in advanced countries is useful in terms of formulating Chinese laws and requirements for now. But the need for a deeper investigation into what works best for the Chinese business and corporate sector and then making appropriate laws, regulations and guidelines remains a challenge.

The social issues existing in society are the matters that laws and regulations were created for. The importance of social relationships in Chinese society is a fundamental aspect to understanding Chinese laws. The social relationship practice is an important cultural factor that lawmakers consider during the process of making laws and regulations. For instance, Inheritance Law regulates the inheritance matters, which is an enormously important social relation in Chinese society. Meanwhile, the inheritance matter, such as succession issue, is a very crucial aspect in family business study therefore also important for the theories of corporate governance. For the better purposes that laws served, understanding the social and cultural contexts is crucial to lawmakers. Another example is the shareholder protection issue, as another important aspect in corporate governance, and even as one of the reflections of corporate governance principles – transparency, is difficult to be operated without creating laws which consider relevant social aspect. It may be for the social reasons as follows: 1) in the case of the large enterprises, one social custom is *diulian* (“losing face”), so they would not like the negative effects when such incidents happen to damage their reputation, therefore they normally bury the conflicts; 2)

in the case of the small to medium-sized companies, it is very common to lack transparency, the closed nature of such firms is the issue. As Ho *et al.* stated, that Chinese business people (here may be referring to private businesses from the content of the article) see secrecy as “a competitive edge, becoming completely transparent in business dealings may be initially challenging in the Chinese context”.¹⁸¹ Particularly in the family businesses, this issue has been a barrier to operating the transparency principle of corporate governance. Transparency is an existing value in many societies that operating by the “rule of law”. Maybe for the above reasons, transparency has always been an important requirement in the regulations of corporate governance.

3.5.1 Rule of Man and Rule of Law

Shi argues that China has been ruled under the “rule of man” for more than 2,000 years.¹⁸² To be specific, people have always grown with the Confucianism notion.¹⁸³ It sometimes the case that Confucian norms could be prioritised above the laws. In contrast, many countries operate based on the “rule of law”¹⁸⁴, which

¹⁸¹ Ho D, Lau A and Young A, *supra* n 117, 577.

¹⁸² Shi C, “International corporate governance developments: The path for China” (2005) 7 (1), *The Australian Journal of Asian Law*, 60-94.

¹⁸³ Confucian notion of the ‘virtuous man’ whereby loyalty is highly prized, especially within the family businesses.

¹⁸⁴ “Rule of law refers to a system in which law is able to impose meaningful restraints on the state and individual members of the fulling elite, as captured in the ... notions of a government of laws, the supremacy of the law, and equality of all before the law.” Wang raised the point of being in the context of the contemporary China, it would be socialist ‘rule of law’ that China develops. “...socialist rule of law is embedded in a socialist market economy (in which public ownership plays a leading role in the markets); a non-democratic system of governance in which the CCP monopolises political power; and a rights protection regime which puts social stability above individual rights, and subsistence above civil and political rights.” Peerenboom R, *China’s Long March Toward Rule of Law* (CUP 2002) in Black E A and Bell G F (eds.), *supra* n 119, 25. Nevertheless, it is noticeable that different countries may apply different definitions of “rule of law”, such as Singapore, that it is not the version based on the liberal democratic model but by efficient and incorrupt government.

is a common practice for other countries. It requires people to control their misbehaviours and the law should be prioritised when the moral notion is conflicted with the law (when people tend to or have broken the law, should be following the law not the human moral rules). Although, politically planned by the CPC central leadership that China is aiming to achieve “rule of law”, it seems to be a long way to achieve it,¹⁸⁵ as commented by Ho *et al.*, “it is unrealistic to expect China to quickly apply the Rule of Law.”¹⁸⁶

Apart from the social rooted reasons and the priority of economic reform from government, which are the factors that prevent China operate “rule of law”.¹⁸⁷ Zhu also raised another important fact – legal procedure. “It is absolutely necessary for China to stress the role of procedural law in the course of establishing the rule of law because emphasising the rule of law means

¹⁸⁵ In my opinion, it is going to be a long way to achieve “rule of law” due to “rule of man” rooted deeply in tradition and culture in China. As defined by Black and Bell, “Custom, as norms that formed naturally in a culture over time...”. Custom is also recognised as a source of law, particularly for commercial and civil disputes in China. Black E A and Bell G F (eds.), supra n 119, 10. At the meantime, because China has not achieved a high level of legalism, it is difficult to apply ‘rule of law’ until economic development, corruption control and other aspects get under controlled to a certain level.

¹⁸⁶ Ho D, Lau A and Young A supra n 117. Although it is commented as unrealistic, the nation of China is positive and determinate to achieve “rule of law”. Peerenboom R, supra n 184, 24-61.

¹⁸⁷ Black E A and Bell G F (eds.), supra n 119, 21. They have indicated that the trend of China progressing towards legal reform through modernization and Westernisation, in which judicial independence, supremacy of the rule of law, judicial reform and political and civil rights are promoted. However, the consequences would be to reduce the Communist Party’s authority and legitimacy. Chinese prominent leaders have tried to keep the trend under their control to avoid that consequence. As former President Hu Jintao announced in 2007, with the “Three Supremes”, that “...from now on, judicial reform must adhere to the leadership of the Communist Party of China; be conducted within the boundaries of socialism with Chinese characteristics; accord with the developmental stage of Chinese society; and ensure that there is effective coordination between organs of bureaucracy and levels of government. Any reform must comply with existing laws, and foreign elements are to be borrowed with caution to ensure they fit with China’s indigenous conditions.” On the other hand, some positive moves, such as legalising open trials, are developed as part of the legal reform. Thus, the conclusion is the Party is trying to develop a legal system with Chinese characteristics for modern China. It can be seen as a balance act between legal reform and the role of the Communist Party.

emphasising legal procedure.”¹⁸⁸ He further stated that procedure must be emphasised if the “rule of law” is raised and noticed, and the procedural law is a milestone of the legal reform achievements. Legal reform is a reflection of all the reforms that happen in economy, social and cultural, even political aspects for China. Meanwhile, the level of emphasising procedural law is also important. The procedural law may have the down sides of influencing the substantial rights. One issue that should be raised here - one of the obstacle factors of adopting the foreign governance laws is the judicial precedents that China does not recognize. It is important at this juncture to understand that concepts of the rule of law in China are not quite the same as in many developed countries. Indeed, in the early years of reform there was a debate between rule through or by law in contrast to “rule of law”¹⁸⁹ In reality, China’s court system has a low political status. The courts lack the status and authority of Western legal institutions. For example, they do not have the capacity to enforce awards or compel the production of evidence. The courts, especially local courts, often take a very parochial view in that they often resist enforcement of judicial awards from outside their jurisdiction. This is a reflection of traditions of localism and also the importance of personal relations as the basis for behaviour. As part of this attitude, the judicial process of ascertaining facts both through internal process and informally as well as the decisions made leave parties to legal proceedings vulnerable to the political connections of their adversaries and abuse of power.

In addition to this, the CCP still plays a dominant if not central role in the courts’

¹⁸⁸ Zhu J W, supra n 115, 102.

¹⁸⁹ For example, Peerenboom R, supra n 184, 1-10.

processes through the Adjudication Committees attached to each court. Despite official directions ordering the limitation of this committee's intervention they continue to review and approve (or otherwise) judicial decisions.¹⁹⁰ Usually chaired by the Party Secretary for the court where they sit and with a membership of senior judges almost all of whom are Party members subject to Party discipline they usually work closely with local Party political-legal committees. Another factor is the local funding of the courts system leaving them potentially subservient to local political imperatives. In such an overall scenario, judicial corruption is often a serious problem.¹⁹¹

The arguments marshalled in ideological conflict in relation to the rule of law in China are used both to subvert and legitimise the state sanctioned ideology often by using seemingly paradoxical arguments. In the context of China many of the arguments relating to the rule of law are perhaps better understood in terms of their intended and actual effects – a pragmatic and to some extent ideological approach – rather than viewing them as logical propositions and good faith arguments.¹⁹² One key aspect of the rule of law in China is the separation of the Party and the State. In this context, it has been argued that such a separation in the organisational sense is not possible in a foreseeable future.¹⁹³ Such a view is arguably reinforced by the notorious “Document 9” (Communique on the current state of the ideological sphere) which was widely circulated among government party officials in 2013. It warns against several

¹⁹⁰ He X, “Black Hole of Responsibility: The Adjudication Committee’ Role in a Chinese Court” (2012) 46 (4) *Law & Society Review*, 681-712.

¹⁹¹ Potter P B, *supra* n 117, 67-70.

¹⁹² Seppanen S, *Ideological Conflict and the Rule of Law in Contemporary China* (CUP 2016)

¹⁹³ Zhang X, “Rule of Law Within the Chinese Party-State and Its Recent Tendencies” (2017) 9, *Hague Journal of the Rule of Law*, 373-400.

Western liberal values including civil society, media freedom and independence of the judiciary. The document makes it clear that one party rule by the CCP remains paramount. In the light of the above discussion corporate governance, particularly in the family business will be largely influenced by political and personal connections to an extent greater than any legal framework or soft code.¹⁹⁴

3.5.2 Corporate Governance and China's Reality

Corporate governance, contains different understandings. Narrowly, it can be understood as the way that a company is directed and navigated¹⁹⁵; Broadly, it can be “characterized as a system of checks and balances to ensure decision makers are accountable to stakeholders”.¹⁹⁶ Many theories have been developed in the field, and as Ho *et al.* summarised other scholars' comments¹⁹⁷,

Several theories have emerged from an array of disciplines churning out diverse prescriptions for governance¹⁹⁸. They are shaped by contextual considerations entrenched in different cultural and regulatory environments¹⁹⁹.

There were insufficient laws and regulations to catch up with the speed of economic development when China started the reform of its economy.

¹⁹⁴ Document 9 translated into English is available on the Chinafile website: chinafile.com/document-9-chinafile-translation (last visited 11 July 2017)

¹⁹⁵ Farrar J, *Corporate governance in Australia and New Zealand* (OUP 2001).

¹⁹⁶ Solomon J, *Corporate governance and accountability* (3rd edn., John Wiley & Sons 2011).

¹⁹⁷ Ho D, Lau A and Young A, *supra* n 117.

¹⁹⁸ Clarke T, *Theories of corporate governance: The philosophical foundations of corporate governance* (Routledge 2004), 1-30. And Deakin S and Hughes A, “Comparative corporate governance: An interdisciplinary agenda” (1997) 24 (1), *Journal of Law and Society*, 1-9.

¹⁹⁹ Mintz S, “Corporate governance in an international context: Legal systems, financing patterns, and cultural variables” (2005) 13 (5), *Corporate Governance: An International Review*, 582—597, available at SSRN: <http://ssrn.com/abstract=791826> (accessed 28 September 2016)

“Companies” were mainly restructured SOEs that were compelled to reform. Transplanting laws from Western jurisdictions that were experienced and advanced was considered to be the best solution. Nevertheless, there were problems during the process of the transplantation into Chinese communist society and culture. For instance, Western laws have generally been operated in a market economy whereas China was just opening up and on the path of developing a socialist economy with Chinese characteristics. Under these complex circumstances, to adapt Western laws with capitalism elements (even models based on Germany’s communitarian capitalist corporate law) into socialist society and with underlying Asian cultural elements would be completely different and challenging. Given the differences between the countries and legal systems, transplantation caused issues for China and the market characterized with Chinese factors. For instance, shareholders’ rights protection, as Ho *et al.* commented, there are more questions raised for shareholders than there were answers during the transplant process.²⁰⁰

As the result of the economic reform, laws and regulations were rushed into force in order to implement and regulate rapid economic changes, especially in restructuring the SOEs that underperformed, and the rapid raise of private enterprises. Lawmakers in China dedicated efforts on such regulations. For instance, the Company Law that came into force on 1st July 1994, was the principal national law to regulate limited companies. The Company Law regulates limited liability companies and joint stock companies. According to Ho *et al.*, 1.2 million limited liability companies and 10 thousand joint stock

²⁰⁰ Ho D, Lau A and Young A, *supra* n 117.

companies existed by the end of 2004.²⁰¹ Thereafter, the first major amendment entered into force on 1st January 2006, and the second major amendment became effective on 28th December 2013, on the day that the Standing Committee published it.

3.5.3 Chinese Enterprises Development

Period	Missions or Achievements
Late 1950s	The goal of Chinese leadership was to develop economy, as the economy was declining and the creditability was threatened for Chinese leadership.
In 1960s	Series of complex plans was set out to foster miserable economy situation. The industries were inefficient and lack of developing abilities.
During the time that state-owned-enterprises reform (since 1970s)	Individual enterprises (those individual proprietorships and small household businesses, which having less than seven workers) grew with an outstanding rate, estimated 300 in 1978 to 21,866 in 1994. Private enterprises (those employing more than seven workers) were estimated from 41,000 in 1978, increased to 432,000 in 1994. An economist commented the situation, that the non-stated sector

²⁰¹ An J, *Chinese company law explanations* (Law Press 2005).

	was an important role for Chinese economy after 15 years of hard work on developing the economy.
By the late 1970s	The priority for China and the Party was modernizing economy.
In early 1980s	To improve the efficiency and profitability of State-owned enterprises, government allowed consolidating enterprises.
	The government encouraged more co-operations between enterprises (joint ventures with foreign firms was encouraged as well at the time).
	Decentralization and relaxing policies on State-owned enterprises decision-making powers.
In 1988	The government recognised the importance of private enterprises. In addition, it was written into the Constitution as “the private enterprise is a necessary and beneficial addition in modernizing the economy”
In 1990 and 1991	Shanghai and Shenzhen stock exchanges market opened. Legal reforms began to process quickly. More corporations got involved to the development.

In 2001	China joined the WTO, which was crucial to evident the economic liberalization of China.
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At a micro economic level, Chinese companies have faced challenges before 2001, mainly because of the SOEs reform. According to Wang, the managers working in SOEs had to change from obeying the guideline from the government to operating independently, they also had to represent shareholders' interests instead of the interests of the government (though often the government was a major shareholder).²⁰² In contrast, at the macro level, SOEs were underperforming compared with the private sector. Based on the data from the Asian Development Bank, between 1993 to 2001, private enterprises grew with a rate of 32 per cent, however, the jobs they provided were 24 million which was only 26 per cent of the market.²⁰³ At that time, Company Law and relevant regulations only could protect equal parties such as individuals or legal persons but not the interests of public against the nation's assets.

The growth of private enterprises and the economic growth as well as the benefits for public were obvious. Apart from the contribution and importance of private enterprises, one issue for private enterprises is the investment. Money has always been an issue for private enterprises in China compared with SOEs, during and after the reform. Government-owned banks provide sufficient funds to SOEs. Under the strict standard procedures from the banks, private enterprises had to choose to access funds from different sources, which

²⁰² Wang F, "China's access to the WTO and its impact on corporate governance" (2004) 17, *Australian Journal of Corporate Law*, 129-135 in Ho D, Lau A and Young A, *supra* n 117

²⁰³ Chai J C H, *China: Transition to a market economy* (Clarendon Press 1998).

sometimes were not always regulated by the regulations and laws but not illegal either. Research indicated that the issue was partially caused by the weak governance of the enterprises, and also the property rights (it did not exist until Property Law came effective on the 1st October 2007). Maramuto concluded that the lack of growth for private enterprises was because of the absence of legal guarantees.²⁰⁴ Chen also commented that the legal reform was hardly contributing to stimulate this matter for further growth.²⁰⁵

SOEs were the main and initial change that China made for economic reform, it was also the main focus for Chinese corporate governance. Indeed, as discussed by Tam and Ho *et al.*, SOEs privatization strongly influenced Chinese corporate governance.²⁰⁶ One key issue concerned access to capital through banks and the stock market. Tam pointed out the importance of having an outsider as a protection for minority shareholders in Anglo-American model.²⁰⁷ However, Chinese SOEs had many scandals of fraud and abusing companies' assets for personal purposes that committed by directors and managers in most listed SOEs in China by 2001.²⁰⁸ In Chinese historical and social customs, corruption was not only committed by directors and managers, it was highly possible that other government officials were involved. On the 7th Plenary Session in 2007 of 16th CCP Central Committee Meeting, Du Shicheng, who was the former Mayor of Qingdao and the Party deputy secretary in Shandong

²⁰⁴ Maramuto M, *Private sector assessment, People's Republic of China* (Asian Development Bank 2003).

²⁰⁵ Chen A, *supra* n 171.

²⁰⁶ Tam O, *The development of corporate governance in China* (Edward Elgar 1999). Ho D, Lau A and Young A, *supra* n 117.

²⁰⁷ *Ibid.*

²⁰⁸ *Ibid.*

province, was found guilty of bribery (6.3 million yuan from 2000 to 2006)²⁰⁹. Qingdao is an important city with rapid economy development and an important port for China, Du was expelled from the Party for alleged corruption. Although the details of the accusation are lack of records, being expelled from the Party is so-called “internal punishment” in China. Being a member of the Communist Party has a privilege of reducing legal sentences when political status was removed if party members make mistakes (such as corruptions). Being expelled from the Communist Party is a very shameful punishment but not a legal punishment. Some party members made mistakes and were expelled from the party with lower legal sentences within the lawful range. It is hard to prove how and what exactly the process is, but the situation exists. Corruption involving government officials was more controlled and the situation improved since Hu Jintao’s governing time.²¹⁰ Moreover, the former manager of the China National Nuclear Corporation Kang Rixin was expelled from the Party for corruption and graft during the 5th Plenary Session of the 17th CPC Central Committee Meeting in 2010. It was disclosed that the corruption involved central Party officials and the weakness of the social factors. The plenary further explored the weakness of the operation of corporate governance in China.

Corporate governance challenge in China is not a simple legal, managerial issue in my view, it is rather a complex result of the society and culture change, rapid economic growth and legal reform. As the central government mostly put efforts

²⁰⁹ “China says senior communist gets life sentence for graft”, 6th February 2008, *China Digital Times*, <http://chinadigitaltimes.net/china/du-shicheng/> (accessed 12 November 2013)

²¹⁰ See the report and news of The Washington Post, by Cody E, “China’s Crackdown on Corruption Still Largely Secret”, *Washington Post Foreign Service*. Sunday, December 31, 2006 <http://www.washingtonpost.com/wp-dyn/content/article/2006/12/30/AR2006123000932.html> (accessed 12 November 2013)

in SOEs for the corporate governance issue, the private sector was neglected, which led private enterprises to mostly adopt other solutions for survival, such as using guanxi for business operations. The statement made by Tomasic and Fu strongly indicates this:

All of these laws have reflected a considerable degree of central government control and have had limited impact on the organization of business activity in China. Historically, Chinese governments have not encouraged commerce, perhaps due to the long-standing policy of national isolation and what some have described as a Confucian disdain for the world of business. This meant that the state provided minimal protection for private business, so that, by default, the family and the relationships of trust became a more secure basis for business activity than formal bodies of law, such as company law.²¹¹

Therefore, as we can understand, historical custom of guanxi has been used to protect relevant parties' interests rather than using legal actions. This is the reason for and also the result of China's social context, culture, law and economy general environment. Further discussion about guanxi will be made in the thesis.

3.6 Chinese Company Law

Chen stated that the stock market and consumer product markets contributed to legal changes.²¹² Under the impacts from market and consumer product markets, the legislation in company law has formed in 20th century in China. Although Chinese Company Law was transplanted mainly from Japan and

²¹¹ Tomasic R and Fu J, "Company law in China" in Tomasic R, (ed.) *Company law in East Asia* (Ashgate 1999), 135.

²¹² Chen Z W, *supra* n 117, 451-472.

Europe, influenced by Taiwan, US, the modern Company Law has some strengths from the legal perspective. For instance, the regulations of shareholders' rights appear to be strong. In contrast with many scholars' views, Ho *et al.* concluded after examining 35 works of leading scholars in China that were written before and after the central government amended the Company law, they found that China did adapt the Anglo-American model, and the shareholders' rights are more advanced than some of the Common Law system countries, obviously China does realize that the shareholders' rights need to be strengthened, demonstrated from two points:

Shareholders decide business policies. Shareholders can inspect board decisions.²¹³

The two demonstrations can be found as Article 34 in Company Act 2005 which is the Article 33 in new Company Act 2013, and Article 38 in Company Act 2005 which is the Article 37 in new Company Act 2013. This Article was seen as the unique Chinese regulation that is quite different from other common law regulations considering that Western common law systems do not encourage shareholders' interference in board decisions.²¹⁴ Ho *et al.* discussed the separation of ownership and management control as Berle and Means' model was the proof of the concept in common law system.²¹⁵ In family businesses, especially in the context of China, the owners always are the ones retaining control of the firms.

²¹³ Ho D, Lau A and Young A, *supra* n 117, 579.

²¹⁴ Little P, "A common lawyer's view of China's company law" (1994) 3 (2) *Asia Pacific Law Review*, 62-72. Ho D, Lau A and Young A, *supra* n 117.

²¹⁵ Berle A A and Means G C, *The modern corporation and private property* (Harcourt Brace 1932).

Article 33 allows shareholders to examine board decisions.²¹⁶ There are different explanations or assumptions from scholars regarding to the reason of having this article. Some argue that being aware of the decisions of the board is a responsibility of shareholders since they are the ones that decide business policies.²¹⁷ Some argue that as the owners of the companies, it is common that they should be informed (including informed and updated).²¹⁸ It is very much in the centre of the debates. First, do shareholders of limited liability companies (LLCs) have the rights to inspect the board decisions? Also, what level of shareholders might have the rights to do so? Second, if the information of the LLCs and boards safe to be inspected? What about issues of confidentiality? Third, if the shareholders have inspections, would they have enough knowledge to void the decisions? Fourth, what about the efficiency of the business operations if the shareholders inspect too much of the board decisions? Legal theories do not provide suggestions on the challenges. However, most shareholders do not have much interest in relation to the business policies unless some serious incidents happen, and board decisions mostly are undertaken by those who are the controlling seats.

To summarise, China has a blended socialist and market economy which is unique in the world. That has created a unique legal system, with many rules adapted from other jurisdictions. China needs to complete the legal reform

²¹⁶ As Ho *et al.* stated, shareholder can examine the boards' decisions, but not the board minutes. There is no strict difference between these two.

²¹⁷ Zhang C S, *Explanations of the Chinese company law* (Chang Chun Press 2005) and Xu A B, *Chinese company law explanations* (Village Reading Materials Press 2005) in Ho D, Lau A and Young A, *supra* n 117.

²¹⁸ Zhao X D, *New company law lecture materials (New Company Law Book Series No. 2)*. (People's Court Press 2005). Geng F and Liu J H, *Decoding the Chinese company law*. (Customs Press 2006). An J, *supra* n 201. Wang F, *supra* n 202.

process to achieve “rule of law” in future. The improvements are continually made to better serve the objectives with each amendment. The legislation of Company Law 2005 indicates the Chinese government’s desire to attract investment and foreign investors. These investors interests have been the drive for China’s legal reform. The cycle of demand and serve really has challenged the traditional Chinese legal culture.²¹⁹ The newest amendment in 2013 further shows the central government aims to prepare Chinese Company Act to develop to a level and similarity with other Company Acts in more advanced countries.

The newest amendment took place at the 6th meeting of the 12th Standing Committee of the National People’s Congress on the 28th December 2013. This amendment was not planned in advance as part of the annual legal reform scheme, but was drafted and reviewed in a very short time frame. This showed the new government’s determination to conduct a revolution of capital registration for companies, especially for small companies, as they are the major objects of the big changes.²²⁰ For the details of the changes, please refer to Appendix 2.

The new amendment is another major change in 20 years since the last big change, there are 12 changes in this amendment and the order of articles has adjustments as well.²²¹ In summary, the major changes include:

²¹⁹ Ho D, Lau A and Young A, *supra* n 117.

²²⁰ Zhang G D, “中国公司法的最新修改及分析” (The latest revisions and the analysis of China’s Company Law) Jincheng Tongda & Neal Law Firm, Vol. 6, *WESTLAW CHINA SPECIAL REPORT*, available at <http://www.westlawchina.com/NewsLetter/view.php?id=143> (accessed 17-21 July 2017).

²²¹ *Ibid.*

- 1) Sub-article 1 in Article 26, sub-article 1 in Article 81: The amendment removed the requirement of paying registered capital in full within 2 years (general companies) and 5 years (investment companies) and the minimum amount of the registered capital of a company with limited liability has been removed as well.²²²
- 2) Sub-article 1 in Article 59: The amendment removed the requirements of the minimum amount of the registered capital 100,000 Chinese Yuan and shall make the capital contributions in one lump sum as stipulated by the articles of association of a one-person company with limited liability.²²³
- 3) Sub-article 3 in Article 27: The amendment removed “The amount of capital contributions made by all of the shareholders in currency shall not be less than 30 per cent of the registered capital of a company with limited liability.” It benefits the investors or shareholders who might invest with intellectual property instead of paying actual cash to a certain percentage.²²⁴
- 4) Impacts over foreign investment enterprises: This amendment leads to whether remove the existing the Law of the People’s Republic of China on Joint Ventures Using Chinese and Foreign Investment, the Law of the People’s Republic of China on Sino-Foreign Joint Cooperative Ventures, the Law of the People’s Republic of China on Wholly Foreign-owned Enterprises in China, amend these laws and ensuring the consistency of the laws with current amendments will be eventually carried out. But the current complex of different authorities with power over foreign related rules will remain unchanged until further amendments to be carried out in future. Foreign

²²² Ibid.

²²³ Ibid.

²²⁴ Ibid.

involved capital registration will be stricter compared with the ones without foreign capital involvement.²²⁵

The new amendment shows that capital contribution will not be required to be recorded as a part of company's registration, and authority will not assess the initial registered capital. There is no need to record the company business license. However, shareholders must still contribute capital according to the company's articles of association. Potentially, the change might lead to the problems of forged capital contribution and the general investing public's lack of knowledge and experience in recognizing such forgeries. To resolve this, reliance on local authorities to regulate or use credit check platforms for the investing public to check the companies' actual capital. The credit check of the companies will help would be investors or potential trade partners to prevent any forgery, but it still requires companies to build up their own credits. The change is a significant movement putting the responsibility on the public and companies to build up the credits and actively check the companies' credits by themselves instead of authorities regulating companies' capital by laws and regulations. Until recently the investing public used to focus very much on the claimed registered capital amount. On the other hand, the change gives company's articles of association strong legal bond for shareholders. It potentially gives shareholders power to supervise each other according to their agreements.²²⁶

However, amendments in sub-article 2 in Article 26 and sub-article in Article 81 clearly state exceptions by laws, "The provisions otherwise prescribed by laws,

²²⁵ Zhu J W, supra n 115, 87.

²²⁶ Ibid.

administrative regulations and the decisions of the State Council on the actual payment of registered capital and the minimum registered capital of a limited liability company shall prevail.” It reserves the right of regulating minimum registered capitals from State Council in future.²²⁷

The change of removing minimum registered capital requirements may encourage a lot more one-person limited liability companies and limited liability companies by shares entering into the market. Currently, the limited liability companies by shares are more recognized by public as bigger companies, therefore it needs to be corrected and adjusted because how companies perform has no relation to the registered capital.²²⁸

The changes of registered capital simplify the procedures of company incorporation as well as capital increase. It makes the incorporation and changes easier for the companies. The new amendment follows the trend of advanced countries’ Companies Acts, by lowering the standard of incorporation, reducing the liability of the shareholders and investors. This development goes a long way towards encouraging investment and entrepreneurs.²²⁹

China’s corporate governance and law reform face great challenges in China’s in the context of its social and cultural inheritance, economic development and its political system mixture. Since the central government aims to build a market economy with Chinese and socialist characteristics, and the legal system must

²²⁷ Ibid.

²²⁸ Ibid.

²²⁹ Ibid.

reflect those socialist characteristics, it is arguable that it is not possible to simply transplant laws and regulations from well-established countries anymore. China needs to develop a different legal system and find a unique path. From now on and in future, China may be able to develop a legal system and become an example as Zhu commented, “the formation of the socialist legal system with Chinese characteristics has laid the practical foundations for studying the structure, features and trends of China’s legal system.”²³⁰ But only by examining the legal system and making law with a better understanding of the Chinese structures and features, social and cultural context will this prove possible. The analysis that researchers obtained from studying the Chinese legal system would be beneficial for understanding and exploring the revolution in legal systems.

Meanwhile, China’s reform is an example of a developing legal system and adapting the system along with unique market and economic situations. It indicates that the laws and regulations are possible to adapt to different situations despite the challenges. Examining the case of China offers legal professionals a different perspective of legal systems, and the importance of thinking “out of the box” further to be creative in the law reform process and development.

3.7 Guanxi

As the largest governing party in control of one of the largest countries in the

²³⁰ Zhu J W, supra n 115, 87.

world, CCP needs to protect its political control whilst protecting its people. For the reason that China has been and has fought hard to be a socialist country, CCP did not want to repeat what happened in the Soviet Union nor change into a capitalist country. Therefore, a unique reform in its economy and society has happened. Opportunists took advantages by connecting with government officials or SOEs managers for personal favours, such as purchasing some parts of SOEs' businesses for a very cheap price then operating them to gain huge profits during the reform of SOEs. The government officials gained financial favour in the process. They formed a good relationship to use political connection to benefit both at the same time, whereas the state's assets were damaged. It is still going on at present, but the forms of "connecting" have changed.

Corruption has been a core aspect for China during its thousands of years of history. Since Imperial times to the present, the governing bodies try hard to control or prevent it from happening. However, corruption comes wherever guanxi exists, political power is a very useful and strong guanxi connection for gaining huge benefits in all aspects. All Chinese businesses desire to work with government for financial security. Guanxi is considered to be very useful in this regard. This has always been the case in history. Although dynasties have risen and fallen, guanxi has always existed for the Chinese, regardless of whether they are carrying on business in or outside of China.

Since CCP started opening up the country and reforming, the legal system has been developed politically and very differently from other countries. To some

extent, the social development is not as fast as those in the spheres of economic and the legal reform. This kind of imbalance would cause a decline of ideology and in some senses a temporary mess. Therefore, amidst the rapid economic development, corruptions and various forms misbehaviours occurred. As a result, the central government has tried to take control of the direction of development as stated by an idiom “having a driver on the driver seat of a high-speed car” to keep it on the path. This includes strictly punishing corrupted government officials. Apparently, China has initially achieved the system in decades that Western legal system has had for hundreds of years, as Zhu commented that “it is absolutely beyond the power of Maine’s”.²³¹ In the past twenty years, there have been many Communist Party members who were expelled or sentenced for their corrupt behaviour, especially in the last five years since Xi Jinping became the leader of CCP.

The details of guanxi will be discussed later in the thesis as a separate chapter. The purpose of briefly discussing here is mainly to discuss the legal system and guanxi. In brief, although legislation is formulated, guanxi is still commonly used. “it is the key to everything: securing a business license, landing a distribution deal, even finding that coveted colonial villa in Shanghai”, as Balfour stated.²³² In a normal development process, naturally things will have a normal cycle, but guanxi has not declined nor disappeared after thousand years but continue to develop into new forms. It even has impacts over the foreign businesses

²³¹ Ibid.

²³² Balfour F, “You Say Guanxi, I Say Schmoozing; How East is Meeting West and Building a Lingua Franca of Business Connections” (2007) 4059, *Business Week*, 84. <http://www.bloomberg.com/bw/stories/2007-11-08/you-say-guanxi-i-say-schmoozingbusinessweek-business-news-stock-market-and-financial-advice> (accessed 10 April 2015).

expanding into China. No one could neglect the power of *guanxi*, and it has been recognized as one of the most important social customs for conducting business activities in China. Taiwanese call capitalism as “*guanxi* capitalism”²³³ and in post-socialist Russia²³⁴. The loose translation of *guanxi* into English is “connections” but this does not do justice as to how *guanxi* is used in the Chinese context. It exists in various forms everywhere in the world, but Chinese use it to a more unimaginable extent. The reason that *guanxi* is so important for Chinese might be because it has the power that operates beyond many other social customs in my view. It sometimes operates above the law is one.

When corruption involves the ordinary people, the law will punish based on the crime they committed, however, when it comes to the government officials who are the Party members, the punishment is slightly different. The first punishment would be CCP internal punishment, which is the “expel from the Party” if the corruption is severe. Then, it would be the punishment according to the law. However, the sentences at the latter stage would be lighter in most cases considering they have been expelled from the Party, which is a very “harsh” punishment. It might be hard to understand, but it is a fact. Unless, there are political reasons for not lowering the sentences, or during the time of *yanda* “严打” (it is a period of time during which the central government orders all legal departments to punish criminals with heavier sentences). However, the

²³³ Hamilton G G, “Patterns of Asian Capitalism: The Cases of Taiwan and South Korea.” (1989) Papers Series No. 28, *East Asian Culture and Development Research Working* in UC Davis, Institute of Government Affairs, University of California.

²³⁴ Hsu C L, “Capitalism without contracts versus capitalists without capitalism: Comparing the influence of Chinese *guanxi* and Russian *blat* on marketization”. (2005) 38, *Communist and Post-Communist Studies*, 309-327. In Aidis R, Estrin S and Mickiewicz T, “Institutions and entrepreneurship development in Russia: A comparative perspective”, (2008) 23, *Journal of Business Venturing*, 656-672.

sentencing process within the Party of making decisions is not open, so it does cause debates and doubts in media and among public in some cases.

Ho *et al.* expressed the view that Chinese legislation does act to lessen guanxi,²³⁵ as one of the purposes of legal reform and a step of achieving China's "rule of law" goal. However, it is still doubtful when "rule of law" will be achieved. In thousand years, China has always been a "relation-based"²³⁶ country. From the research and evidences that scholars examined and discussed, China will not change the governance mechanism for a long term, even if China tries to change. In my view, it is the consequence that legal reform is imbalanced with the rapid economy and social changes. To balance up the process, finding a suitable social and cultural ideology is needed. Lessening the impact of guanxi and achieving the aim of "rule of law" requires changes in ideology and culture of the Chinese. This is not going to be easy for this strong historically rooted custom. The challenges for legal system are also deeply rooted in the social and historical aspects in China.

²³⁵ Ho D, Lau A and Young A, *supra* n 117.

²³⁶ Lau K L A and Young A, "Why China Shall Not Completely Transit from a Relation Based to a Rule Based Governance Regime: A Chinese Perspective", (2013) 21 (6), *Corporate Governance: An International Review*, 577-585.

Chapter 4 Corporate Governance Mechanisms and Analysis

4.1 Vulnerability of Small Businesses

The global financial crises have occurred over the last couple of centuries and more recently in 2008. They have highlighted the vulnerability of small businesses in economic downturns, particularly in relation to their ability to raise capital, especially loan capital.²³⁷ In this environment, small businesses face difficulties, particularly during the times of economic crisis and the recovery period. The instability in the market and the uncertainties that are caused by financial crises and their aftermath make small businesses vulnerable.²³⁸ There are various national and international economic, financial and business research publications which have focused on the impact that financial crisis has on small businesses.²³⁹ However, analyses through the lens of law and regulation are not so common.²⁴⁰ Finance and other support for small businesses could be accessed through legal frameworks.²⁴¹ As most research has been focusing on

²³⁷ Dr Akeseli O, the description of the seminar that will be presented. <http://events.sas.ac.uk/events/view/15819>, (accessed 21 February 2014). Ward R and Jenkins R, *Ethnic Communities in Business: Strategies for Economic Survival* (first published in 1984, digital version, CUP 2009).

²³⁸ Early as in 1930s, because of the banking failures, the small firms were affected by the financial crisis. The author argued the link between the financial sector and output, and the financial disruptions in 1930s reduced the credit efficiency, caused the availability of credit decreased. Bernanke B S, "Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression", (1983) National Bureau of Economic Research working paper No. 1054, accessed online <http://www.nber.org/papers/w1054.pdf> (accessed 11 March 2014).

²³⁹ Ibid. Ben S. Bernanke demonstrated the credit availability was effected by financial crisis, further to effect small businesses. Also, Berger A N, and Udell G F, "The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle", (1998) 22, *Journal of Banking & Finance*, 613-673, 614. They commented again that financial crises affected small business, include Asia and elsewhere.

²⁴⁰ Ibid.

²⁴¹ In the early 1990s, US intended to use the policy 'credit channels' of monetary policy, and attracted the research attention to small businesses and their funding issues. Berger and Udell, *supra* n 239.

the role of small businesses in the context of the economic environment rather than on legal aspects, it could be beneficial for small businesses if the research concentrated more on enhancing their financial access based on the market changes. Creating potentially better legal vehicles could help small businesses to survive, to respond to changes in the business environment more flexibly and adapt to varying market conditions and environments. However, some argue that a tailored legal vehicle for small businesses (in the UK context) is a misconceived idea as existing forms are more than sufficient and much depends on the entrepreneur's desire to build and enlarge the business or remain small.²⁴² Indeed, some commentators have argued, by analogy to eco-systems, that a greater number of flora and fauna, in this context legal business vehicles, will ensure a greater survival and development rate as economic circumstances change. They define the role of organisational law as "establishing the rights and responsibilities of all stakeholders concerning an organisation in order to mitigate uncertainty for those stakeholders".²⁴³

4.2 Overview of Corporate Governance and Circumstances in China

UK corporate governance system is a well-developed one, others include the US, Germany and Japan²⁴⁴. According to some commentators the US system of corporate governance is one where large investors often take a more active

²⁴² For example, Freedman J, "The quest for an ideal form for small business - A misconceived enterprise" and Hicks A, "Legislating for the needs of the small business", both in Rider B and Andenas M, (eds.) *Developments in European Company Law: The Quest for an Ideal Legal Form for Small Business* (Kluwer Law International 1999).

²⁴³ Fisher E and Ormerod P, supra n 112.

²⁴⁴ Shleifer A and Vishny R W, "A Survey of Corporate Governance", (1997) LII (2), *Journal of Finance*, 737-783.

involvement with long-term interests in businesses.²⁴⁵ Though the Anglo-American system, often based on suggestions arising out of Agency theory is regularly criticised for its short termism other theories are also influential. Whereas, China is one of the East Asian countries having a relationship-based corporate governance system.²⁴⁶ Moreover, China has been seen as a country with a “bad corporate governance operation”, although China is recognised as the second largest economy in the world.²⁴⁷ The reason might be the culture, society and history of China itself.²⁴⁸ Furthermore, as Thomsen and Conyon commented, corporate governance in China has undergone dramatic changes since the 1980s, arguably because of the capital market reforming process.²⁴⁹ Since 1978 China’s “open door” policy achievement, the economy has grown rapidly, the GDP growth rate as an assessment of overall trade increased from approximately 8% in 1977 to 35% in 1999, and has continually grown until the worldwide financial crisis in 2008.²⁵⁰ Whilst China had transplanted some aspects of Western corporate laws, the changes in corporate governance did not follow the path of other major common law systems such as the US.²⁵¹ The reason might be that China has discovered the importance of corporate

²⁴⁵ Jensen M C, *A theory of the firm: Governance, residual claims and organizational forms* (2nd printing, HUP 2003). Chew D H, (ed.) *Studies in International Corporate Finance and Governance Systems - A Comparison of the U.S., Japan, and Europe* (OUP 1997).

²⁴⁶ Lau K L A and Young A defined China is a relation-based governance country, Lau K L A and Young A, supra n 236. Ruskola T, “Conceptualising Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective” (2000) 52 *Stanford Law Review*, 1598. Rajan R and Zingales L, “Which Capitalism? Lessons from the East Asian Crisis”, (1999) 11 (3), *Journal of Applied Corporate Finance*.

²⁴⁷ China is one of the two largest developing economies in the world, Morck R K and Steier L, supra n 50, 8.

²⁴⁸ Lau K L A and Young A, supra n 236.

²⁴⁹ Thomsen S and Conyon M, *Corporate Governance: Mechanisms and Systems* (McGraw Hill Higher Education Berkshire 2012). The book concerns with publicly traded companies rather than other organisations.

²⁵⁰ *Ibid.* 270. Further reading please see the previous chapter of Chinese political and legal system research.

²⁵¹ *Ibid.*

governance and has attempted to some extent to apply its theories and regulations in practice but under the governance of the CPC, whose ideological aim is to develop the market as “a market economy with unique Chinese socialist characteristic”²⁵². Therefore, corporate governance in China is at a relatively immature stage but does not necessarily deserve the label “bad”, but rather the label “unique” as it follows its own path dependency.

The legislature obviously needs to have a deeper understanding of corporate governance theories and regulations, and properly consider Chinese cultural and historical ideology in order to form a clearer guidance for enterprises with better standards of practice. During the process, it requires a cautious approach rather than control enterprises in a heavy-handed manner. I would submit that in order to apply corporate governance theories, CPC and all levels of government need to enhance their knowledge and understanding of businesses.

Since the early 2000s, there have been various legal reforms in China.²⁵³ The purpose was for corporate governance arrangements to improve, for investors to have sufficient confidence to invest and to show that China has been aiming to balance the political and economic influences²⁵⁴. Thomsen and Conyon argue that the recent corporate governance innovations have increased transparency and strengthened owners’ rights at certain points.²⁵⁵ However, ownership is still

²⁵² Ibid.

²⁵³ Ibid.

²⁵⁴ Thomsen S and Conyon M, supra n 249. According to Thomsen and Conyon, government ownership and control of the economic activity are still crucial for many companies worldwide. China is the most obvious country that the corporate governance arrangements are influenced by government. However, the book concerns with publicly traded companies rather than other organisations.

²⁵⁵ Ibid.

largely in the concentrated form in China, which means the rights of minority shareholders will continually be an issue to consider.²⁵⁶

Based on the current situation, applying good corporate governance practice is still very difficult, especially in the case of SOEs, the unique characteristic of government that controls the ownership, often presents most of the challenges. However, based on the situation that even the SOEs are applying corporate governance into the businesses, it appears that government has noticed the importance of having a good corporate governance system in businesses of all sizes, improving their performance and developing the economy. This chapter aims to examine small and medium-sized businesses, which in China mainly are family businesses. Therefore, the SOEs are not included in the discussions. The real problem is the attitude of officials to the private sector.

The current trend for extending and developing businesses worldwide is attracting investment. Including foreign direct investment. With globalisation, it is important for businesses to attract investment. This is especially so in the case of China. The general direction of business development in China is adapting to the modern global economy to stabilise the market and enhance investor confidence²⁵⁷. Thus, applying corporate governance and improving it is a necessary step to reach the goal.

²⁵⁶ Ibid. 69. This agency problem is a concern for minority investors. The problem might be more acute when the State is the ultimate owner of the firm, or where the State has objectives that are different from value maximization. In terms of internal corporate governance, China's listed firms are adding independent directors to the board and are improving incentive arrangements. What is clear is that there has been significant reform in a short time. If the implementation of high-quality reforms continues, it might protect all investors' capital.

²⁵⁷ Ibid.

4.2.1 Corporate Governance and Firms

Corporate Governance and Firm Performance

In general, and from all the aspects of the literature, corporate governance has been applied to practice and believed to be good for improving firm performance. There are different ways of applying corporate governance to solve the issues existing in firms based on individual cases and circumstances.²⁵⁸

In many jurisdictions across the globe the majority of firms are family-controlled regardless of their size. From Canada to Hong Kong many listed companies are under family control. The research of File and Prince indicates that “Regardless of the definitions used, it is likely that family businesses represent the most prevalent form of enterprise in the United States...a significant proportion of the purchasing power in the U.S. market.”²⁵⁹ According to many prior studies, a significant proportion of the businesses in Asia and Europe are publicly listed family-controlled firms.²⁶⁰ Also Anderson and Reed concluded that one-third of publicly held firms in the US were classified as family controlled.²⁶¹ Apart from these powerful and wealthy large family firms, small and medium-sized

²⁵⁸ Business Roundtable, “Corporate Governance and American Competitiveness” (1990) 46 *Business Law*, 241. Lawton P, “Berle and Means, Corporate Governance and the Chinese Family Firm” (1996) 6 *Australian Journal of Corporate Law*, 348, 349-350.

²⁵⁹ File K M and Prince R A, “A Psychographic Segmentation of Industrial Family Business”, (1996) 25 (3), *Industrial Marketing Management*, 223-234, 224. Hall P D, “A Historical Overview of Family Business in the United States” (1988) I *Family Business Review* 193. Astrachan J H and Shanker M C, “Family Businesses’ Contribution to the US Economy: A Closer Look” (2003) XVI (3) *Family Business Review*, 211.

²⁶⁰ Anderson R C and Reeb D M “Founding-Family Ownership and Firm Performance: Evidence from the S&P 500”, (2003) 53, *Journal of Finance*, 1301-1328. Wong Y J, Chang S C and Chen L Y, “Does a Family-controlled Firm Perform Better in Corporate Venturing?” (2010) 18 (3), *Corporate Governance: An International Review*, 175-192.

²⁶¹ Anderson R C and Reeb D M, “Who Monitors the Family?” (2003) 5, available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=369620. (accessed 11 March 2014).

companies are mostly all family controlled, and they are the research subjects of this thesis.

Furthermore, in relationship to firm performance and corporate governance, in general, Thomsen and Conyon find that group control rights have a negative impact on the performance. Ownership control mechanisms, derived mainly from pyramid ownership structures in China, enabling the owners to prioritise their interests before those of the shareholders.²⁶² As discussed in Chapter 2 pyramid ownership structures in family controlled firms were largely done away with in the UK under the influence of the stock exchange and institutional investors.

They point out that it is important to note that the “underlying economic requirements to identify causal relationships are often difficult to isolate”²⁶³. This point reflects the view of some commentators, that corporate governance in China is mainly a “relationship based governance” system.²⁶⁴ In China, one of the key issues is the bureaucrat’s role impacting on enterprises. Politically connected CEOs in China can affect performance for the better or worse.²⁶⁵ Private Chinese firms adopt a variety of corporate political strategies.²⁶⁶ There is research regarding the relationship between CEO turnover, firm performance and corporate governance. Research indicates that “poor performance in

²⁶² Ibid. Original statement was “enable the dominant owners to expropriate the value from minority shareholders or tunnel corporate resources for their own interest”.

²⁶³ Thomsen S and Conyon M, supra n 249, 279.

²⁶⁴ Ruskola T, supra n 246.

²⁶⁵ Thomsen S and Conyon M, supra n 249, 279.

²⁶⁶ For example, Ma H, Lin S and Liang N, *Corporate Political Strategies of Private Chinese Firms* (Routledge 2013). Shi C, *Political Determinants of Corporate Governance in China* (Routledge 2013).

China's firms leads to greater than expected CEO turnover. This provides evidence that the proposed corporate governance reforms are effective"²⁶⁷.

For instance, the research that Kato and Long did targeting circa 600 firms between 1998 and 2002, examined Chinese CEO turnover in a pooled cross-section of data.²⁶⁸ Their result did not show the correlation between CEO turnover and firm performance. Meanwhile, it also shows the importance of corporate governance arrangements. In conclusion, the evidence indicates that the internal governance of firms (in other words, the internal mechanisms of corporate governance) affect performance in a positive way.²⁶⁹

In the debates of firm performance, the board of directors have a very crucial role in management. There have been managerial considerations of corporate governance in the 20th century focused very much on organisation theories and strategic management, as well as management of finance, marketing and operations, but relatively little on the role of the board.²⁷⁰ As Bob Tricker commented on the importance of the board, "yet the board of directors of a company, indeed the governing body of every corporate entity, is ultimately responsible for that organisation's decisions and its performance. It is the board that is accountable to the owners, members, and other legitimate stakeholders. The directors should be providing direction and supervising the work of executive management."²⁷¹

²⁶⁷ Ibid.

²⁶⁸ Kato T K and Long C X "Executive turnover and firm performance in China", (2006) 96 (2), *American Economic Review*, 363-367.

²⁶⁹ Thomsen S and Conyon M, supra n 249, 290.

²⁷⁰ Tricker B, *Corporate Governance: Principles, Policies, and Practices* (OUP 2009), 7.

²⁷¹ Ibid.

Controlling Families and Corporate Governance Theories

It is a commonly held view that in most emerging countries, a controlling family normally is the largest shareholder, and it controls the ownership of a firm.²⁷² Agency theory is one of the most important theories in the centre of corporate governance. Agency theory mainly exists in larger size of firms where the ownership and control are separated. The theory suggests the separation of ownership and control in public firms actually raises the potential conflicts of interests.²⁷³ In this sense, there are possibilities of personal interests being pursued at the expense of other constituencies in the company, for example, managers might pursue their own interests on the expenses of the interests of shareholders.²⁷⁴ The reason that Agency theory has been examined so intensively and exclusively is largely because it widely applies in large firms, usually in the Anglo-American context. This is because their multinational companies are powerful and important in many economies worldwide. Other viable theories such as Coase's theory of the firm and Richardson's hybrid model appear to have been partially eclipsed in this regard.²⁷⁵ In recent years a number of theoretical perspectives have been developed in relation to family business ranging from Agency theory and Behavioural theory to combinations

²⁷² Claessens S, Djankov S and Lang H P, "The Separation of Ownership and Control in East Asian Corporations", (2000) 58, *Journal of Financial Economics*, 81-112. Morck R, Wlfenzon D and Yeung B, "Corporate Governance, Economic Entrenchment and Growth", (2005) 43, *Journal of Economic Literature*, 655-720. Wong, Chang and Chen, supra n 260.

²⁷³ Jensen M C and Meckling W H "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", (1976) 3, *Journal of Financial Economics*, 305-360, in Wong, Chang and Chen, supra n 260.

²⁷⁴ The studies show this opinion included Morck R, Shleifer A and Vishny R W, "Management Ownership and Market Valuation: An Empirical Analysis", (1988) 20, *Journal of Financial Economics*, 293-315. Anderson R and Reeb D supra n 260 and 261.

²⁷⁵ Coase R H, "The Nature of the Firm" (1937) 4 *Economica* (new series), 386-405.

Richardson G B, "The Organisation of Industry" (1972) 82 (327) *Economic Journal*, 883-896.

thereof (for example, Behavioural Agency theory) to Kinship and Gender theories.²⁷⁶ More recent empirically based research examines whether Agency or Stewardship is the more effective form of managerial governance in family firms. The results indicated the greater effectiveness of stewardship over agency governance irrespective of a manager's family affiliations.²⁷⁷

In the case of family businesses (mainly in SMEs), the prior literature has suggested that family businesses might provide the solution for the agency problem.²⁷⁸ The major studies suggested that in family businesses, the large shareholders are normally the controlling families, and they have enough power and incentive that can monitor managerial decisions on daily basis. The controlling families are commonly involved with daily business management, therefore they are normally the force that efficiently reduce the conflicts between managers and shareholders.²⁷⁹ In this case, possibly larger firms could learn some operations that small and medium-sized businesses have, to adapt and apply to their own, to improve their business performance. Specifically, the studies show that family ownership may affect corporate venturing in a positive way.²⁸⁰ It might be because, commonly, family shareholders in the family firms, expect or at least have the intention to let their children inherit the businesses,

²⁷⁶ For an overview of these theoretical approaches, Nordqvist M *et al.*, supra n 6.

²⁷⁷ James A E, Jennings J E and Jennings P D, "Is it Better to Govern Managers via Agency or Stewardship? Examining Asymmetries by Family Versus Nonfamily Affiliation" (2017) 30 (3) *Family Business Review*, 262-283.

²⁷⁸ McConaughy D, Matthews C and Fialko A, "Founding Family Controlled Firms: Performance, Risk and Value", (2001) 39, *Journal of Small Business Management*, 31-49. Anderson R and Reeb D supra n 260 and 261. Chrisman J J, Chua J H and Litz R A, "Comparing the Agency Costs of Family and Non-Family Firms: Conceptual Issues and Exploratory Evidence", (2004) 28, *Entrepreneurship Theory and Practice*, 335-354, in Wong, Chang and Chen, supra n 260.

²⁷⁹ The agency theory-based studies included Shleifer A and Vishny R W, "Large Shareholders and Corporate Control", (1986) 94, *Journal of Political Economy*, 461-488. Shleifer A and Vishny R W, supra n 244.

²⁸⁰ Wong, Chang and Chen, supra n 260, 2.

therefore, family firms invest more efficiently. Also, with the high family involvement in managerial decisions, they are more patient and cautious on making investment to business opportunities.²⁸¹ There remains the problem of “tunneling” or the expropriation of value out of minority shareholders’ holdings.²⁸²

Corporate Governance and Chinese Firms

Thomsen and Conyon, examined the quality and consequences of corporate governance practices in the Fortune 100 largest listed Chinese firms in 2004, in regard to the aspects of the aggregate quality of corporate governance and disclosure practice, as measured by reference to the revised OECD Principles of Corporate Governance Index (CGI). The index is assembled as 90 questions probing the transparency, disclosure and rights of shareholders.²⁸³ The result they find is the differences in corporate governance quality and the firm performance – higher performance for better governance.

In contrast, an important finding of Thomen and Conyon is that they found Chinese firms that listed overseas have better corporate governance, disclosure

²⁸¹ Westhead P and Cowling M, “Family Firm Research: The Need for a Methodological Rethinks”, (1998) 23, *Entrepreneurship Theory and Practice*, 31-56; James H, “Owner as Manager: Extended Horizons and Family Firm”, (1999) 6, *International Journal of the Economics of Business*, 41-56. Bruton G, Ahlstrom D and Wan J, “Turnaround in East Asian Firms: Evidence from Ethnic overseas Chinese Communities”, (2003) 24, *Strategic Management Journal*, 519-540. Casson M, “The Economics of the Family Firm”, (1999) 47, *Economic History Review*, 10-23. Olson P D, Zuiker V S, Danes S M, Stafford K, Heck R K Z and Duncan K A, “The Impact of the Family and the Business on Family Business Sustainability”, (2003) 18, *Journal of Business Venturing*, 639-666. Zahra S A, “Entrepreneurial Risk Taking in Family Firms”, (2005) 18, *Family Business Review*, 23-40, in Wong, Chang and Chen, supra n 260.

²⁸² For a consideration of “tunneling” see generally Lang L H P (ed.), *Governance and Expropriation* (Edward Elgar 2005).

²⁸³ Thomsen S and Conyon M, supra n 249, 278.

and transparency compared with the Chinese firms that are not listed overseas. Nevertheless, they pointed out that the good performance was not necessarily caused by good corporate governance. They concluded that although Chinese corporate governance may have been improving, it has not brought up the Chinese companies' market valuation.²⁸⁴

Other Organisational Forms

There are other substantial parts of corporate governance that are commonly raised in international contexts. Such as not-for-profit firms, government organisations, cooperatives, associations, mutual and foreign subsidiary firms. Some of these forms are large and listed, also play important roles in corporate governance. They exist globally, but research examining their governance is much less common. The reason that academic started to paying attention to is because the disclosure requirement that some of these public firms tended to meet, just over the last two decades.²⁸⁵ With the time, the research will be covering more parts of these forms in corporate governance subject.

Of particular note one relatively unique organisational form in China – Township and Village-owned Enterprises – this organisational form does not exist elsewhere, and has attracted interest from scholars worldwide.

²⁸⁴ Ibid.

²⁸⁵ Ibid. 68.

The Nature of Township and Village-Owned Enterprises “乡镇企业” (xiangzhen qiye)

Township and Village-owned enterprises in China are controlled by local governments (town and village level), but owned by local citizens.²⁸⁶ The reason for creating this type of ownership is because, 1) the governments can provide the security and resources to ensure the success of these enterprises; 2) solving the problem of local citizens' low income and poor living conditions.²⁸⁷ This form has grown rapidly since the late 1970s, in 1993 only, these enterprises have produced about 40 per cent of the nation's total industrial product and the employment of 112 million.²⁸⁸ In 1995, the sector has grown at the annual rate of more than 30 per cent, and produced 30 per cent of total GDP.²⁸⁹ In 2012, the development has reached to RMB 60 trillion in total, increased 9 per cent compared with the previous year, and provided 1.64 billion employment.²⁹⁰ Therefore, the importance and the contribution of township and village-owned enterprises are significant.

This structure in the enterprises has benefits for all relevant parties. The government, the controlling party, shares the benefits with citizens who are the

²⁸⁶ Chang C and Wang Y J, "The Nature of the Township-Village Enterprise", (1994) 19, *Journal of Comparative Economics*, 434-452.

²⁸⁷ Ibid. 434.

²⁸⁸ Ibid. 435. *People's Daily* (Overseas Edition, 8th January 1994), 1.

²⁸⁹ Chang C, McCall B P, and Wang Y J, "Incentive contracting versus ownership reforms: evidence from China's township and village enterprises", (2003) 31, *Journal of Comparative Economics*, 414-428, 417.

²⁹⁰ “乡镇企业总产值 60 万亿，农民人均纯收入逾 1/3 来自乡镇企业” (township and village-owned enterprises total value reaches 60 trillion, rural people average income one third comes from township and village-owned enterprises) (24 December 2012, Edition 1), *People's Daily*, http://paper.people.com.cn/rmrb/html/2012-12/24/nw.D110000renmrb_20121224_10-01.htm, (accessed 08 March 2014).

owners of these enterprises. Local officials can enhance their political career by achieving economic growth locally and be recognised for their achievement by central government.²⁹¹ Citizens win access to the key resources that other types of enterprises do not have, and improve their welfare. The control by local government is the main feature distinguishing this type of enterprise from others. Therefore, township and village-owned enterprises are not really private enterprises.

The Development

In the opinion of many commentators, township and village-owned enterprises are one of the most important factors in China's rapid growth since the late 1970s.²⁹² The developmental steps of giving this enterprise form political and legal recognition were taken in the 1980s and 1990s. The property of township and village-owned enterprises were given protection by the government in 1983.²⁹³ Government officially legalized private ownership in 1988.²⁹⁴ Finally in 1996, the township and village-owned enterprises law was passed.²⁹⁵ Before mid-1990s, government sold some small township and village-owned enterprises to private owners and transformed some larger ones into joint stock companies.²⁹⁶

²⁹¹ Murakami N, Liu D and Otsuka K, "Technical and allocative efficiency among socialist enterprises: the case of the garment industry in China", (1994) 19, *Journal of Comparative Economics*, 410-433. Chen H Y and Rozelle S, "Leaders, managers, and the organisation of township and village enterprises in China", (1999) 60, *Journal of Development Economics*, 529-557, 530.

²⁹² Chang C, McCall B P and Wang Y J, *supra* n 289, 417.

²⁹³ *Ibid.* 418.

²⁹⁴ *Ibid.*

²⁹⁵ *Ibid.*

²⁹⁶ *ibid.* 419.

The success of township and village-owned enterprises, which is the example of central planning and private workforce joint ownership, is in contrast with pre-1989 Eastern European unsuccessful public ownership reforms.²⁹⁷ Meanwhile, it indicates that private ownership is an important element in encouraging economic growth in a market-oriented economy.²⁹⁸

The Structures

In township and village-owned enterprises (TVOEs), the typical structure is citizens in a town or village are owners, local government appoints managers, so they could report to local government and run businesses at the same time.²⁹⁹ This operation is named as “the responsibility arrangement”.³⁰⁰ Another operation is “the contracting arrangement”, which is the manager or managers sign their employment duration based on the contracts which are linked to their compensation with the enterprises’ performance.³⁰¹ With the development of “the contracting arrangement”, in 1980s, local government and enterprises experimented with joint stock ownership. Some TVOEs were transformed by government, the equity holders could choose managers through the board of directors.³⁰² The equity of the township and village-owned enterprises was divided into three parts: the citizens had a collective equity stake, and this was represented by the local government; the employees had a collective equity

²⁹⁷ Kung K S and Lin Y M, “The Decline of Township-and-Village Enterprises in China’s Economic Transition”, (2007) 35 (4), *World Development*, 569-584, 569.

²⁹⁸ Ibid.

²⁹⁹ Chang C, McCall B P and Wang Y J, supra n 289.

³⁰⁰ Ibid.

³⁰¹ Ibid.

³⁰² Ibid.

stake, which was controlled by the Employee Representative Meeting; Each employee had an individual stake, which was tied with the personal contribution. The selected board of directors has the right to make major decisions.

Other forms, such as proprietorships and partnerships where allowing a small number of workers working together, were allowed for township and village-owned enterprises since early 1980s. To sum up, there are responsibility (*fu ze zhi*), contracting (*cheng bao zhi*), leasing (*zu lin*), privately owned (*si ying*), partnership (*he zuo zhi*), auction off (*pai mai*) and joint stock ownership (*gu fen zhi*) in township and village-owned enterprises.³⁰³

Family Enterprises in Township and Village-Owned Enterprises

The rural township and village-owned enterprises exist in a specific background, and they are a form of community economy.³⁰⁴ The most common and powerful organisation in a community economy is the family form.³⁰⁵ Because there are township and village-owned enterprises transformed into family enterprises, the family regime in township and village-owned enterprises is an important factor and will continue to exist for a long time.³⁰⁶

³⁰³ The forms were stated in Chang C, McCall B P, and Wang Y J, supra n 289, 419.

³⁰⁴ Pan B S, “乡镇企业中的家族经营问题—兼论家族企业在中国的历史命运” (*xiangzhen qiye zhong de jiazu jingying wenti – jianlun jiazu qiye zai zhongguo de lishi mingyun*, *The managerial issue of family running in township and village-owned enterprises: the history and destiny of family enterprises in China*), (1998) Edition 1, *中国农村观察* (*zhongguo nongcun guan cha*, *Observation of Rural China*), <http://www.cnki.com.cn/Article/CJFDTotal-ZNCG801.002.htm> (accessed 08 March 2014).

³⁰⁵ *Ibid.*

³⁰⁶ *Ibid.*

The township and village-owned enterprises build on the basis of “家庭联产承包责任制”(*jjating lianchan chengbao zeren zhi*), means it is a household contract responsibility system with remuneration linked to output.³⁰⁷ Regardless of whether it is group-owned or individually-owned, they all have family regime involved at certain levels.³⁰⁸ Therefore, an examination of the family organisation in this type of enterprises would benefit the research on township and village-owned enterprises. Family enterprises are and will be one of the most important forms in all organisations in China. This factor has made township and village-owned enterprises a complex entity.

The family enterprises mentioned here mainly are the ones that transformed from “集体企业”(*jiti qiye*) “collectively-owned enterprises”.³⁰⁹ This type of family enterprises might have family members and relatives who work for local government. Thus, this type of enterprises is complex also because of its political connections. The family enterprises will be examined in the next chapter.

Township and Village-Owned Enterprises and Corporate Governance

There are some large township and village-owned enterprises existing in China, and there are unclear issues of corporate governance in the enterprises.³¹⁰ The

³⁰⁷ Ibid.

³⁰⁸ Ibid.

³⁰⁹ Ibid.

³¹⁰ Fan G and Chen Y, “过渡性杂种：中国乡镇企业的发展及制度转型”(*guoduqi zazhong: zhongguo xiangzhen qiye de fazhan ji zhidu zhuanxing*) “Transitional Hybrids: Development of TVEs and Institutional Transition in China”, (July 2005) 4 (4), *China Economic Quarterly*, 937-952

unclear property rights might cause the issues.³¹¹ However, the development of markets and the increase of entrepreneurship in China will tend to redefine the relative ownership rights with local government and the enterprises. With the relatively recent enactment of property law, the issues will hopefully be solved in future. In order to operate the enterprises in a more market-oriented environment, changes will have to be made to improve its efficiency.³¹² However, these enterprises are only regulated under specific law and regulations, and heavily dependent on government policies and orders. The “Township and Village-Owned Enterprises Law of People’s Republic of China” (“中华人民共和国乡镇企业法”) (*zhonghua renmin gongheguo xiangzhen qiye fa*) was enacted on 1st January 1997³¹³ indicating the government’s supports for this type of enterprise, but the regulations will have to be reviewed to coordinate with other regulations and market developments.

4.3 Corporate Governance and Mechanisms

4.3.1 Corporate Governance Mechanisms and Literature

A survey of corporate governance, conducted by Shleifer and Vishny, found that most advanced market economies might be able to solve most of the corporate governance problems but not the corporate governance mechanisms issue.³¹⁴

³¹¹ Ibid.

³¹² Ibid.

³¹³ The “Township and Village-Owned Enterprises Law of People’s Republic of China” (“中华人民共和国乡镇企业法”) (*zhonghua renmin gongheguo xiangzhen qiye fa*), http://www.gov.cn/banshi/2005-06/01/content_3432.htm, (accessed on 12 March 2014).

³¹⁴ “Most advanced market economies have solved the problem of corporate governance at least reasonably well, in that they have assured the flows of enormous amounts of capital to

As they commented, corporate governance is a vast practical and important subject, even to advanced market economies. There are debates concerning existing governance mechanisms, and how effective or ineffective they are. In the context of the assessment of the US corporate governance system, Jensen expressed a different opinion compared with the Easterbrook and Fischel as well as Romano, Jensen held the opinion that the US corporate governance system is deeply flawed whereas the latter authors hold a very optimistic opinion.³¹⁵ For countries like the US, UK, Germany and Japan, corporate governance mechanisms are mature (but differ considerably). In contrast, less developed countries often lack corporate governance mechanisms. As Shleifer and Vishny commented, Italian corporate governance mechanisms are not developed at all, and essentially result in firms being unable to gain capital from outsiders.³¹⁶

Mechanisms and Literature - Categories

There is an underlying assumption in the relevant literature, that most corporate governance mechanisms will improve corporate economic performance.³¹⁷ The

firms, and actual repatriation of profits to the providers of finance. But this does not imply that they have solved the corporate governance problem perfectly, or that the corporate governance mechanisms cannot be improved." Shleifer A and Vishny R W, supra n 244, 737.

³¹⁵ Easterbrook F and Fischel D, *The Economic Structure of Corporate Law*, (Harvard University Press 1991). Romano R, *The Genius of American Corporate Law* (American Enterprise Institute Press 1993).

³¹⁶ Shleifer A and Vishny R W, supra n 244, 738. "Understanding corporate governance not only enlightens the discussion of perhaps marginal improvements in rich economies, but can also stimulate major institutional changes in places where they need to be made."

³¹⁷ As Steen Thomsen and Martin Conyon stated, the reason such as the managers are pressed by the mechanisms and they have to work harder or enable the shareholders to make better choices. "Beyond this point, which is difficult to define and varies from mechanism to mechanism and from firm to firm, the costs start to kick in. From that point increasing use of this governance mechanism will destroy the value." Thomsen S and Conyon M, supra n 249, 47.

problems associated with solving central governance issues are highly demanding and a number of governance mechanisms have been developed for this purpose. The underlying purpose for developing a good combination of corporate governance mechanisms is to find the optimum approach in the best interests of the individual firm. Good corporate governance essentially consists of tailoring these mechanisms to the individual firm.

It has been proposed that mechanisms of corporate governance can be categorised into “social norms”, “trust and reputation”, “company law”, “large owners”³¹⁸, “shareholder activism”³¹⁹, “takeovers”³²⁰, “boards”, “incentive systems”, “creditors and capital structure”, “auditors”, “analysts”, “competition”³²¹.

³¹⁸ “The vast majority (most likely 99%) of all companies are owned by one or two shareholders who also manage the company. ...Both in theory and in practice it makes more sense to have a manager own the firm than somebody from the outside, because the manager has more information and is therefore in a better position to make decisions.” Thomsen S and Conyon M, *supra* n 249, 52.

³¹⁹ Poulsen T, Strand T and Thomsen S, “Voting Power and Shareholder Activism: A Study of Swedish Shareholder Meetings”, (2010) 18 (4), *Corporate Governance: An International Review*, 329-343.

³²⁰ Thomsen S and Conyon M, *supra* n 249, 55 and 56. Hostile takeovers are a famous and dramatic governance mechanism. However, they are not commonly used in practice but also contributed to some cases. Empirically, far from all hostile takeovers are directed at companies with bad corporate governance and bad performance. M&A may even be a symptom of bad governance as when a company with plenty of free cash flow uses it to build empires by buying other companies.”

³²¹ Nickell S J, “Competition and Corporate Performance”, (1996) 104 (4), *Journal of Political Economy*, 724-746. Nickell S J, Nicolitsas D and Dryden N, “What makes firms perform well?”, (1997) 41 (3-5), *European Economic Review*, 783-796. “Competition in the market for products and services is a fundamental correction mechanism for any kind of inefficiency in a market-based system, and this also includes inefficiency in corporate governance.” Competition can help address governance problems in several different ways, evidence shows that productivity growth is higher in companies which are faced with competition. Shareholders will also benefit from high productivity and low costs, but profits will obviously be squeezed by price competition, so shareholders have an incentive to avoid competition. “Most economists would claim that the market ultimately gets it right. Grossly inefficient firm will adapt or go out of business. But it may take a long time, particularly if they are sitting on large amounts of cash or have strong market positions. In the meantime (and when the market fails to do the job) there is a role for other governance mechanisms.” Thomsen S and Conyon M, *supra* n 249, 60.

Among all the mechanisms of corporate governance, some are more important or prior to some others. As stated above, Bob Tricker had raised the importance of boards of directors, but prior to the 1980s not much was examined or discussed concerning the role of the boards in the context of governance. Thomsen and Conyon gave the example of the process of selecting CEOs and in that process, the ownership is prior to board structure, and is prior to incentives.³²² However, all the processes would happen under the regulatory framework, therefore, apparently the regulation is the most prior feature to others. In other words, on this approach, law is the most important mechanisms in corporate governance.

However, there are exceptions in practice. For instance, individual shareholders or board members are usually not influenced by laws and regulations, but ownership structure is.³²³ Therefore, the shareholders are prior to board members, who are elected by shareholders; and then board members are prior to managers. In some Chinese corporations, which are applying corporate governance mechanisms for different reasons, such as being listed overseas, they would follow the logical priority as stated above. However, in other corporations, especially in SOEs, the Chinese managers and boards are mainly appointed by government, it would be completely different from the mechanisms priority above. Although not all the mechanisms are equally important,³²⁴ the identity of decision makers and the needs in governance system would choose the right ones to apply.

³²² Thomsen S and Conyon M, *supra* n 249, 46.

³²³ *Ibid.*

³²⁴ *Ibid.*

The relationship between “mechanisms” of corporate governance and corporate governance itself may be clarified, as follows “corporate governance is about finding the golden mean, that is, how a particular set of mechanisms create most value in a particular situation.”³²⁵ However, the combination of mechanisms has to be set under individual circumstances. In some companies, it might be better not to have a board, so, for example, that some companies might only need large owners.³²⁶ From a personal point of view, in small and medium-sized companies (family businesses), it is important to determine what mechanisms could be the best for them individually. This is also the part of the purpose of this research, that raising the issue of having proper legal forms, meanwhile considering the mechanisms for family businesses governance, in order to improve their performance and financial sustainability.

There are social norms as a part of mechanisms, but corporate scandals underline the fact that people are immoral.³²⁷ The social norms are currently named as corporate social responsibility (CSR). Trust and reputation are amongst of the most important in informal governance mechanisms. For instance, before there was corporate governance or company law, the huge investment projects were financed from the general public based on the good faith and reputation.³²⁸ But this mechanism has also proved by scandals that it is not perfect at all. In the case of Chinese family businesses, from a historical perspective, reputation has always played an important role in business activities, from the earliest imperial periods to modern China, businessmen do

³²⁵ Ibid. 47.

³²⁶ Ibid.

³²⁷ Ibid. Scandals such as Maxwell to Enron, Parmalat and Lehman.

³²⁸ Ibid. 48.

business based on their reputation, in this case, it is not only the firm reputation, it might mainly depend on the owners' reputation.

To summarise, there are different mechanisms in corporate governance that we can put in practice. However, they need to be based on the individual needs of each firm's own weaknesses and strengths, but does not mean to use them individually each time.³²⁹ It can be chosen to use more than one mechanism at one time for their connections among them.³³⁰ However, the governance problems are not solved completely by using all mechanisms at the same time altogether. Indeed, the classic mechanisms of Agency Theory, for example, such as independent non-executive directors, remuneration and audit committees *et cetera* may not be appropriate for many SMEs.

The mechanisms of corporate governance or so called corporate governance systems change over time. This is demonstrated by examples of German and French cases, that demonstrated the changes have happened over time.³³¹ The changes show the trend and debate of whether the corporate governance system is turning to the converging point. Indeed, with globalisation and international investment activities, more and more corporations apply corporate governance systems. Therefore, there might be a converging point, for the

³²⁹ Thomsen S and Conyon M, *supra* n 249, 60. Thomsen and Conyon gave an example of personal ownership, it might be a good mechanism for a wise first generation owner, but not the second generation incapable son.

³³⁰ *Ibid.* 61. They commented that the different mechanisms are not necessarily used one each time, they are actually commonly used more than one at the same time in practice.

³³¹ *Ibid.* 68. German banks tend to reduce the shareholdings in German companies and not as the major block holders anymore, which leads to the debate of whether Germany could be cited as a case of purely bank governance system. Also in the case of France, which was known for government ownership, has changed to privatization in many leading firms and they do not appear to be standard state-controlled firms.

reason of governments could reform and change the system. According to Shleifer and Vishny, “corporate governance mechanisms are economic and legal institutions that can be altered through the political process – sometimes for the better.”³³² Their research indicates that the question of governance reform is not necessary as the product market will be the force for corporations to adopt good governance mechanisms and practice. This will be in order to minimise the cost of competition.³³³

The Definition of Mechanisms

Corporate governance systems are different around the globe. The mechanisms are different as well and used to different levels in various countries. Therefore, researchers commonly use “corporate governance systems” instead of “corporate governance mechanisms”,³³⁴ as explained above. This circumstance may lead to the importance of discussing the definition of corporate governance mechanisms.

The term “mechanism” in ordinary dictionary has been defined in the following meanings³³⁵: 1. an assembly of moving parts performing a complete functional motion, often being part of a large machine; linkage. 2. the agency or means by which an effect is produced or a purpose is accomplished. 3. machinery or mechanical appliances in general. 4. the structure or arrangement of parts of a

³³² Shleifer A and Vishny R W, supra n 244, 738.

³³³ Ibid.

³³⁴ Thomsen S and Conyon M, supra n 249, 68.

³³⁵ Mechanism, Dictionary.com, <http://dictionary.reference.com/browse/mechanism>, (accessed 22 February 2014).

machine or similar device, or of anything analogous. 5. the mechanical part of something; any mechanical device: the mechanism of a clock.

In Collins World English Dictionary, the term has been defined as³³⁶:

1. a system or structure of moving parts that performs some function, esp in a machine
2. something resembling a machine in the arrangement and working of its parts: the mechanism of the ear
3. any form of mechanical device or any part of such a device
4. a process or technique, especially of execution: the mechanism of novel writing
5. philosophy
 - a. the doctrine that human action can be explained in purely physical terms, whether mechanical or biological
 - b. the explanation of phenomena in causal rather than teleological or essentialist terms
 - c. the view that the task of science is to seek such explanations
 - d. dynamism compare vitalism strict determinism
6. Psychoanal
 - a. the ways in which psychological forces interact and operate
 - b. a structure having an influence on the behaviour of a person, such as a defence mechanism

³³⁶ Mechanism. Dictionary.com. *Collins English Dictionary - Complete & Unabridged 10th Edition*. HarperCollins Publishers. <http://dictionary.reference.com/browse/mechanism> (accessed 22 February 2014).

In the search of corporate governance mechanisms, it shows different definitions of the mechanisms. One of the definitions is the corporate governance mechanisms are the policies, guidelines, and controls to manage an organisation and reduce inefficiencies.³³⁷ According to the Thomsen and Conyon, they define a country's corporate governance system as a set of governance mechanisms in use in a given country or context. The fact that they are used in combination indicates some degree of consistency and stability. They define "system" as "a set of practices, mechanisms, institutions and rules that remain stable over sufficiently long periods of time".³³⁸

From the understanding of the mechanisms of corporate governance, and the purpose of it serving, perhaps the mechanism is: a regulatory behaviour framework to regulate relevant parties in a corporation, to ensure the corporation operates and serve its purposes.

Mechanism and Literature - Classifications

Apart from the "categories" of mechanisms, there are generally three "types" of mechanisms: Internal mechanisms, external mechanisms and independent

³³⁷ "What Are the Different Kinds of Corporate Governance Mechanisms?", WiseGEEK, <http://www.wisegeek.com/what-are-the-different-kinds-of-corporate-governance-mechanisms.htm> (accessed 22 February 2014).

³³⁸ Thomsen S and Conyon M, supra n 249, 68. "In some countries, such as Germany or Japan, financial transactions between large companies and banks tend to be based on stable relationships rather than anonymous trades. There is a close relationship between firms and the suppliers of finance. In other economies, such as the US or the UK, corporate finance arrangements are more likely to be based on market-based contracting arrangements." As mentioned before, that German mechanism or system is bank-based, but as here mentioned, Germany is cited in the category of "relation-based corporate governance".

external mechanisms.³³⁹ Internal mechanism is obviously the control from inside of a corporation. It controls and monitors the activities inside of the organisation and takes action when any wrongful activities happen, which include owners, managers and employees. They include operations, reports and performance measurement systems. Internal mechanisms include oversight of management, independent internal audits, structure of the board of directors into levels of responsibility, segregation of control and policy development.³⁴⁰

External control mechanism is the control from outside of the corporations, such as regulators, governments, trade unions and financial institutions. These objectives include adequate debt management and legal compliance. External mechanisms are often imposed on organisations by external stakeholders in the forms of union contracts or regulatory guidelines. External organisations, such as industry associations, may suggest guidelines for best practices, and businesses can choose to follow these guidelines or ignore them. Typically, companies report the status and compliance of external corporate governance mechanisms to external stakeholders.³⁴¹

There is also the independent external audit. An independent external audit of a corporation's financial statements is part of the overall corporate governance structure. An audit of the company's financial statements serves internal and external stakeholders at the same time. An audited financial statement and the

³³⁹ Davoren J, "Three types of corporate governance mechanisms", <http://smallbusiness.chron.com/three-types-corporate-governance-mechanisms-66711.html> (accessed 22 February 2014).

³⁴⁰ Ibid.

³⁴¹ Ibid.

accompanying auditor's report helps investors, employees, shareholders and regulators determine the financial performance of the corporation. This exercise gives a broad, but limited, view of the organisation's internal working mechanisms and future prospects.³⁴²

Mechanism and Literature - SMEs (Family Businesses)

Corporate governance mechanisms may be applied to small and medium-sized businesses. And it might be easier to apply to such businesses. For small and medium-sized businesses, owners normally take place of monitoring the decisions and employees, which is the internal mechanism essentially. Meanwhile, when the businesses go to banks for loans, having external auditing service or other financial services, that would be external mechanisms and independent external mechanisms. Therefore, in all cases and all situations, small and medium-sized businesses have the involvement of mechanisms even without acknowledging them.

The research of Wong, Chang and Chen demonstrated the mechanisms of corporate governance have impacts on family-controlled firms.³⁴³ Their study indicated that the external governance mechanism of institutional investors is particularly important for family-controlled businesses when internal governance mechanisms do not perform effectively. The finding was consistent with the

³⁴² Ibid.

³⁴³ Wong, Chang and Chen, supra n 260, 24.

research of Wahal and McConnell, which is that institutional ownership can lessen the intensity in family control and corporate venturing.³⁴⁴

4.4 Company Law

The history of capitalism and corporations are deeply linked.³⁴⁵ In the US or in any other countries, the vast majority of SMEs are not listed firms.³⁴⁶ Also, these unlisted SMEs are the main drive for employment and economic growth in all nations. As scholars Guinnane *et al.* commented that enterprises existed relying on the legal framework which allowed the owners and investors to take responsibilities as well as to be protected to a certain extent.³⁴⁷ However, SMEs are not as described in the large-scale enterprises “system”³⁴⁸. Broadly speaking, SMEs are similar in the baseline of “closely held by founders or by families”³⁴⁹, and it has been assumed that limited liability is an ideal form for business organisations in general.³⁵⁰

US corporations and those based in other common law jurisdictions have largely been created within Anglo-American style legal institutions, the support and protection this model provided (along with its inherent weaknesses such as

³⁴⁴ Wahal S and McConnell J J, “Do Institutional Investors Exacerbate Managerial Myopia?”, (2000) 6, *Journal of Corporate Finance*, 307-329. In Wong, Chang and Chen, *supra* n 260.

³⁴⁵ Guinnane T W, Harris R, Lamoreaux N R and Rosenthal J L, “Ownership and Control in the Entrepreneurial Firm: An International History of Private Limited Companies”, (2007) Yale University Economic Growth Center Discussion Paper, No. 959, available at SSRN: <http://ssrn.com/abstract=1071007> (accessed 23 January 2014).

³⁴⁶ Thomsen S and Conyon M, *supra* n 249

³⁴⁷ Guinnane, Harris, Lamoreaux, and Rosenthal, *supra* n 345, 3.

³⁴⁸ As Steen Thomsen and Martin Conyon described that the system people characterize is tended to focus on the largest and most visible companies in a nation. Thomsen S and Conyon M, *supra* n 249, 68.

³⁴⁹ *Ibid.*

³⁵⁰ Guinnane, Harris, Lamoreaux, and Rosenthal, *supra* n 345, 3.

short-term tendencies) has been less influential in other countries, such as European countries.³⁵¹

The business law has strong impacts on economic changes, and *vice versa*.³⁵² From the legal perspective, as Reisberg commented, “an outdated, obscure legal structure can create costs for business ... in particular for small businesses”.³⁵³ The partnership was the only affordable company type for SMEs in Britain in the 19th century; most SME owners were subject to the disadvantage of corporations.³⁵⁴ When the private limited liability company form was introduced in Britain in 1907 it became popular quickly.³⁵⁵ Interestingly, the option of limited liability company came to the US much later, only after the mid-twentieth century.³⁵⁶ The French and German limited partnership form is more flexible and adaptable for entrepreneurs than the British and American forms.³⁵⁷

In summary, wherever the form is applied, the legal framework is important.³⁵⁸ This matters more for SMEs as they need more of a supportive legal context, than public companies, for example.³⁵⁹

³⁵¹ Ibid.

³⁵² Ibid.

³⁵³ Reisberg A, supra n 111, 317.

³⁵⁴ Ibid.

³⁵⁵ Private limited liability company started in Germany in 1892, and France in 1925.

Guinnane, Harris, Lamoreaux, and Rosenthal, supra n 345, 4.

³⁵⁶ Ibid.

³⁵⁷ Ibid.

³⁵⁸ Ibid.

³⁵⁹ Ibid. 5.

4.4.1 The United Kingdom Company Law

UK is an advanced post-industrial economy and with an innovative legal system, further to be recognized as the origin of the common law.³⁶⁰ There was no statute for limited partnership until 1907, whereas the Companies Act of 1844 as the general incorporation came into law a long time ago although limited liability was only introduced after a long debate over a decade later.³⁶¹

The Policy of “Think Small First”

After the mid-nineteenth century, the general incorporation laws in the UK started to create the corporate form that was attractive to SMEs.³⁶² With the enactment of the Limited Liability Act and Joint Stock Companies Acts, Company Law has developed into its modern form.³⁶³ Traditionally, company law was written for public companies although the majority of companies in the UK are small.³⁶⁴ The origin of “limited liability” came from public companies, where they tended to attract investments from the public but with the limited corporate debts liability. The Limited Liability Act 1855 marked the time that legislation encouraged capital from private investors.³⁶⁵ With time, in the early 20th century, businessmen found that this model might be good to apply to family firms and other private businesses. Therefore, since early 2000, with the

³⁶⁰ Ibid. 6.

³⁶¹ Ibid. 14.

³⁶² Ibid.

³⁶³ Wild C and Weinstein S, *Smith and Keenan’s Company Law*, (16th edn. Pearson Education 2013), 2.

³⁶⁴ Reisberg A, *supra* n 111, 322.

³⁶⁵ Wild C and Weinstein S, *supra* n 363, 4.

new limited liability vehicles were created, a culture of enterprise raised, and that resulted a trend of support for an easy path to limited liability forms.³⁶⁶ According to Freedman, the UK Company Law Review examined ways of attracting small business owners in to the new form.³⁶⁷ At the time, they did not need to have the capital from public investors. However, these companies have become the prominent force for economic growth and employers. This type of company is ubiquitous and numerous worldwide, and continually growing with their own advantages compared with public companies. Most importantly, they have been developed to attract investments from public all over the world and operate under company laws in different jurisdictions,³⁶⁸ The movement in UK changed as the Parliament and Board of Trade used to charter corporations, enacted legislation for general incorporation without limited liability in 1844, further enact limited liability in 1855-56.³⁶⁹ The contractual nature of the corporation further emphasised in the 1862 Companies Act.³⁷⁰ The estimate showed that partnership form persistently existed, which with the trade partnerships were required registration in practice with 1872 the Committee on Partnerships.³⁷¹ In 1885, by a conservative estimate, the number of important partnerships was about 100,000, whereas the limited liability companies (exclude one-person companies) at the most 5 to 10 per cent in the economy.³⁷² In general, the corporate form started to dominate after more than fifty years after the general incorporation was enacted.³⁷³ SMEs stayed safe in terms of

³⁶⁶ Freedman J, "Limited Liability: Large Company Theory and Small Firms", (2000) 63 (3), *The Modern Law Review*, 317-354.

³⁶⁷ Ibid.

³⁶⁸ Tricker B, supra n 270, 9.

³⁶⁹ Guinnane, Harris, Lamoreaux, and Rosenthal, supra n 345, 14.

³⁷⁰ Ibid.

³⁷¹ Ibid. 22.

³⁷² Ibid.

³⁷³ Ibid.

the legal vehicle they were familiar with in that most of them were in the form of partnerships, while private limited liability company form was introduced into UK.³⁷⁴ It appears that businessmen tended not to choose the corporation because they might find other forms better fitted their needs.³⁷⁵

There are various policies underlying corporate law from enabling economic activity by providing a suitable legal vehicle and then to regulate corporate activities.³⁷⁶ Meanwhile, Company Law is also the fundamental basis of corporate governance.³⁷⁷ This is the concept of the Company Law in the context of UK and other Western countries, where the conception of capitalism is in the free-market economies.³⁷⁸ Therefore, with the market develops, the Company Law was the part that worked by legislature in order to work with the market, to regulate, to protect, to limit all potential changes, including good or bad changes. But the reality is the company law appears to be designed for large enterprises. According to Guinnane *et al.*, “the purpose of the law was to protect investors in publicly held companies, it raised the costs of organizing all types of corporations, whether they issued shares to the public or not”.³⁷⁹ They also provided that the German law in 1884 made the corporate form less attractive, especially to SMEs.³⁸⁰ In the UK circumstances finally forced Parliament to respond. The Loreburn Committee was set up in 1905 to consider changes to the law, thereafter, the amendment to the Companies Act in 1907 was enacted

³⁷⁴ Ibid.

³⁷⁵ Ibid.

³⁷⁶ Tricker B, *supra* n 270.

³⁷⁷ Ibid.

³⁷⁸ Ibid. 9. Hadden wrote the comment in 1972 on British company law.

³⁷⁹ Guinnane, Harris, Lamoreaux, and Rosenthal, *supra* n 345, 27.

³⁸⁰ Ibid. The number of companies registered declined from 5,082 in 1897 and 4,849 in 1900 to 3,343 in 1901 and 3,725 in 1904.

to create the private limited company.³⁸¹ Since then, the lawful private limited form became available. With the growth of the corporate form, there are concerns on the aspect of the accountability of managers to shareholders, therefore, the law has to reform the relevant area.³⁸² After the Great Depression the Companies Act 1948 ensured “shareholder democracy” within the companies.³⁸³ The UK government’s Bullock Report in 1977 proposed to reform in order to allow employees to the selection of board of directors.³⁸⁴ A two-tier management structure therefore was suggested by the report³⁸⁵, which is also similar to China’s corporate governance structure. However, these reforms have never been implemented in the UK.³⁸⁶ Moreover, the Insolvency Act 1986 and the Company Directors Disqualification Act 1986 were regulating the directors’ misconduct.³⁸⁷

In the modern UK, the Companies Act 2006 had the regulation for small and medium-sized companies, and the Act presents a “wholesale rethink” of corporate law.³⁸⁸ This Act is the most complex piece of corporate legislation that Parliament enacted, which contains 47 Parts (1,300 sections) and followed by 16 Schedules, moreover, there are over 70 statutory instruments along with the Act.³⁸⁹ In addition, the Limited Liability Partnerships Regulations (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804) represent the

³⁸¹ Ibid. And Companies Act 1907 (7 Edw. 7c. 50).

³⁸² Wild C and Weinstein S, supra n 363, 5.

³⁸³ Ibid. Ensured a number of member-authorizations were introduced alongside the ability of shareholders to remove directors via a simple majority vote.

³⁸⁴ Ibid.

³⁸⁵ Ibid.

³⁸⁶ Ibid.

³⁸⁷ Ibid.

³⁸⁸ Wild C and Weinstein S, supra n 363, 58.

³⁸⁹ Reisberg A, supra n 111, 216.

completion of the application of the Companies Act 2006 to limited liability partnerships.³⁹⁰ This also repealed much of the Limited Liability Partnerships Regulations 2001 (SI 2001/1090), set out the detailed provisions for Limited Liability Partnership by applying the Companies Act 1985, the Insolvency Act 1986 and other enactments in a considerable degree.³⁹¹ There is the new Model Articles in the 2006 Act, replacing Table A as the template, which is a huge change from “one size fits all” to “think small first”.³⁹² This Model Articles have provided a model for private companies limited by shares, limited by guarantee and public companies limited by shares.³⁹³

Previous corporate legislations in UK hit on small businesses in a very brutal way.³⁹⁴ In contrast, this new Act is clearer and more understandable.³⁹⁵ During the reform progress, it has been proven that the Act 2006 emphasised and focused on small private companies more. For instance, the *Strategic Framework* in the Company Law Review written consultation documents series, which contained “small private companies are particularly important in job creation and need an optimal legal climate” as one of the arrangements as its missions.³⁹⁶ In addition, one of the key issues that was clearly raised as a priority for reform was the “problems of the small, or closely-held company”, seen as within of “the scope of company law”.³⁹⁷ Furthermore, one of the consultation

³⁹⁰ Wild C and Weinstein S, supra n 363, 58.

³⁹¹ Ibid.

³⁹² Ibid. preface xviii. Reisberg A, supra n 111, 329-330. “Think small first” strategy for small and private companies raised as one of the three core policies at the heart of the Company Law Review. It also is one of the four key objectives of the Companies Act 2006, which is to ensure better regulation and a “Think Small First” approach.

³⁹³ Wild C and Weinstein S, supra n 363, 58.

³⁹⁴ Reisberg A, supra n 111, 317.

³⁹⁵ Ibid.

³⁹⁶ Ibid. 328.

³⁹⁷ Ibid.

document *Developing the Framework*, contained corporate governance and the policies for small private companies' legislative treatments.³⁹⁸

Sections 381-384 in the Companies Act 2006 are divided for private companies (small companies including parent companies and groups), with the introduction of the accounting exemptions.³⁹⁹ And the small companies are free from complying with many of the accounting standards from the Accounting Standards Board.⁴⁰⁰ As regards other accounting standards, the Financial Reporting Standard for Smaller Entities (FRSSE) confirmed that small companies can ignore these standards.⁴⁰¹ Sections 465-467 are divided for companies, parent companies and groups in the medium-sized range.

Definitions of Small and Medium-Sized Companies

In the Company Law, the definition of small companies is,

A small company is one which has been within the limits of two of the following thresholds since incorporation or, if not within the limits at incorporation, then for the current financial year and the one before:

Turnover £5.6 million or less

Balance sheet total (i.e. total assets) £2.8 million or less

Employees 50 (average) or less.⁴⁰²

The definition of Medium-sized companies is,

³⁹⁸ Ibid. 329.

³⁹⁹ Wild C and Weinstein S, supra n 363, 18.

⁴⁰⁰ Ibid. 19.

⁴⁰¹ Ibid. 19.

⁴⁰² Ibid. And the Companies Act 2006, s 382.

A medium-sized company is one which has been within the limits of *two* of the following thresholds since incorporation or, if not within the limits at incorporation, then for the current financial year and the one before:

Turnover £22.8 million or less

Balance sheet total (i.e. total assets) £11.4 million or less

Employees 250 (average) or less.⁴⁰³

Nature of A Corporation

“A corporation is a succession or collection of persons having at law an existence, rights and duties, separate and distinct from those of the persons who are from time to time its members.”⁴⁰⁴ In the sense of the classification of corporations, mainly is between corporations sole and aggregate.⁴⁰⁵ And corporation aggregate includes chartered companies, statutory companies, registered companies (general), and registered companies (community interest companies).⁴⁰⁶ The classification is based on the ways of the creation, which is different from Chinese corporations in Chinese Company Law.

The Community Interest Companies form, has been called a new form for registered companies, also regulated by company law. However, there are several requirements that the Community Interest Companies have to meet, and

⁴⁰³ Ibid. The Companies Act 2006, s 465.

⁴⁰⁴ Ibid. 2. Two distinguishing features of a corporation are: 1) it is a person at law; 2) It has perpetual succession. As all practitioners and academics in the field know about these features, therefore there is no detailed description on this matter.

⁴⁰⁵ Ibid. 5.

⁴⁰⁶ Ibid.

it is understandable that the form is specifically serving community purposes in an adapted corporate form.

In sections 755-760 of the Companies Act 2006, these articles are intended for the smaller businesses (SMEs).⁴⁰⁷ They are governed under the Companies Acts and relevant case law, except the articles of association of the company.⁴⁰⁸

In UK Company Law, the private companies are the companies which are not public companies.⁴⁰⁹ Under Company Law, the private companies are mainly designed for the smaller businesses, which may be founded by two or more persons. However, the Section 7 of the Companies Act 2006 permits single-member private limited companies to form.⁴¹⁰ In addition, as the regulations have been amended some relevant parts to associate to this form.⁴¹¹ The sole proprietor form has been considered an important development in company legislation. Some scholars believe that sole proprietor (one-man company) could be beyond the size of small businesses.⁴¹² Additionally, in terms of the liability that such companies take on, compared with the limited liability companies, the sole proprietor companies do not seem to have much advantages in practice. It does not commonly exist in all countries.⁴¹³

⁴⁰⁷ Ibid. 14.

⁴⁰⁸ Ibid.

⁴⁰⁹ Ibid.

⁴¹⁰ Ibid.

⁴¹¹ Ibid.

⁴¹² The fact that one is a sole proprietor (Einzelunternehmer/EU) does not mean that one is entirely dependent upon himself alone. He can hire employees, conclude work contracts and avail himself of the support and cooperation of the family. For this specific kind of business, no particular regulations exist. Registration takes place only in special cases (when it is beyond the size of a small firm) and only if the firm is registered does the sole proprietorship have a company name.

⁴¹³ In Austria, the regulations do not particularly exist. Munkert M J and Seidl C, "Chapter 3 Austria", in Munkert M J, Stubner S and Wulf T, *Founding a Company: Handbook of Legal Forms in Europe* (Springer-Verlag Berlin Heidelberg 2010), 21. In France, the law regulates in different legal forms, *Société par Actions Simplifiée* (SAS): the SAS is a simplified form of the SA with fewer legal requirements in terms of organisational structure, making it fairly flexible

Registration for Single-member Companies

Although the registration documents are the same as multi-member companies, there are articles and amendments to company legislation. At present, a public single-member company requires to have the two directors and a secretary for the company, in total there can be one member but has to be three officers at least.⁴¹⁴ In a private single-member company, the sole member can be the director and a company secretary is not the legal requirement.⁴¹⁵ However, one member and one officer are needed in such a company, therefore, if a secretary is appointed then there would be have one member and two officers.⁴¹⁶ Also, under the regulations, there are no re-registration requirements.⁴¹⁷ There are no requirements of resolutions and no filing requirements at Companies House. But the statements of the changes of members must be entered to the Register of Members when the cases happen.

(limited liability company). There must be at least two shareholders (with a maximum of 50), and the starting capital requirement is lower than that of the SA. *Société à Responsabilité Limitée (SARL)*: the SARL is a private limited liability company with at least two shareholders. It is the most widely used limited legal form in France, mainly because of the reduced complexity of this entity compared with the SA. The SARL, like the SAS, is suitable for SMEs. An additional benefit, from a small enterprise's perspective, is that there are no requirements regarding starting capital. The EURL is a subcategory of the SARL with only one shareholder. And one form that is similar to a general partnership of UK law is *Société en Nom Collectif (SNC)*. It is not to create and the partners take on personal responsibility, and it is not very common as the stated above two forms, the responsibility will be shared equally if the company goes bankrupt.

⁴¹⁴ Wild C and Weinstein S, supra n 363, 16.

⁴¹⁵ Ibid. ss 154, 270, 271 and 274.

⁴¹⁶ Ibid.

⁴¹⁷ Ibid.

The Conflicts

Historically, UK Company Laws were designed mainly for public companies. When private companies were formed, these laws could not directly resolve all issues they faced, and private owners and investors had concerns of the lack of protection in law. Some commentators have raised the need of having special articles for these companies, especially the single-member companies. The regulations that single-member companies shall follow carry the conflicts with the company's structure of a single-member company.

Apart from the articles' conflicts that might need to be reviewed, I would suggest reviewing the forms of companies in legislation. For instance, is that necessary to have separate forms for sole proprietorship and single-member companies? Or rather to categorise them into one form and with detailed regulations to individual circumstances.

As commented, there is little benefit in filing abbreviated accounts for medium-sized companies in many circumstances. The Companies Act 2006 allows the filing of an abbreviated balance sheet only for small companies, whereas sections 465-467 allow medium-sized companies to modify only its profit and loss account, but other full accounts and reports must be filed.⁴¹⁸ In the case of small businesses, they seem to have more reasonable reports than medium-sized companies. The exemptions are debatable, so the reviews to the details of what information that medium-sized companies should disclose are

⁴¹⁸ Ibid. 18.

necessary. Currently all factors of the details of turnover profits and markets are required, although sometimes it is a disadvantage in the market.⁴¹⁹

Recent Changes in Company Law

There are essential relevant legal forms in UK law as follows:

- The unincorporated legal forms, which the feature is that they do not have separate legal personality: The Sole Trader, The Unincorporated Association, The Partnership, The Limited Partnership, Trust;⁴²⁰
- Incorporated legal forms include: Limited Company [Company Limited by Shares – either a Private Limited Company (LTD) or a Public Limited Company (PLC), Company Limited by Guarantee], The Limited Liability Partnership (LLP);⁴²¹
- Community Interest Company (CIC);⁴²²
- Charitable Incorporated Organisation (CIO).⁴²³

One key principle of UK company law is the shareholder primacy, as also maintained in the Companies Act 2006.⁴²⁴ One of the main changes in company legislation is the Companies Act 2006 section 172 requires a director to “act in the way he considers, in good faith, would be most likely to promote the success

⁴¹⁹ Ibid.

⁴²⁰ Department for Business Innovation and Skills, “A Guide to Legal Forms for Business” (November 2011), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31676/11-1399-guide-legal-forms-for-business.pdf (accessed 12 March 2014).

⁴²¹ Ibid.

⁴²² Ibid.

⁴²³ Ibid. The new legal form available from 2012.

⁴²⁴ Collison D, Cross S, Ferguson J, Power D and Stevenson L, “Financialization and company law: A study of the UK Company Law Review”, (2014) 25, *Critical Perspectives on Accounting*, 5-16, 5.

of the company for the benefit of its members as a whole”.⁴²⁵ Thus, there is a range of other interests, such as employees, the community and the environment which directors may take into account.⁴²⁶ Previously in the Companies Act 1985 section 309 only simply stated the interests of the employees and members. Therefore, it is obvious that the duties of directors have expanded and are not limited to the company itself anymore.

The importance of private companies (SMEs)⁴²⁷ is obvious for economic growth. Therefore, the Company Law has the section 246-249 for private companies regarding their accounting exemptions. UK Company Law considers the market has the disadvantages for small and medium-sized companies, thus the requirements of reports are less strict. The Companies Act 2006 has introduced some changes into the area, for instance, additional rules on the directors’ remuneration report, which is part of the annual reporting process.⁴²⁸ There are Financial Services and Markets Act 2000 and the rules made by the Financial Services Authority (it existed between 2001 and 2013) regulate public limited companies, but there are changes towards to the SMEs.⁴²⁹

In terms of small companies, they are subject to the “small companies regime” now, regulated in section 381. The Companies Act 2006 ss 382-384 defined whether the company is “small”, as stated above.⁴³⁰ And s 382(7), s 383(1) and s 383(3) regulate whether parent companies may qualify as small companies in

⁴²⁵ Ibid. 6.

⁴²⁶ Ibid.

⁴²⁷ Wild C and Weinstein S, supra n 363.

⁴²⁸ Ibid. 528.

⁴²⁹ Ibid.

⁴³⁰ Ibid. 529.

groups.⁴³¹ In terms of medium-sized companies, ss 465-467 of the Companies Act 2006 regulate the different reporting regime.⁴³²

4.4.2 Chinese Company Law

Chinese Economic Environment

After financial crisis, investments have become one of the most important and challenging projects for all economies in globally, including advanced economic countries. There has been an increase of privately financed companies, while most businesses are trying to attract foreign investments. China, as one of the most attractive economies for private equity deals, the funds and attention are from international and domestic levels.⁴³³ The growth of private equity market in Mainland China has been considerable, and China has become the second largest private equity market just after the US (1st).⁴³⁴ In the near future, there will be a significant number of global private equity investors investing their funds in the China market⁴³⁵, as informed investors recognized that the China's market still has potential to grow.

⁴³¹ Ibid.

⁴³² Ibid.

⁴³³ Aizenman J and Kendall J, "The Internationalization of Venture Capital and Private Equity", (2008) *NBER Working Papers 14344*, available at SSRN: <http://www.ssrn.com/abstract=1275544> (accessed 12 March 2014).

⁴³⁴ EMPEA, *H1 2009*, (2009), *Emerging Markets Activity*, <http://www.altassets.com/private-equity-knowledge-bank/surveys/article/nz171133.html> in Shen W, "When Private Equity Meets China: Clashes between Locked-In Transactional Models and the Chinese Regulatory Regime", (2010) 28, *Company and Securities Law Journal*, available at SSRN: <http://ssrn.com/abstract=1826343> (accessed 24 February 2014).

⁴³⁵ Emerging Markets Private Equity Association and Coller Capital, "Private Equity Investors Favour China, Brazil – Survey", (2009), <http://www.reuters.com/article/privateequity/idUSSIN43057820090406> (accessed 12 March 2014).

Legal Environment

Chinese market and legal system is not the same as Western market and legal systems.⁴³⁶ However, the modern laws in China were mainly transplanted from the Western countries.⁴³⁷ The concepts of modern companies and relevant legal frameworks are mainly based on the Western influences and knowledge. The recent two amendments of Company Law have shown encouragement towards entrepreneurs in China. Until the Company Law 2005 was abolished⁴³⁸, the minimum initial capital had been RMB 30,000⁴³⁹ (equivalent to £2,936.46⁴⁴⁰); its intention was to protect creditors.⁴⁴¹ However, as proved by other major advanced economies, which did not employ a minimum initial capital, this was not a requirement, especially for SMEs. The newly amended Company Act 2013 came into enforcement, and the minimum capital requirement in Article 26 and Article 81 in Company Act 2005 was removed. Please refer to the Chapter 3 for details. These changes exhibited that the central government moved fast to meet the level of advanced legal frameworks. The new amendment will benefit

⁴³⁶ Chan G Y M, "Why Does China not Abolish the Minimum Capital Requirement for Limited Liability Companies?" (2009), available at SSRN: <http://ssrn.com/abstract=1442791> (accessed 3 March 2014).

⁴³⁷ Chan A C K and Young A, "Chinese Corporate Governance Regime from a Historical-Cultural Perspective: Rethinking Confucian System of Governance" (3 October 2012), available at SSRN: <http://ssrn.com/abstract=2156300> (accessed 23 February 2014).

⁴³⁸ Chan, G Y M, *supra* n 436.

⁴³⁹ *PRC Company Law*, Art 26; *PRC Company Law*, Art 81. "The MRC is RMB30,000 (US\$4,411.76) in the case of a limited liability company"; RMB 5 million (US\$735,294) in the case of a company limited by shares. A foreign-invested company limited by shares (FICLS) is an option for private equity to acquire "shares". The regulations governing the FICLS do not expressly provide the mechanism for the creation of preferred shares. Besides, approval for such FICLS is managed on a centralized basis by the Ministry of Commerce in Beijing, which sets very high capital thresholds, including a minimum capital requirement of RMB 30 million (US\$4.4 million), a very high target to meet for many start-up companies in China. Shen W, *supra* n 434.

⁴⁴⁰ According to the currency rate on February 25, 2014, calculated on <http://www.xe.com/currencyconverter/> (accessed 25 February 2014).

⁴⁴¹ Apart from the protection for creditors, Chan also comment another possibility as "preventing frivolous incorporation", Chan G Y M, *supra* n 436, 1.

SMEs and micro enterprises, but it will also bring challenges for SMEs as they will have to develop and improve the implement of articles of associations, which is part of government policy – maximise the freedom of action and give away the monitoring power.

The Company Law

General Introduction

The development of Chinese Company Acts, not taking into account the 1950s regulations regarding to the private enterprises, the first law that relates to the companies in the new PRC would be 1978 Foreign Equity Joint Ventures Law. Thereafter, the Private Enterprises Regulations 1988, the Regulation and Advisory for Limited Liability Company and Incorporated Company in 1990s, and the Company Act 1993 were the milestone for the history of modern Chinese Company Law.⁴⁴² The recent amendments of Company Act 2005 and 2013 are the further reform led by the central government in the newest Chinese context. Please refer to the discussion in Chapter 3 for further details of Company Acts.

There were regulations for private enterprises (in Chinese, named as *Siying Qiye*)⁴⁴³, the regulations included 1992 and 2011. The 1992 regulation was a

⁴⁴² Jiang P, Zhao X D and Chen S, 中国《公司法》的修改及价值 (Chinese “Company Law” Reform and Value), conference discussion in 2005, Article.chinalawinfo.com, accessed at http://article.chinalawinfo.com/Article_Detail.asp?ArticleId=31305, (accessed 26 February 2014).

⁴⁴³ The definition of *Siying Qiye* (private enterprises) in China was made by National Bureau of Statistics of the People’s Republic of China (中华人民共和国国家统计局 *Zhonghua renmin*

temporary regulation, which became redundant since the 2011 regulation came into force on 30th September 2011. Apart from replacing the 1992 temporary regulation, this 2011 regulation also had adjustments for the enacting in 1998 The Regulation for Dividing Business Types Registration, extended the enterprises that investing by Hong Kong, Macau, Taiwan investors⁴⁴⁴, also other foreign investors⁴⁴⁵.

The Reform of Company Law and its Values

This revision of Company Act in 2005 and 2013 are obviously very important.

The Act 2005 could be the most important legal reforming movement in Chinese

gongheguo guojia tongji ju), and State Administration of Industry and Commerce (国家工商行政管理局 *Guojia gongshang xingzheng guanli ju*), which is in the Article 9 of the regulation 《关于划分企业登记注册类型的规定》 (The regulation of business types registration division) (published as [2011] No.86.) The regulation has 22 Articles in total and was enacted from 30th September 2011. This regulation was the replacement of previous 《关于经济类型划分的暂行规定》 (The temporary regulation of economic types division) in 1992. The Article 9 defines private enterprises are invested and established by natural person or controlled by natural person, in order to hire labors and profit economic organisation. According to the Company Law, Partnership Enterprises Law and Temporary Regulation for Private Enterprises, the private enterprises include registered private limited liability company (私营有限责任公司), private joint stock limited company (私营股份有限公司), private partnership company (私营合伙企业), and private individual proprietorship company (私营独资企业). Furthermore, in the Article 9, the definitions of the four types have been given as: 1. The private individual proprietorship company is, according to the regulation, the company that invested and manage by one natural person, hiring labors, and the investor take unlimited liability to the company debts; 2. The private partnership company is the company that invested by more than two natural persons, based on the agreement, invest together, manage together, share profits and losses together, hiring labors, and take unlimited liability to company debts; 3. The private limited liability company is the limited liability company that invested by more than two natural persons or controlled by a sole natural person; 4. The private joint stock limited company is the corporate enterprise that invested more than five natural persons, or a sole natural person controls the share. 《关于划分企业登记注册类型的规定》 (The regulation of business types registration division)

<http://nhs.saic.gov.cn:9080/wcms2/actsociety/normal/html/1216.htm>, (accessed 12 March 2014), http://www.stats.gov.cn/statsinfo/auto2073/201310/t20131031_450535.html (accessed 12 March 2014).

⁴⁴⁴ In the Article 2, added in **Other** into the enterprises that invested by Hong Kong, Macau, Taiwan investors; and increase 200 to 290 stated above enterprises.

⁴⁴⁵ In the Article 2, added in **Other** into the foreign invested enterprises; and increase 300 to 390 stated above enterprises.

legal history before the 2013 Act came into enforcement. Act 2005 had 219 Articles, less than former amount of 230 Articles. Its purpose was to deal with the securities market's growth and encourage better corporate governance for listed companies, and to adapt the private sector's speedy development in China (the expansion of private limited liability companies).⁴⁴⁶

Before Act 2005 came into enforcement, Company Act 1993 was a milestone for China's legal system. Despite the limitations in the Company Act 1993 (for instance, it very much focused on the reform of SOEs, which led to many issues in practice), it was a very important Act for China when Professor Jiang Ping commented about the changes of China's Company Acts. He also mentioned that, Qiu Xiaohua, the Deputy Director of the National Bureau of Statistics of the People's Republic of China (NBS) then, praised the importance of Act 1993 for its contribution to the economy as the number of private enterprises increased,⁴⁴⁷ and the Act contributed at least 1-2 per cent to the 9% GDP rate of China.⁴⁴⁸ The Company Act 2005 became a stepping stone for later development of the Chinese economy. Due to political debate, it took some years to revise. The 2013 Act is a new milestone for enterprises in China. It removes the official requirement of registration capital and leaves the right to shareholders by articles of association.

⁴⁴⁶ Bath V, "The Company Law and Foreign Investment Enterprises in the People's Republic of China: Parallel Systems of Chinese-Foreign Regulation", (2007) 30 (3), *University of New South Wales Law Journal*, 774-785. Sydney Law School Research Paper No. 09/42, available at SSRN: <http://ssrn.com/abstract=1410383> (accessed 23 February 2014).

⁴⁴⁷ *Ibid.*

⁴⁴⁸ Jiang P, Zhao X D and Chen S, *supra* n 442.

According to Law Professor Jiang Ping, the real beginning of Chinese Company Law was 1983, there were no enterprises with shares (no incorporated companies), and the main purpose of having a Company Law was to regulate SOEs. Concluded by Jiang Ping and other three scholars, it was the parallel thinking based on the prediction that there might be incorporated companies setting up in future, and most importantly it was for many SOEs.⁴⁴⁹ Therefore, we can summarise the progress of reforming Company Law was from “regulating State-Owned Enterprises, to reforming State-Owned Enterprises, further to encouraging investment” over the past 30 plus years.

China is considered to have a “civil law” system. Regulations were written to govern and had to be obeyed. This ideology began to change when the market economy crept into China; its laws had to be friendly for businesses. The new Company Law is aiming to encourage investment and entrepreneurs. China is creating a friendly environment for innovation. The Company Law reflects the idea of “establishing enterprises then regulating them”⁴⁵⁰, rather than “having regulations but not encourage to establishing enterprises”. The latter apparently will not benefit the nation at all, and against the serving purpose of having law. Professor Zhao Xudong commented that the Company Act 2005 was a complete change and almost a new law-making process. The Company Act 2005 changed almost all of the previous provisions so that only 24 of the previous articles remained unchanged. The content of the Company Act 2005 was extended and covered a wide range of needs. The innovation and

⁴⁴⁹ Ibid.

⁴⁵⁰ Ibid. Jiang Ping expressed the idea of having new Company Law is valuable for economic growth, it is necessary to encourage enterprises establishment, then to regulate them.

underlying policy/ideology seemed to go beyond most predictions and expectations from many scholars in the field. In general, the Company Act 2005 appeared to be a very successful achievement. The Company Act 2005 referenced many of the most advanced Company Laws and regulations in other model countries, with the considerations from Chinese law makers they were adapted extensively to the need of China's developing direction and ideology. Building on the progress of the 2005 Act, the Act 2013 further made significant changes on SMEs and micro enterprises. Please refer to the Chapter 3 for further details.

From the comments of law scholars, the Company Law 2005 shows the new trend of adapting the market with unique Chinese socialist characteristics and future developing direction. Also, the Act details the types of companies that will fit to China's economy; the options for companies, which is one of the improvements; the rules and regulations that companies have showing the integrity and the balance of taking responsibilities and rights, the safety and efficiency, the relationships among all parties, and the interference of government and companies' self-control *et cetera*.

The essential points of new Company Law 2005 were:

- Encouraging investment and entrepreneurships, which is one of the most important points;
- Deregulation (*Fangsong Guanzhi*), respect the will of the related parties;
- More focus on the balance of rights that related parties have within the companies.

The Company Law 2005 included the concepts of capital and the type of sole trader⁴⁵¹ (*yiren gongsi*) company. In terms of capital it requires, since 1993, the capital required in the Company Law was one of the strictest worldwide. It showed by the high requirements on capital that invested to establishing companies, and the strict criminal responsibility in Criminal Law. But Act 2013 removed the registration capital requirement, which gives flexibility to the enterprises themselves, and give shareholders rights to monitor each other.

The previous Company Law mainly focused on the capital and had strict capital requirements for it was an underlying policy to protect creditors' rights if companies went bankrupt. However, the disadvantage was that it limited investors' investments and discouraged the establishment of companies. With time, scholars in China realized that other countries, such as US and Hong Kong (which until relatively recent, China was directly guided and influenced by the UK) have much lower capital requirements, but use other rules to protect creditors. Therefore, the removal of the capital registration requirement in the 2013 revision changed the previous rules, even though its inclusion in Company Law was debated heavily. The revision brought significant opportunities to entrepreneurs, and led to growth in China's national economy.⁴⁵²

In more advanced countries, such as the US and the UK, there are requirements in laws that businesses need to meet, although the start-up requirements for companies are lower than in China. For instance, the taxation in the UK and the requirements in taxation are strict for companies in operation.

⁴⁵¹ As in UK Company Law, it might be more accurate to translate to sole proprietorship.

⁴⁵² Jiang P, Zhao X D and Chen S, *supra* n 442.

Minimum Registered Capital Requirement in Revised Company Law and Debates

China made minimum registered capital in Company Law based on the consideration of some advanced countries' company laws, such as some European countries have.⁴⁵³ In this sense, it is not difficult to recognise the Company Law in China has referenced and transplanted from other advanced countries, and adapted and improved based on the circumstances in China. That resulted in China having similar regulations but different from other contexts. Taking an example of the typical private equity, the model of acquiring preferred shares is difficult to apply in China, as the factors such as the concepts of shares, authorised capital and issued capital do not apply to limited liability companies under Chinese corporate law.⁴⁵⁴

In Articles 26 and 81, the law ruled “not less than 20% or the minimum registered capital must be contributed upfront but the remainder can be made within two years from the date of establishment or five years in the case of an investment company either in the form of a limited liability company or a company limited by shares”.⁴⁵⁵

⁴⁵³ For instance, Italy still requires a minimum initial capital investment of 10,000. *Civil Code* (Italy), Art 2463. Shen W, supra n 434.

⁴⁵⁴ Ibid.

⁴⁵⁵ *PRC Company Law*, Acts 26 and 81. Under the *PRC Company Law 1993*, capital contributions had to be made upfront.

Lau⁴⁵⁶ queried the reason for the capital requirement for a LLC in China was 2,000 times of a private limited company in the UK.⁴⁵⁷ However, the answer was not immediately clear. Lau proposed that the figure of the minimum capital investment for registering a limited liability company is a “half-way house.”⁴⁵⁸ According to Professor Lau, the high requirement of minimum capital in the old Company Law did not suit with the rapid growing China’s market so it should be reduced, the revised Company Law therefore fell into line with the trends in many other countries.

This minimum capital requirement was interpreted as an integral part of the so-called “legal capital system”.⁴⁵⁹ The “legal capital system” is from the origin of the continental European model of Company Law, especially German Company Law. Chinese legal system has always been categorized as a “Civil Law” system. Therefore, given its “communitarian capitalist” classification China’s copying of elements of the German model is not surprising. The idea of a minimum capital requirement had been adopted in order to protect creditors, in case of the potential abuse of limited liability by shareholders. Chan raised the question of the adoption and evolution of the legal capital system in China as it was an area of academic debater, but he did not find any work showing the explanation of how the figure RMB 30,000 for limited liability companies was confirmed.⁴⁶⁰

⁴⁵⁶ Lau K L A, “Why are the initial paid-up capitals of private limited companies in China 2,000 times bigger than those in the United Kingdom?” (2007) 28 (8) *Company Lawyer*, 248-252.

⁴⁵⁷ Chan, G Y M supra n 436.

⁴⁵⁸ Ibid.

⁴⁵⁹ Ibid.

⁴⁶⁰ Ibid. 3-4.

The figure of RMB 30,000 was not particularly designed to be 2000 times greater the UK requirement nor mysterious after all. As Professor Wang Yong, Jiang Ping, Zhao Xudong, and Chen Su (the latter three professors were the primary members in the team of revising Company Law) commented, the Chinese Company Law 1993 was not the most advanced company law in the world, but had the strictest registered capital requirements in the world.⁴⁶¹ The RMB 30,000 requirement was not decided based on specific reasons. Informally, it might be the discussion of the legislature; officially, it might as some professors estimated, that it might be decided based on the risk and loss that entrepreneurs can take; or it might because of the income rates in most of regions, how much people will be willing to invest after the living expenses; or it might because the legislature suggested different amounts, and RMB 30,000 was a compromise, not too high nor too low.⁴⁶² To sum up, the minimum registered capital figure did not have specific reason to be RMB 30,000 in China's Company Act 2005.

The removal of registered capital requirements in the Company Act 2013 reflects the new changes of China's context. The further action of attracting funds and entrepreneurs. Company Act 2013 could be deemed as same level as advanced countries' legal framework in general despite the challenges in practice. China's legal reform has entered to a complete new and higher level.

⁴⁶¹ Jiang P, Zhao X D and Chen S, *supra* n 442.

⁴⁶² *Ibid.*

The Issues

There were issues in the Company Law 2005. For instance, the one-person limited liability company⁴⁶³ type was recognised, but with higher requirements compared with LLC when it was established. For instance, unlimited liability would apply when the acting director could not prove the capital of the company was separated from his own. He must provide auditing reports. In the LLC, it only requires more than two natural persons to set up, which is easier to establish and safer in liability. Therefore, there could be a possibility that the sole trader intends to register a second natural person to avoid unlimited liability. In China, it is highly possible that the second person could be family relatives, close friends *et cetera*, it is the *guanxi* mind-set. In this case, the second person might only show on the registration but not actually involved with the management or business activities. From the liability perspective, there may be more entrepreneurs preferring the limited liability company than sole trader company.

In addition, there was a unique new change in the Company Law 2005, the term “manager” was introduced into the Company Law as the legal representative of a company. In accordance with Article 13, the legal representative of a company shall, according to the provisions of its articles of association, be assumed by the chairman of the board of directors, acting director or manager, and shall be registered according to law. If the legal representative of the company is

⁴⁶³ According to the Article 58 in the Company Law 2005, the definition is "one-person limited liability company" as mentioned in this Law refers to a limited liability company with only one natural person shareholder or a juridical person shareholder".

changed, the company shall go through the formalities for modifying the registration.⁴⁶⁴ As commented by law scholars in China, this was mainly based on the consideration of SOEs. Some scholars disagreed with the Article. The underlying consideration is that the manager and the chairman of the board of directors are at the same administration level in SOEs, which is the unique rule in SOEs in China.⁴⁶⁵ This scenario is only a political and administrative consideration in China's case.⁴⁶⁶ From a normal and general legal perspective, a manager is bound with a contract and is an employee of the company.

The Company Law is currently more adapted to the concept of contract, which is strongly influenced by western concept but also synthesises with the current state of the Chinese economy and general situation. The conflict between regulation enforcement and the contractual element has always been discussed, even in the late 1980s to early 1990s in the US. Professor Jiang Ping raised it at the conference around 2002. The concept has been considered and shown in the new Company Law revision.⁴⁶⁷

⁴⁶⁴ Article 13 of the Company Law. 法律教育网 (Falv jiaoyu wang) China Law Education, 新版《中华人民共和国公司法》(2005年修订, 2006年1月1日施行) 英汉对照法律英语 [New Company Law of the People's Republic of China (2005 revised, 1st Jan 2006 enacted) English-Chinese compare version], accessed at <http://www.chinalawedu.com/new/23223a23228a2010/20101222shangf112139.shtml> (accessed 26 February 2014).

⁴⁶⁵ Jiang P, Zhao X D and Chen S, supra n 442.

⁴⁶⁶ Chinese State-Owned Enterprises normally have the manager pointed by government, therefore, it is not as Western managers who hired by the company based on the contract terms.

⁴⁶⁷ Jiang P, Zhao X D and Chen S, supra n 442.

Piercing Corporate Veil, Disregard of Corporate Personality

The Company Law showed the balance that among all parties that relates to companies. The Company Law 1993 did not have the regulation regards the balance of the parties' rights, therefore, there were issues in practice. The new revisions had corrected and many rules had shown the concept of maintaining balance among parties. For instance, the General Provisions of the Company Law, Article 20 "piercing corporate veil".

Article 20 stated that the shareholders of a company shall comply with the laws, administrative regulations and articles of association, and shall exercise the shareholder's rights according to law. None of them may injure any of the interests of the company or of other shareholders by abusing the shareholder's rights, or injure the interests of any creditor of the company by abusing the independent status of juridical person or the shareholder's limited liabilities. Where any of the shareholders of a company causes any loss to the company or to other shareholders by abusing the shareholder's rights, it shall be subject to compensation. Where any of the shareholders of a company evades the payment of its debts by abusing the independent status of juridical person or the shareholder's limited liabilities, and thus seriously damages the interests of any creditor, it shall bear joint liabilities for the debts of the company.⁴⁶⁸ Although

⁴⁶⁸ Article 20, original description is "The shareholders of a company shall comply with the laws, administrative regulations and articles of association, and shall exercise the shareholder's rights according to law. None of them may injure any of the interests of the company or of other shareholders by abusing the shareholder's rights, or injure the interests of any creditor of the company by abusing the independent status of juridical person or the shareholder's limited liabilities. Where any of the shareholders of a company causes any loss to the company or to other shareholders by abusing the shareholder's rights, it shall be subject to compensation. Where any of the shareholders of a company evades the payment of its debts by abusing the independent status of juridical person or the shareholder's limited

many advanced countries have this “piercing corporate veil” existing in the legal systems, in both of the “civil law” and “common law” systems, most of the rules are in the case law or exceptional regulations. China’s Company Law has clearly written the concept into the general provision of the statutory law.

4.4.3 Law in Emerging Market

The Company Law shows several points that proved itself as a very advanced law in Chinese law scholars’ opinions. The deep reason is the legislature in China is moving from transplanting western laws to adapting laws into Chinese unique characteristics, and this trend will make more advanced laws for China in future. However, there are many issues exist in the progress. And transplanting process is not based on the economic, cultural and conceptual contexts, therefore, the similar regulations in Company legislation show different interpretations.

Based on the general understanding, there are some differences but not limited to these occurred in Chinese Company Law and UK Company Law:

liabilities, and thus seriously damages the interests of any creditor, it shall bear joint liabilities for the debts of the company.” 法律教育网 (Falv jiaoyu wang) China Law Education, 新版《中华人民共和国公司法》（2005年修订, 2006年1月1日施行）英汉对照法律英语 [New Company Law of the People’s Republic of China (2005 revised, 1st Jan 2006 enacted) English-Chinese compare version], available online at <http://www.chinalawedu.com/new/23223a23228a2010/20101222shangf112139.shtml> (accessed 26 February 2014).
Company Act 2005 revision and 2013 revision, China Law, <http://search.chinalaw.gov.cn/law/detailSearchOne?LawID=333154&Query=%E5%85%AC%E5%8F%B8%E6%B3%95&IsExact=&PageIndex=3>, and <http://search.chinalaw.gov.cn/law/detailSearchOne?LawID=394865&Query=%E5%85%AC%E5%8F%B8%E6%B3%95&IsExact=&PageIndex=3> (accessed 7 September 2017).

- The forms and categories are different: UK Company Law shows more specific and detailed categories compared with Chinese Company Law on the types of registered companies. It might be because these two countries are in completely different government governance systems and the legal systems.
- The succession of a corporation is mentioned under UK Company Law, but not under Chinese Company Law.
- The transferable nature (convention regulation) among company forms does not exist in China, the corporations may apply to the State Administration for Industry and Commerce of the PRC for certain changes, but not in the case of changing legal forms.
- The classification of companies: Under UK Company Law, the private company is a company which is not a public company, this is not the same as under Chinese Company Law. Under UK Company Law, “there are no restrictions on the right to transfer the shares of the company or on the number of its members unless the articles contain such restrictions”.⁴⁶⁹
- Single-member companies: Under the UK Company Law, the documents which are sent to Companies House are the same as those required for multi-member companies.⁴⁷⁰ However, the single-member company cannot have the sole director acts as the company secretary as well, based on the s 282 and s 283. In other words, there must be at least two officers in a single-member company.⁴⁷¹

⁴⁶⁹ Wild C and Weinstein S, *supra* n 363.

⁴⁷⁰ *Ibid.*

⁴⁷¹ *Ibid.*

- Company secretary: As stated above, that the sole director cannot be the company secretary at the same time. However, in Chinese Company Law there is no such position in companies in the regulations.
- The accounting exemptions for private companies (SMEs), but the regulations show the opposite in China, which is that the smaller sizes companies are, the stricter on the assets assessments and auditing requirements.
- The regulations of small and medium-sized company group: Under s 247A of UK Company Law, a company which has subsidiaries, i.e. it is a holding or parent company, although it satisfies the definition of a small or medium company, cannot be treated as one unless the group as a whole is small or medium within the definitions given below. Thus, if the parent company qualifies as a small company but the group is medium-sized, the parent would only be entitled to the exemptions available to a medium-sized company when preparing individual accounts. This article is not created in Chinese Company Law.

4.5 Conclusion

It has been found that there are differences between UK Company Law and China Company Law in regard to the legal forms and regulations. Although the Chinese legislature has transplanted Western terms and regulations in general, the ideology and understanding towards Company Law and businesses are omitted in China. The revised Chinese Company Law has made impact and support to entrepreneurs. However, the issues do exist and will appear because

of the lack of understanding and ideology. There are limitations in this thesis that cannot cover all differences in Company Law in the two jurisdictions, but there have been many scholars work on the matters. This chapter aims to examine the mechanisms of corporate governance, suggest to considering legal vehicle before establishing a business is crucial for entrepreneurs. Meanwhile, in terms of the research subject, family businesses, they shall review carefully before choosing legal vehicle, along with the consideration of proper mechanisms in the businesses. The business will perform well under such suggestion – the careful consideration of having a combination of proper legal vehicle and mechanisms of corporate governance from a very early stage, such as planning to establish a business.

Chapter 5 Family Business and Analysis

5.1 Introduction

The majority of businesses in worldwide are family businesses.⁴⁷² Family businesses have been seen as the first successful and most important type of firms, particularly important for short industrial history countries.⁴⁷³ As early as a paper that published in 1983, Richard Beckhard and W. Gibb Dyer, Jr., concluded that nearly 96 per cent (14.4 million out of 15 millions) of businesses in the US are family-controlled.⁴⁷⁴ Family businesses account for two thirds of all businesses around the world.⁴⁷⁵ 85.4% of private enterprises are family owned in China.⁴⁷⁶ 25% of the total UK GDP is generated by UK family firms.⁴⁷⁷ Europe has 44.8% of the top 500 family businesses.⁴⁷⁸ Two decades later, the percentage is still high in globe. From the perspective of employment, family-owned businesses provide most of the jobs in the market.⁴⁷⁹ Furthermore, in term of the contribution they make for economy of the country, 40 per cent of

⁴⁷² Shanker and Astrachan, *supra*, n 259; Gersick K E, Davis J A, Hampton M M and Lansberg I, *Generation to Generation: Life Cycles of the Family Business* (Harvard Business School Press 1997). Segaro E, "Internationalization of family SMEs: the impact of ownership, governance, and top management team", (2012) 16, *Journal of Management and Governance*, 147-169.

⁴⁷³ Morck R K and Steier L, *supra* n 50, 1-64.

⁴⁷⁴ Beckhard R and Dyer W G Jr., "Managing Continuity in the Family-Owned Business", (1984) 12 (1) *Organizational Dynamics*, Summer, 5-12.

⁴⁷⁵ "Family Enterprise Statistics from around the World", *Family Firm Institute – Global Data Points*, <http://www.ffi.org/page/globaldatapoints>, (accessed 14 August 2017)

⁴⁷⁶ *Ibid.*

⁴⁷⁷ *Ibid.*

⁴⁷⁸ "Top 500 family businesses firms amount to the third-largest economy in the world", *EY News releases*, <http://www.ey.com/gl/en/newsroom/news-releases/news-ey-top-500-family-businesses-firms-amount-to-the-third-largest-economy-in-the-world> (accessed 14 August 2017)

⁴⁷⁹ Beckhard R and Dyer W G Jr., *supra* n 476.

the gross national product was made by family-owned businesses.⁴⁸⁰ Family-owned businesses are one kind of businesses that survives longest in the history, and continually contribute to all economies in the world.

The research that specifically focuses on the family businesses has been over three decades. It is widely recognised to be important subject to be researched on. There have been many studies conducted on family businesses, especially in management study. However, there are areas in family business study that have not been concentrated on, for instance, some scholars brought out the fact the “family variable” has not been examined in organisational research.⁴⁸¹ According to some commentators, “not considering the family as a variable in organisational research can lead to incomplete and misleading findings.”⁴⁸² Family businesses are distinguishable and important to be further examined from different studies. It is also necessary to be studied at a comprehensive level.

Some family businesses have hundreds of years of history, nevertheless, the challenges for family businesses are various globally. Contexts of different countries are so different that this seems to be a reason for the variety of forms of family businesses. However, with the development of research from varying perspectives and a deeper understanding of family business, many scholars have found and confirmed that all different family business have a certain

⁴⁸⁰ Ibid.

⁴⁸¹ Voordeckers W, Van Gils A and Van den Heuvel J, “Board composition in small and medium-sized family firms” (2007) 45 (1) *Journal of Small Business Management*, 137-156. Dyer G W and Dyer J W, “Putting the family into family business research” (2009) 22 (3) *Family Business Review*, 216-219, in Segaro E, supra n 472, 147-169.

⁴⁸² Segaro E, supra n 472.

developing pattern, so named after the development of human beings - Life cycle.⁴⁸³ The theory is very crucial for obtaining a better understanding of family businesses, and transitions through the various stages have strong impacts on businesses and their governance. Therefore, the research of life cycle theory cannot be neglected in this thesis.

5.2 Definition of Family Business

Defining family businesses has been a challenge and difficult to define from a comprehensive level. The reason for scholars' attempts to define family business is to distinguish this type of business from other types. Family businesses have many factors that makes them different from non-family businesses, for instance, their families are different from other businesses' families.⁴⁸⁴ Distinguishing factors help to provide guidance to family businesses. Knowing the differences, families of family businesses could understand the features that make them different then manage the challenges arising in the businesses and in family affairs.⁴⁸⁵ A family also needs to recognise the interests of the company and work as one in order to support the success of the company.⁴⁸⁶ Unity is a very crucial factor in overcoming difficulties. There are various conflicts in family businesses, which exist between family members or

⁴⁸³ Wong S L, "The Chinese Family Firm: A Model." (1985) 36 (1), *The British Journal of Sociology*, 58-72, Gersick K E, Davis J A, Hampton M M and Lansberg I, supra n 472.

Neubauer F and Lank A G, "Stages of Evolution of Family Enterprises", *The Family Business: Its Governance for Sustainability* (MacMillan Business Press 1998).

⁴⁸⁴ Institute for Family Business, "Family business challenges: understanding family business", available at <http://www.ifb.org.uk/media/35658/understandingfamilybusinessd4.pdf> (accessed 30 July 2014).

⁴⁸⁵ Ibid.

⁴⁸⁶ Ward J, *Perpetuating the Family Business: 50 Lessons Learned From Long Lasting, Successful Families in Business* (PALGRAVE MACMILLAN 2004), 74.

between businesses and families.⁴⁸⁷ For instance, the workplace role conflict, which is not exactly systematically examined in family business research, but it is commonly recognised as happening among family members.⁴⁸⁸ Although there is lack of evidence and empirical work to prove these conflicts⁴⁸⁹, they affect family and business in family firms and become a great challenge.⁴⁹⁰ In addition, the conflicts are more obvious and vital compared with other forms of enterprises. These conflicts that arise between family and business can damage business performance and the family relationships,⁴⁹¹ as well as give rise to long-term tensions in the business and family. Therefore, it requires a lot of effort to understand and overcome from business side and family side together to operate a successful family business. All in all, to distinguish family businesses from other business types will help family businesses to face existing and forthcoming challenges.

Most definitions of family businesses include the “family” factor in definitions. Alternatively, some conclude a family business is simply a family with a business operation. According to Carr and Sequeira family businesses have the following characteristics, “...suggests that the family business plays a great role in the career choices of individual family members, and in particular the children of family members associated with the business. In fact, the attitudes and

⁴⁸⁷ Beehr T A, Drexler J A, Jr. and Faulkner S, “Working in small family businesses: empirical comparisons to non-family businesses”, (1997) 18, *Journal of Organizational Behavior*, 297-312.

⁴⁸⁸ Ibid.

⁴⁸⁹ Ibid.

⁴⁹⁰ Other conflicts include time-based conflict, strain-based conflict and behavior-based conflict, which are named as interrole conflict; women in the workplace or dual-career couples are named in work-family conflict.

⁴⁹¹ Kellermanns F W and Eddleston K A, “A family perspective on when conflict benefits family firm performance”, (2007) 60 *Journal of Business Research*, 1048-1057.

subjective norms related to this career choice may be reflective of this influence. Thus, the attitudinal and behavioural mechanisms within the family business can shape or influence subsequent entrepreneurial intent".⁴⁹² Beehr, Drexler Jr and Faulkner identified the following as relevant characteristics: "some people in such firms [family firms] are related to others through both work and non-work roles. These often include, for example, roles as employer and employee as well as mother or father and son or daughter".⁴⁹³ Churchill and Hatten defined family businesses as follows: "family businesses are basically owner-managed enterprises with the family involved within the business".⁴⁹⁴ In the research of Brenes *et al.*, a family business is defined as a company which is mostly owned and managed by a single root family.⁴⁹⁵ Chua *et al.* define a family business as "family" plays an important role and supports business in its ownership, stated as "... a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families".⁴⁹⁶

⁴⁹² Ajzen I, Heibroner R L, Fishbein M and Thurow L C, *Understanding Attitudes and Predicting Social Behavior*, (Prentice-Hall PTR, 1980) in Carr J C and Sequeira J M, "Prior family business exposure as intergenerational influence and entrepreneurial intent: A Theory of Planned Behavior approach", (2007) 60 *Journal of Business Research*, 1090-1098.

⁴⁹³ Beehr T A, Drexler J A, Jr. and Faulkner S, *supra* n 487.

⁴⁹⁴ Churchill N C and Hatten K J, "Non-Market-Based Transfers of Wealth and Power: A Research Framework for Family Businesses", (1987) *American Journal of Small Business*, 51-64.

⁴⁹⁵ Brenes E R, Madrigal K and Requena B, "Corporate governance and family business performance", (2011) 64 *Journal of Business Research*, 280-285.

⁴⁹⁶ Chua J H, Chrisman J J, and Sharma P, "Defining the family business by behavior", (1999) 23 (4), *Entrepreneurship Theory and Practice*, 19-39.

Some of definitions include the level of majority ownership and family control within the firm⁴⁹⁷, or the likelihood of family succession⁴⁹⁸, which existed since the early years of the literature. The researchers such as Berry⁴⁹⁹, Lansberg, Perrow and Rogolsky⁵⁰⁰, Burch⁵⁰¹, Barnes and Hershon⁵⁰² and Ward⁵⁰³ defined family businesses by ownership, ownership and management involvement of an owning family, and generational transfer.⁵⁰⁴ One of the commonly recognised is “family businesses are a business in which owners intend to pass ownership to one or more other family members and a business in which the owner and at least one other family member work.⁵⁰⁵ The advantage of these definitions is that it is easier to distinguish family businesses by defining them by family involvements since other business types sometimes do have different levels of family involvements. The disadvantage is that the definitions might put some small family businesses out of the circle. However, the definition of family businesses keeps developing, there are recent research is focusing more on the family business culture.⁵⁰⁶

⁴⁹⁷ Gallo M A and Sveen J, “Internationalizing the family business: facilitating and restraining factors”, (1991) 4 (2) *Family Business Review*, 181-190 in Carr J C and Sequeira J M, supra n 492.

⁴⁹⁸ Churchill N C and Hatten K J, supra n 494.

⁴⁹⁹ Berry B, “The development of organization structure in the family firm” (1975) III (1) *Journal of General Management*, 42-60, in Astrachan J H, Klein S B and Smyrnios K X, “The F-PEC scale of family influence: A proposal for solving the family business definition problem”, (2002) XV (1), *Family Business Review*, 45-58.

⁵⁰⁰ Lansberg, Perrow, and Rogolsky (1988) in Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

⁵⁰¹ Burch (1972) in Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

⁵⁰² Barnes and Hershon (1976) in Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

⁵⁰³ Ward and Sorenson (1987) in Beehr T A, Drexler J A, Jr. and Faulkner S, supra n 487.

⁵⁰⁴ Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

⁵⁰⁵ Ward, supra n 503, Ward and Aronoff (1990) in Beehr T A, Drexler J A, Jr. and Faulkner S, supra n 487.

⁵⁰⁶ Litz (1995), Dreux IV and Brown (1999) in Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

It seems that in the literature, the trend of defining family businesses has become more specific with time. A research conducted by Astrachan, Klein and Smyrnios, developed the F-PEC scale, they commented that the relevant issue is not whether a business is a family business or non-family business, but that it is the family involvement and influence on the firm that matters. The F-PEC scale is an alternative way of assessing family influence on a continuous scale.⁵⁰⁷ The scale covers three features, which are power, experience and culture. The researchers chose three dimensions, power, experience and culture, as the subscales for F-PEC.⁵⁰⁸ From the power dimension of the scale, Astrachan, Klein and Smyrnios confirmed that the ownership can influence a business. In family business, it is the family that can influence the business.⁵⁰⁹ However, ownership is only one aspect that affects family businesses. Other features, such as governance and management involvement, as well as legal, political and economic factors in different countries are all influencing the businesses.⁵¹⁰ It appears that more alternative definitions are the trend in the research for defining family businesses.

The above definitions are only a portion of varying discussions, there is still no universal definition of a family business. However, consider there is lack of mentioning the understanding, skills, family values and such factors that are valued most in family business ownership and operation from generations to

⁵⁰⁷ Astrachan J H, Klein S B and Smyrnios K X, supra n 499.

⁵⁰⁸ Ibid.

⁵⁰⁹ Ibid.

⁵¹⁰ Ibid.

generation⁵¹¹, it might be possible for businesses to meet criteria of family businesses and to be recognised as family businesses.

The criteria of the definition shall consider what forms a family business takes rather than give a sentence or a paragraph. The possible consideration of criteria may include:

- “family” as an important factor running through businesses; the leading roles of managing businesses are family members (founder’s family and relatives);
- the ownership and supports are in the control of one root of family (surname, registration of households *et cetera*);
- the behaviour of recruiting family members and relatives to work for businesses;
- share same family values and norms, in certain cultural awareness;
- have the intention of running through generations;⁵¹²

5.3 Corporate Ownership

Ownership is an issue that is viewed as an independent mechanism from other governance mechanisms.⁵¹³ It is an issue that relates to the life cycle theory, which shows the importance of the theory that will be discussed later in this chapter. Ownership and control is important to every corporation, including

⁵¹¹ Carr J C and Sequeira J M, *supra* n 492.

⁵¹² Which is also raised by Ward, *supra* n 503.

⁵¹³ Brunninge O, Nordqvist M and Wiklund J, “Corporate Governance and Strategic Change in SMEs: The Effects of Ownership, Board Composition and Top Management Teams” (2007) 29 (3) *Small Business Economics*, 295-308.

family firms. There are debates about family business definitions because of the ownership issue and there are studies towards life cycle models for understanding ownership. The research shows that succession planning is to serve the purpose of keeping ownership within a family for family firms, as named as close corporations.⁵¹⁴

Ownership and management are clearly separated in publicly held and large corporations, whereas most closely held small and medium-sized enterprises may not.⁵¹⁵ Most of closely held small and medium-sized enterprises are family firms. The estimation for family firms is from 42 to 95 per cent in the US.⁵¹⁶ The same members or the members from a single root of family commonly constitute their ownership.⁵¹⁷ Their ownership, governance and top management team have been examined in family business studies.⁵¹⁸ The ownership of family businesses develops the definition of family firms. One of the definitions is defined by ownership, which is also the feature that is recognised to distinguish family firms from others.⁵¹⁹

⁵¹⁴ Wells H, supra n 45.

⁵¹⁵ Cowling M, "Productivity and Corporate Governance in Smaller Firms" (2003) 20 (4) *Small Business Economics*, 335-344. Schulze W S, Lubatkin M H, Dino R N and Buchholtz A K, "Agency Relationships in Family Firms: Theory and Evidence" (2001) 12 (2) *Organization Science*, 99-116. Schulze W S, Lubatkin M H and Dino R N, "Toward a theory of agency and altruism in family firms" (2003) 18 (4) *Journal of Business Venturing*, 473-490, in Segaro E, supra, n 472.

⁵¹⁶ Davis P and Stern D, "Adaptation, Survival, and Growth of the Family Business: An Integrated Systems Perspective" (1981) 34 (3) *Human Relations*, 207-224; Kanter R M, "Work and Family in the United States: A Critical Review and Agenda for Research and Policy" (1989) 2 (1) *Family Business Review*, 77-114; and Ward, supra n 503 in Beehr T A, Drexler J A, Jr. and Faulkner S, supra n 487.

⁵¹⁷ Segaro E, supra, n 472. Brunninge *et al.*, supra n 513.

⁵¹⁸ Segaro E, supra, n 472.

⁵¹⁹ *Ibid.*

Small and medium-sized enterprises tend to operate locally and regionally before moving to internationalize their businesses.⁵²⁰ Because different countries have different laws and regulations to comply with, the businesses that expanded in international environment would have to adapt to the local governance system. The ownership, governance and other mechanisms would have changed and localized to meet the governance mechanisms in each jurisdiction, where the cross-listing is often beneficial for improving governance.⁵²¹

The board structures and compositions include a one-level board system in the US and the most western countries.⁵²² The two-level system that a board member of management board or governance board member is not allowed to sit as a member of both boards at the same time, which is the situation in Germany, Switzerland, and the Netherlands.⁵²³ The corporate governance literature shows that concentrated corporate ownership structure exists in both developed and developing countries, but the US is with dispersed ownership structures.⁵²⁴ UK is also in the same ownership structures as the US.⁵²⁵

The US has grown and matured in the 20th century, and formed a mixture of corporate ownership structures, named as a “Market Oriented Blockholder Model (MOBM)”.⁵²⁶ This model primarily is the corporate public ownership

⁵²⁰ Ibid.

⁵²¹ Ibid.

⁵²² Astrachan J H, Klein S B and Smyrniotis K X, supra n 499.

⁵²³ Ibid.

⁵²⁴ Pichhadze A, “The nature of corporate ownership in the USA: the trend towards the market oriented blockholder model”, (2009) 5 (1), *Capital Markets Law Journal*, 63-88, 63.

⁵²⁵ Ibid.

⁵²⁶ Ibid. 64.

blockholder level,⁵²⁷ is a public corporate ownership model that shows the block holdings develop along with the market mechanisms.⁵²⁸ The performance of this model is good overall because it is a mechanism of corporate governance to monitor management function and develop liquid markets.⁵²⁹ This model is important for the reasons that it reflects the realities in the market, and it is a trend that the US ownership affects influences worldwide.⁵³⁰ In other words, US ownership structure has led and influenced other countries in terms of improving corporate governance, to further benefit economies in many parts of the world.⁵³¹

Historically, the trend was that US ownership developed from concentrated to dispersed during the late 19th and early 20th centuries.⁵³² Organisations used the corporate form to raise funds from public investors, which resulted the dispersed ownership in public firms.⁵³³ This trend was also a beginning of the financial capitalism, opening a new era of equity investments.⁵³⁴ During that time, by the 1930s, the wealth and power was very much held by the largest corporations in the US because of the dispersed ownership in these firms.⁵³⁵ However, Berle and Means did not significantly comment on the value of small and medium sized public companies much, but recognised the contribution made by listed firms.⁵³⁶ According to the study, there were 573 corporations

⁵²⁷ Ibid.

⁵²⁸ Ibid. 72.

⁵²⁹ Ibid. 64.

⁵³⁰ Ibid.

⁵³¹ Ibid.

⁵³² Ibid. 65.

⁵³³ Ibid. 66.

⁵³⁴ Ibid.

⁵³⁵ Berle A A and Means G C, supra n 215, in Pichhadze A, supra n 524, 66, 67.

⁵³⁶ Ibid. 67, 68.

listed on the New York stock market on the day of 9th March 1929, there was 81.7 per cent of the total assets was made from the largest 130 firms, whereas the rest of 18.3 per cent was made from 443 remaining firms.⁵³⁷ It appeared that the 443 non-large firms made up a very small portion of the total assets, however, Berle and Means showed that they were 77 per cent of all the listed firms.⁵³⁸ They also discovered that the dispersed ownership level raise with the size of the firms, the larger size it is, the more dispersed ownership it has.⁵³⁹ The other trend came from the separation of the ownership and control, was the rapid growth of institutional investors in 1950s.⁵⁴⁰ That included mutual funds, pension funds and insurance companies.⁵⁴¹ They were a characteristic for the largest public firms in the US.⁵⁴²

After the period of 1960s, the ownership structure in the US was still commonly having dispersed ownership.⁵⁴³ Institutional investors continued to grow during 1970s⁵⁴⁴, and were still increasingly important to global financial system.⁵⁴⁵ 70 per cent of the US and the European syndicated leveraged loan market was owned by institutional investors and hedge funds.⁵⁴⁶ It was still continually transferring share ownership from individual investors to institutional investors

⁵³⁷ Ibid. 68.

⁵³⁸ Ibid.

⁵³⁹ Ibid. Demsetz H and Lehn K, "The structure of corporate ownership: causes and consequences", (1985) 93 (6), *Journal of Political Economy*, 1155-1177, 1155, 1158.

⁵⁴⁰ Ibid.

⁵⁴¹ Ibid.

⁵⁴² Ibid. 69

⁵⁴³ Ibid. 71-72

⁵⁴⁴ Ibid. 74

⁵⁴⁵ BIS, Committee on the Global Financial System, Institutional Investors, Global Savings and Asset Allocation, CGFS Papers No. 27, 31 (Bank for International Settlements, 2007) <http://www.bis.org/publ/cgfs27.htm>. (accessed 10 August 2014); Pichhadze A, supra n 524, 73.

⁵⁴⁶ Ibid. 73

during that period.⁵⁴⁷ Since 1960s, institutional investors had increasingly important roles in term of monitoring their portfolio companies.⁵⁴⁸ It had brought into the re-concentration of shareholdings situation in the capital markets because of the participation of institutional investors, according to Davies.⁵⁴⁹

In the case of the UK, the tax rules and rates caused ownership stakes reduction and institutional investors' growth at the same time according to Cheffins and Bank.⁵⁵⁰ In contrast, Pichhadze expressed that the taxation made the transfer from one block holder that owns the share to smaller block holders, such as the family investors transfer the share ownership to the institutional investors.⁵⁵¹ During the 1970s, institutional investors were continually in strong positions in the US securities market, but the holdings became less and concentrated in few large firms.⁵⁵² Meanwhile, direct individual share ownership declined.⁵⁵³ The situation showed that the process of transformation from individual block holders to financial block holders had begun in earnest, and it has continued till the present.⁵⁵⁴ Institutional investors used shareholder rights and other legal tools to influence managements and boards of their public corporations.⁵⁵⁵ According to Strine, stockholders have influenced corporate boards and corporate strategy over the past 30 years.⁵⁵⁶

⁵⁴⁷ Ibid.

⁵⁴⁸ Ibid.

⁵⁴⁹ Especially the pension funds and insurance companies among all institutional investors. Davies P L, *Gower and Davies' Principles of Modern Company Law* (7th edn, Sweet and Maxwell 2003), 337; Pichhadze A, supra n 524, 74.

⁵⁵⁰ Cheffins B R and Bank S A, supra n 62. In Pichhadze A, supra n 524, 74.

⁵⁵¹ Ibid.

⁵⁵² Ibid.

⁵⁵³ Ibid. 75

⁵⁵⁴ Ibid.

⁵⁵⁵ Ibid. 77

⁵⁵⁶ Strine L Jr., "Risk-Taking by Boards and the Financial Crisis", in Pichhadze A, supra n 524, 79

The ownership of large companies is varied in different countries.⁵⁵⁷ Corporate governance exists in many large family-controlled corporations across the world, either rich or poor economies. Particularly, it is common to find in Israel, Hong Kong and Sweden.⁵⁵⁸ In the case of Britain, there is no controlling shareholder in all the largest corporations. In the US, rich families only control a few leading companies, whereas in Mexico, a few extreme rich families control the large corporate sector. In Argentine and Canada, most of the firms or many listed companies are controlled by wealthy families.

MOBM is a self-regulatory mechanism, which is market-driven, it brought ownership to blockholders (especially institutional investors).⁵⁵⁹ There would be possibilities for family businesses to develop similar self-regulatory corporate governance mechanisms in order to overcome challenges. Just as with the strong position of institutions in their portfolio firms, large-sized family businesses could develop on its own and small and medium-sized family businesses could adapt and create individual model, which could well monitor the management and the ownership. The monitoring improvement could help the governance system and corporate strategy.

⁵⁵⁷ La Porta R, López-de-Silanes F and Shleifer A, "Corporate Ownership around the World", (1999) 54 (2), *Journal of Finance*, 471–517 and Morck and Steier, supra n 50, study reported so.

⁵⁵⁸ Morck and Steier, supra, n 50, 2., La Porta *et al.*, supra n 557.

⁵⁵⁹ Pichhadze A, supra n 524, 79

5.4 Corporate Ownership in China

The liberalization and reform in China's market brought rapid economic growth in China. Since the time that China started opening to foreign investors and privatizing corporate enterprises, China has faced many challenges. Ownership is one of the issues of concern existing from the early reform period.

China started two major changes back then: the reform in state-owned enterprises with minority ownership shares; and stock markets.⁵⁶⁰ The action of issuing minority shares in ownership led to the recent years of legal and regulatory developments, which is seeking to protect minority shareholder rights.⁵⁶¹

In terms of corporate ownership in China⁵⁶², a joint public-private ownership structure is one feature that stands out for modern Chinese enterprises, also it is a typical characteristic for some large state-owned enterprises in early period of reform.⁵⁶³ With time, the process of privatization is making progress, legal, political and economic developments are adapting to privatisation transition. Then the step is adapting successful privatization models and foreign models to nurture the private business sector.⁵⁶⁴

⁵⁶⁰ Goetzmann W and Köll E, supra n 105, 149-184.

⁵⁶¹ Ibid.

⁵⁶² Ibid.

⁵⁶³ Ibid.

⁵⁶⁴ Ibid.

One model considered by William Goetzmann and Elisabeth Köll is a model for capitalism with Chinese characteristics.⁵⁶⁵ China has created one code of corporate governance for its own jurisdiction last century.⁵⁶⁶ Today, in the most important strategic enterprises and sectors, they were reformed into public-private enterprises.⁵⁶⁷ This capitalism model, in the understanding of western culture, is seen as a new model that with Chinese characteristics, is “China’s creation and adaption.”⁵⁶⁸ However, from the historical and cultural perspectives, China has always been under the impact of officials and supervised by officials. In imperial times, local officials were so called *Fu Mu Guan* (parental officials), in control of their local economy, public safety and businesses matters.

Apart from the big scale of enterprises with public-private structure, the predominant form of business – family business – these private firms have existed since imperial period in China before the public-private structure was created.⁵⁶⁹ The family businesses were mostly successful operating mainly in imperial silk, salt, mines and such sectors that were closely controlled and supervised by government. Many would sparingly collaborate with government. This is not difficult to understand, in imperial times, all the wealth and land belong to the emperor, doing business was not easy for small businesses, therefore, the small businesses grew relying on their connections. Connections with other businesses locally, or with local officials, which meant that wealth came with the connection with governments. This situation is not necessarily an

⁵⁶⁵ Ibid.

⁵⁶⁶ Ibid.

⁵⁶⁷ Ibid., they are financed by equity capital, but governed by officials.

⁵⁶⁸ Ibid.

⁵⁶⁹ Ibid.

example of corruption, but so called guanxi, which will be discussed and explained later in this thesis. Guanxi is not corruption but guanxi can be corruption if people cross lines. Such connections were crucial for family businesses, especially the successful ones operated locally and nationally.

Another corporate structure models, which have strong Chinese cultural and social context, newly developed and adopted with Western models – the models with strong influence of kinship networks.⁵⁷⁰ Agreeing with the findings of Faure⁵⁷¹ and Choi⁵⁷², Goetzmann and Köll find that Chinese families have strong influences over the businesses. It is very rare that family businesses have the control of equity and the separation of management. Therefore, corporate governance issues are often least applied to Chinese family businesses.

In contrast with many advanced economic countries, on the aspect of minority shareholder protection issue, China has a weaker system. However, China has been enforcing better corporate transparency and shareholder accountability,⁵⁷³ which is a developing process of corporate governance in the context of China.⁵⁷⁴ One important finding is that Chinese founders and their families did not establish their ownership in the enterprises through majority shareholding.⁵⁷⁵

⁵⁷⁰ Ibid.

⁵⁷¹ Faure D, “The control of equity in Chinese firms within the modern sector from the late Qing to the early Republic” in Brown R A (ed.) supra n 97, 60-79.

⁵⁷² Choi C C, “Competition among brothers: The Kin Tye Lung Company and its associate companies” In Brown R A (ed.) supra n 97, 98-114.

⁵⁷³ Goetzmann W and Köll E, supra n 105.

⁵⁷⁴ Lin N and Chen C J, “Local elites as officials and owners: Shareholding and property rights in Daquizhuang”, 168, in Oi J C and Walder A G (ed.) *Property rights and economic reform in China*. (Stanford University Press 1999), 145-170; Goetzmann W and Köll E, supra n 105, 177. The scholars stated above mentioned that property law has implications under the shareholding system in China today.

⁵⁷⁵ Goetzmann W and Köll E, supra n 105.

5.5 Life Cycle Theory and Corporate Governance Mechanisms

Corporate governance has been recognised as important for all enterprises increasingly, that includes the private sector.⁵⁷⁶ According to Brenes *et al.*, “corporate governance is a guidance and management structure aligning and organizing ownership management and business management. Corporate governance comprises three different elements: the stockholders’ assembly, the board of directors and the top management team.” In the case of family businesses, the stockholders’ assembly, board composition and management team are different compared with other corporations. Therefore, the corporate governance structure will be different in individual cases of family businesses.

Life cycle models have been examined to understand and analyse family business continuity. Essentially this literature helps family businesses to understand the business development process, planning strategies in order, for example, to process the succession progress smoothly. The main challenge for family businesses throughout its cycle of development is the communication among families and businesses. Therefore, a corporate governance structure and mechanisms for controlling and improving such purpose is desired.

Brenes *et al.* conducted research on assessing several mechanisms in 22 family businesses to find out the impact of these mechanisms on family business performance.⁵⁷⁷ They identified that succession and equity control issues are

⁵⁷⁶ *The Company Secretary*, Research, available at <https://www.icsa.org.uk/products-and-services/knowledge-and-guidance/research/the-company-secretary-report> (accessed 03 August 2014).

⁵⁷⁷ Brenes E R, Madrigal K, Requena B, *supra* n 495.

the key problems for family businesses.⁵⁷⁸ As families of these businesses are concerned about whom will be the suitable successor to continue the businesses. Furthermore, the related concern is how members in the families will inherit equity shares to partake in the ownership of the businesses.⁵⁷⁹ The research was conducted based on the fact that these family businesses tried to avoid or solve conflicts and created relevant mechanisms in the firms to ensure decisions and policies are made and implemented within families and businesses.⁵⁸⁰ According to Brenes *et al.*, mechanisms of governance system aim to ensure the implementation of decisions and policies that family and business made, to improve the implementation of the strategy and to control the family and business transparency between all stockholders. The board of directors apparently is a key mechanism on keeping family business balance and continuity.⁵⁸¹

Apart from the recommendation of having the board of directors, which mainly was focused in the research of Brenes *et al.*, there are other mechanisms that can be created by family businesses, the paper suggests that the businesses can make policies and protocols according to their own situations and conditions, be innovative on the matter. However, assessments for these mechanisms are crucial during the process of continuity, the relevant assessing tools need to be created relevantly. If as the impacts of corporate governance mechanisms are so important for family businesses, as the tools for family businesses continuity,

⁵⁷⁸ Brenes E R, Madrigal K, Molina G, "Family business structure and succession: critical topics in Latin American experience", (2006) 59 (3), *Journal of Business Review*, 372-374.

⁵⁷⁹ Brenes E R, Madrigal K, Requena B, *supra* n 495.

⁵⁸⁰ *Ibid.*

⁵⁸¹ *Ibid.*

there need to be criteria for these business mechanisms, in order to assess the direction and success of the businesses. These corporate governance mechanisms may or may not be the same as within other corporations, considering the purpose is to create transparency for stockholders, bridge families and businesses, prevent or solve conflicts, make decisions, strategies and policies for business performance *et cetera*. In addition, the assessments for these mechanisms can be variable to serve the purpose, for instance, have an assessment scheme for board members, regardless whether it is family board or non-family board, both of them need to join the assessment or appraisal annually (or a certain period of time), and based on the criteria such as their commitment and loyalty to the businesses, and their level of business knowledge business knowledge. It is important to measure the efficiency and reliability of the board members.

Board composition is varying in individual cases, also it is different in varying contexts of culture and general environment.⁵⁸² For instance, the US boards have the stockholders that own the largest number of shares on boards for public companies (control purposes), whereas in state-owned companies (mainly public companies) in China, the Communist Party members usually sit on boards (also for controlling purposes). Brenes *et al.* listed the factors such as political, historical, legal and economic factors as external aspects; and also the internal aspect such as business culture are fundamental for the board's structure and the selection procedure.⁵⁸³ In the case of family businesses, there

⁵⁸² Ibid. 280.

⁵⁸³ Ibid. 281.

are factors such as confidence, respect, power, and/or family links.⁵⁸⁴ Although individually for public companies the legal requirements in each country are varying, Boards in general include independent, non-executive members to meet objective independent requirement in many countries.⁵⁸⁵

With globalisation, financial markets and the intention of investing globally have reduced the particularities in board composition locally and culturally. In the US, a convergence of a single board model is the trend and has become popular.⁵⁸⁶ However, the scandals such as Enron and WorldCom have raised the awareness of the board's failure to detect fraud.⁵⁸⁷ As Brenes *et al.* suggested, these failures raised the importance of the balance of power as the purpose of corporate governance serves. Therefore, the importance of complying with corporate governance has clarified again in practice and in theory.

5.6 Life Cycle Theory and Succession in Family Business

5.6.1 Life Cycle Theory in Family Business

Business development has certain pattern, and in the case of family businesses, there are developing stages, which is named by scholars as “life cycle models”. Scholars believe that the growth of business is similar to human being, from birth to death. Business as a legal personality given by Company Law, has separated

⁵⁸⁴ Ibid.

⁵⁸⁵ Ibid.

⁵⁸⁶ Ibid.

⁵⁸⁷ Ibid.

personality, therefore, the birth of a company is starting up the company and register it according to the Company Law. The death of a company is announcement of its ending, complying with Insolvency Law. From birth to death, a business might experience several periods of growth, such as expand, reform, failure.

Life cycle theory is used to analyse the developing stages of family businesses. It is not only a theory itself, it relates to several other important theories, and develops family business field of research. Through the research of life cycle theory, family business field has expanded and linked with other disciplines theories, finally connecting into an interdisciplinary net. For instance, life cycle theory provides the prediction of issues that would exist in next stages for family business founders and their successors, allowing them to understand which stage their businesses have reached, and what are the next steps for their businesses, when should they plan for the succession, when should they prepare for retire *et cetera*.

Furthermore, life cycle theory analyses and shows family business developing stages, it leads to the discussion of succession planning, minority shareholder protection, apart from the ownership issue stated above in this chapter. Firstly, succession planning is caused from the stressing point between generations when the last generation passes ownership and control to the next generation. Secondly, succession is a transfer of power between generations and it is an option for families that do not seek to sell their businesses – “non-market

considerations”.⁵⁸⁸ Therefore, the key in succession planning is who is the right successor. Thus, analysis of life cycle models could help to plan succession in advance and prepare the success of succession planning.

Life cycle models are the key aspect in life cycle theory, it closely relates to ownerships. Life cycle theory is essential for understanding developing stages of businesses, in between of the stages, tensions occur in family businesses. It could be the tension between generations, or between ownership and management. Succession issue as one of the most influential issues for family business is worthy to examine closely.

Chinese Family Firms' Life Cycles

Wong Sui-lun found a classic model that can be applied to many large privately owned publicly listed companies.⁵⁸⁹ In his research, he introduced four stages in family business development, as emergent, centralized, segmented and disintegrative stages. At emergent stage, a business is built as a partnership type, and then grows into a business that owned by a founding family through varying changes in shared ownership, thereafter, it grows into a steady stage, eventually becomes unstable, as the last stage is the cousins confederation stage.⁵⁹⁰ Although the model has been an outstanding research result in life cycle theory, since opening up period in China, economic, legal and regulatory

⁵⁸⁸ Churchill N C and Hatten K J, supra n 494.

⁵⁸⁹ Wong S L, supra n 483. Lawton P, “Modeling the Chinese family firm and minority shareholder protection: The Hong Kong experience 1980-1995” (2007) 49 (5/6), *Managerial Law*, 249-271.

⁵⁹⁰ Wong S L, supra n 483.

reforms started, and under the impact of Chinese modern social and cultural contexts, it is doubtful if the model still applies to most Chinese corporations.

Other Life Cycle Models in Literature

Other scholars have developed other life cycle models, in general, they recognised that family business and its ownership development is very similar to human beings' development cycles. Gersick *et al.* raised the model based on such human beings' cycles, and supported by Neubauer and Lank, "young business family", "entering the business", "working together" and "passing the baton".⁵⁹¹

Compared with Wong's model, this human beings' model is obvious and easy to recognise and understand in terms of the developing process, therefore, the succession process is easy to perceive. Furthermore, there is a perceived weakness Wong's model, since 1978 China started "opening up" policy, the rapid economic, legal and political developments, along with western knowledge and some elements of culture have flooded into China. Family business owners have learnt to apply western management techniques into their Chinese context, these developments might affect the adoption of the model. Overall, in life cycle literature, succession issue is prominent and exists through all stages in all life cycle models.

⁵⁹¹ Neubauer F and Lank A G, *supra* n 483, 27-55. Gersick K E, Davis J A, Hampton M M and Lansberg I, *supra* n 472.

Minority Shareholder Protection in Family Businesses

Secondly, life cycle theory leads to an important issue in corporate governance – minority shareholder protection. The reason is life cycle theory provides analysis of stages and along with the changes between generation and ownership changes. During the changes, the minority shareholder protection becomes an obvious issue for corporations. The life cycle models indicate the likely stress points during which problems and stresses can occur and disputes between family members occur.

Minority Shareholder Protection

Large corporations, especially the public listed ones have easier access to the assets and cash from investors, who generally trust the governing body to increase firm performance. For the reason of complying with legal, disclosure and other transparency regulation requirements in different jurisdictions, shareholder rights are required to be protected. However, in countries that have weak legal protection for minority shareholders, excess cash premium is larger.⁵⁹² Furthermore, as Frésard and Salva found, the insiders are able to take their own benefits out of the expense of minority shareholders in poor governance mechanisms.⁵⁹³ Where the countries have low level of minority shareholder protection, there is a large discount on the value that investors place on cash holding, but not in the countries that minority shareholders are protected

⁵⁹² Frésard L and Salva C, "The value of excess cash and corporate governance: Evidence from US cross-listings", (2010) 98 *Journal of Financial Economics*, 359-384.

⁵⁹³ Ibid.

effectively.⁵⁹⁴ Therefore, the protection of minority shareholders is an important issue for firms in all countries, but a difficult issue to solve.

In term of family business and investors, Morck and Steier highlight the fact that in the countries where stock markets exist but with fewer investor protection legal regulations, majority of companies are family businesses, compared with the countries with no stock markets.⁵⁹⁵ Which means, minority shareholders' rights could be continually in violation if the families of family businesses keep control conservatively, or over protect their control rights in the business. Since they find this kind of close control governance system is beneficial for their private benefits.⁵⁹⁶ As we can see from the US stock market, and its demanding legal disclosure requirement, there are solutions to encourage a better corporate governance operating environment. With developing economy and law in China, from the new code that combined international corporate experiences and Chinese business structure (including limited liability), the requirements of transparency and accountability, have laid the foundations for minority shareholder protection in China.⁵⁹⁷

⁵⁹⁴ Ibid. Pinkowitz L, Stulz R and Williamson R, "Does the contribution of corporate cash holdings and dividends to firm value depend on governance? A cross-country analysis" (2006) 61 (6), *Journal of Finance*, 2725-2751.

⁵⁹⁵ Morck and Steier, supra n 50, 6.

⁵⁹⁶ Ibid.

⁵⁹⁷ Goetzmann W and Köll E, supra n 105.

Minority Shareholder Protection and Corporate Governance

From the research results, investors' value discounts as a result of large agency conflicts and insiders freely access to cash reserves.⁵⁹⁸ If the institutions are weak and/or exterior mechanisms are not effectively monitoring the controlling insiders, the risk is high with cash reserves.⁵⁹⁹ From the experience of cross-listing in the US, which can provide potential solutions or effective methods to such issue – the potential private benefits associated with cash holdings and reduce or even end the discount investors place on their valuation.⁶⁰⁰ The research shows positive result that US cross-listing increases corporate governance standards. The corporate governance mechanisms also could protect minority shareholders' rights, to prevent controlling insiders' unlawful actions in firms.

Shareholder Disputes

Shareholder disputes happen in throughout the world. In fact, the disputes can often be related to the life cycle models of family business. Taking an example of *Re Yenidje Tobacco Co.*,⁶⁰¹ in the early stages of development in a family business, the dispute happened between partners, and that mostly happened among brothers or other family members. Also as the cases of *Re Cuthbert Cooper & Sons Ltd.*, and *Brady v Brady*, all happened between inheritors.⁶⁰² In

⁵⁹⁸ Ibid. Evidence from Dittmar A and Mahrt-Smith J, "Corporate governance and the value of cash" (2007) 83 (3) *Journal of Financial Economics*, 599-634.

⁵⁹⁹ Frésard L and Salva C, supra n 592.

⁶⁰⁰ Ibid.

⁶⁰¹ Lawton, supra n 589, 250.

⁶⁰² These cases show the issue that how the business should be run and divided well between inheritors, furthermore, how to solve the more complicated situations, such as the

the case of *Re Shiu Fook Co Ltd.*⁶⁰³, a shareholder (the concubine of the deceased founder of the company) was in dispute but failed because she had not used other remedies. Many cases like these showed that the shareholder disputes are closely related to the life cycle model of Wong Sui-lun. Furthermore, these disputes need to be solved by constituting the corporate governance mechanisms in Chinese family businesses. The disputes of minority shareholders can be deemed as the result of the connection between life cycles and succession issue.

Succession Disputes

Succession is one aspect of the ownership issue. Succession disputes are very common for Chinese family businesses. Take the example of *Re Yenidje Tobacco Co.*⁶⁰⁴, the last generation controlled the ownership, or not completely hand over the power in the second stage of life cycle. It is very common in succession planning, that the former generation has governing power and control over the firm, or they still get involved in the management of businesses after they retired. The case of *Re H R Harmer Ltd.*⁶⁰⁵ demonstrates the issue as well. The cases show several issues that are extant in succession procedure. Firstly, a good succession planning process is important since it is helpful to pass power and control successfully from the last generation to the next. Secondly, the psychology of the last generation and next generation is important

problem of polygamy exists commonly in Hong Kong. *Re Cuthbert Cooper & Sons Ltd.* [1937] Ch 392, and *Brady v Brady* [1989] AC 755 HL in Lawton, supra n 589, 250.

⁶⁰³ [1989] 2 HKC 342, in Lawton, supra n 589, 250.

⁶⁰⁴ [1916] 2 Ch 426, in Lawton, supra n 589, 250.

⁶⁰⁵ [1959] 1 WLR 62, [1958] 3 All ER 689.

to be understood, in other words, the communication between two generations is important. Thirdly, the family and business, as two constituent parts of family business, play crucial roles in succession. At last, the institutions within family businesses play important roles as well during succession process.

Thus, to examine the minority shareholder protection, as stated above, life cycle models can be helpful. The potential issues and stages that disputes and actions of minority shareholder could happen and arise in different stages; meanwhile, this issue connects to the succession issue. Therefore, the life cycle theory was discussed earlier in this chapter.

Minority Shareholder Protection in China

Violation of minority shareholders' rights could happen during transitioning stages when controlling shareholders and listed companies are in play. Although there are several actions were taken in law by the government, which are the Company Law 1993, Company Law 2005 and Company Law 2013, it is still at the stage of improving and implementing minority shareholder protection. China put the Securities Law, the Ministry of Finance's regulation (improving information disclosure) and others in to force to be a series of supplementary regulations to improve corporate governance matters. These regulations include shareholder voting rights ("one share, one vote"),⁶⁰⁶ fiduciary duties⁶⁰⁷, as well as the requirements of transparency, annual auditing reports, mid-year reports

⁶⁰⁶ Liu G S and Sun P, "State-dominated corporate governance system in transition: the case of China" in Mallin, C.A. (ed.) *Handbook on international corporate governance* (Edward Elgar 2006) 112.

⁶⁰⁷ Ibid.

and unaudited quarterly reports in the first corporate code⁶⁰⁸. The requirements for annual shareholders' general meeting, legal and accountability reforms are all used to improve the protection issue in corporate governance.

The solutions and new regulations to cover and eliminate the weaknesses in corporate governance are needed in China. As one of the main reason that government should make progress in legal reform, it is obvious that the government has been trying to create efficient laws in to enforcement, especially on the aspect of minority shareholders' rights protection. However, the limited experiences of government make the progress difficult.⁶⁰⁹ This will be improved over time, the Company Law 2005 was an example, as more effective laws will be enacted and legislated in future.

Minority Shareholders and Family Businesses

The biggest threat to minority shareholders is the founding families in businesses, according to some research of international corporate ownership. Even some recent press reports also described that minority investors could be harmed by controlling families. The founders or founding families usually are the large shareholders in family businesses, their power and controlling position make them a threat to minority shareholders' wealth.⁶¹⁰ According to the

⁶⁰⁸ Goetzmann W and Köll E, supra n 105.

⁶⁰⁹ Liu and Sun, supra n 607.

⁶¹⁰ La Porta, López de Silanes, and Shleifer, supra n 557, Claessens, Djankov, and Lang, supra n 272; and Faccio M and Lang L P H, "The Ultimate Ownership of Western European Corporations", (2002) 65 (3) *Journal of Financial Economics*, 365-395 discuss in their papers; Villalonga B and Amit R, "How are U.S. Family Firms Controlled?" (2009) 22 (8) *Review of Financial Studies*, 3047-3091.

research of the US, which is the country with the highest separated ownership, the founding families control is very high in a third of the 500 largest corporations and more than half of all public corporations.⁶¹¹ According to Faccio and Lang, “without vigilant oversight, large shareholders such as founding families are prone to exploit minority shareholder wealth”.⁶¹² In addition, DeAngelo and DeAngelo documented, as Anderson and Reeb claimed that “large-concentrated shareholders extract private rents through special dividends”.⁶¹³ There are other scholars holding similar opinions, the findings of Shleifer and Vishny 1986 and 1997 all reported and suggested that it was quite common that founding families did extract private benefits and harm other investors’ interests in large American public corporations. Minority shareholders are in a very vulnerable situation in the case of family controlled businesses.

Founding families exploit private benefits from minority shareholders with many different methods in family businesses. Even in the US, the founding families could access to other shareholders’ wealth by using “their sheer stake through mechanisms such as dual-class stock, pyramidal ownership, and cross-holdings”⁶¹⁴. Excessive compensation schemes and related-party transactions are also used as common methods.⁶¹⁵ For instance, Anderson and Reeb gave

⁶¹¹ Anderson and Reeb, supra n 260 and 261, Villalonga B and Amit R, “How do Family Ownership, Control, and Management Affect Firm Value” (2006) 80 (2) *Journal of Financial Economics*, 385-417.

⁶¹² Faccio M and Lang L P H, supra n 610.

⁶¹³ DeAngelo H and DeAngelo L, “Controlling Stockholders and the disciplinary role of corporate payout policy: A study of the Times Mirror Company” (2000) 56 (2) *Journal of Financial Economics*, 153-207, and Anderson and Reeb, supra n 260 and 261, 1.

⁶¹⁴ As La Porta, López de Silanes, and Shleifer, supra n 557; Claessens, Djankov, and Lang, supra n 272; and Faccio M and Lang L P H, supra n 610, reported, provided by Villalonga and Amit, supra n 610, 3, the ways that founding families obtained the wealth of other shareholders were various, even in the US.

⁶¹⁵ Also, Claessens, Djankov and Lang, supra n 272, noted in Anderson and Reeb, supra n 260 and 261, 1.

an example of, the founding Rigas family, as “Adelphia Communications” largest shareholder, using firm assets to their private benefit without interference from the board or other shareholder groups.⁶¹⁶

Thus, it is important to explore the solutions for such situation. It is hard to find a certain and proper solution to reduce founding families’ influences and control power in family businesses, meanwhile, some studies also mentioned that some traditional mechanisms of corporate governance, which supposed to use to reduce the control of founding families and solve the conflicts between leadership and shareholders, could not work effectively in the case of family businesses.⁶¹⁷ Furthermore, according to some research, many issues such as corporate control, incentive compensation in family businesses, did not work as well as non-family businesses.⁶¹⁸ Therefore, the minority shareholder protection has been a serious issue for family businesses and also has been recognized and widely criticized by researchers.

The issue is difficult to solve because of the power and control of founding families in family businesses. After all, family businesses are built by founding families, the wealth of the businesses comes from their hard work, which could be one of the reasons that they do not consider about the rights of minority shareholders; Psychologically, founding families are in the powerful positions and they consider they own the business rather than see it as a separated legal identity, therefore, they would want to use the business assets for their private

⁶¹⁶ Anderson and Reeb, supra n 260 and 261.

⁶¹⁷ Ibid.

⁶¹⁸ Barclay and Holderness (1989), Shivdasani (1993), and Kole (1997) in Anderson and Reeb, supra n 260 and 261.

benefits. Therefore, a series of exterior and interior mechanisms need to be put into force to help the power balance. The experiences of the US could be beneficial for the solutions.

Family Ownership and Family Control

The situation and the reasons stated above could be some of the causes for the minority shareholder protection issue. There are also other issues that deeply affect the issue itself. The ownership and life cycle theory affect shareholder protection issue, according to the report of Martin De Holan and Sanz, “the mechanisms deployed to abuse the rights of minority stakeholders are multiple and quite well-known, and range from the internal consumption of profits to the transfer of assets at below-market prices (“tunneling”), and include other well-known tricks such as manipulation of transfer prices within conglomerates among many others.”⁶¹⁹ It seems that everything is controlled by the ownership of family businesses.

However, does the ownership in family business specifically cause the violation for minority shareholder protection? Some of the evidence and research show that there is no significant difference between the better and weaker protection environments in terms of this.⁶²⁰ In other words, from the academic research, family ownership and control is not inefficient in protecting minority shareholders’

⁶¹⁹ Martin De Holan P and Sanz L J, “Protected by the family? How closely-held family firms protect minority shareholders” (2006) Instituto de Empresa Business School Working Paper No. WP06-02, available at SSRN: <http://dx.doi.org/10.2139/ssrn.1019268> (accessed 28 September 2016)

⁶²⁰ *Ibid.* 1.

rights,⁶²¹ which means, family ownership and control cannot be the only solution for minority shareholder protection, as the research of Martin De Holan and Sanz commented.⁶²²

There are exceptions in practice, according to the empirical research of Martin De Holan and Sanz, there are some large and multinational family businesses performing well on the issue of minority shareholder protection.⁶²³ They protect their minority shareholders' rights, moreover, they achieve this based on the relationship between their minority shareholders and their families rather than the requirements of law. This soft mechanism potentially has become one of the solutions to work in these businesses. In general cases, the behaviour that families have, which exploit private benefits from minority shareholders, is because families control the firms and they believe that they own all the assets of the firms. If minority shareholders want to get what they should be given, they tend to get close to the core families. In other words, if they are close to families, they can get the benefits through personal connection, where families in firms are willing to give. However, it is not fair to minority shareholder, as they invest in the firms, and they should not be the party that beg to get what they should get. The soft mechanism could be double-edged sword, for the shareholders who could have close relationship with the founding families, their rights could be protected, but in a hypothetical scenario.

⁶²¹ Ibid.

⁶²² Ibid.

⁶²³ Ibid.

The Ownership Mechanisms of Family Businesses

International corporate ownership literature suggests that founding families control the benefits of minority shareholders by using many different mechanisms.⁶²⁴ As stated above ownership mechanisms are crucial for the issue of minority shareholder protection apart from the soft mechanism that work in practice. There are several mechanisms of ownership that have been academically researched. However, dual-class stock is the one that has been widely examined.

As an example of the agency problem, dual-class stock has been looked in the context of “insider holdings”⁶²⁵. However, as scholars reported that the party that gets major benefits is still founding families.⁶²⁶ Gompers, Ishii, and Metrick found that “the single most important determinant of dual-class status is having a person’s name in the firm’s name”⁶²⁷, the examples are like Wrigley, or Ford⁶²⁸, this is a very obvious sign or proxy of family control in family businesses. All of these scholars acknowledged, the separation of ownership and control activated by dual-class stock, caused the problem between large shareholders and

⁶²⁴ Villalonga and Amit, supra n 610.

⁶²⁵ Ibid, 4.

⁶²⁶ DeAngelo H and DeAngelo L, “Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock” (1985) 14 (1) *Journal of Financial Economics*, 33–69. Nenova T, “How to Dominate a Firm with Valuable Control: Dual Class Firms Around the World: Regulation, Security-Voting Structure, and Ownership Patterns” (2001) available at SSRN: <https://ssrn.com/abstract=1017603> (accessed 14 September 2016). As Villalonga and Amit, supra n 610 mentioned, this situation happens in 79 per cent of dual-class firms in the comprehensive international samples of the paper of Nenova and also for 95 per cent of US dual-class firms.

⁶²⁷ Gompers P A, Ishii J L, and Metrick A, “Extreme Governance: An Analysis of Dual-Class Companies in the United States” *AFA 2005 Philadelphia Meetings, Rock Center for Corporate Governance Working Paper No. 39* (2008) available at SSRN:

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=562511 (accessed 29 September 2017)

⁶²⁸ Villalonga and Amit, supra n 610, 4.

minority shareholders, because the large shareholders normally are families and minority or small shareholders are normally not from the controlling families.⁶²⁹

In addition, founding families can improve their control through their position and power in the board of directors and leadership by using dual-class stock. It protects the controlling family shareholders but not the smaller shareholders which is non-family members mostly.⁶³⁰ Meanwhile, they limit the public shareholders' rights by governance supplying, and by using voting agreements and pyramids.⁶³¹ They also pointed out that "privately held investment vehicles" are the way that founders and their families enhance their control of their businesses.⁶³² Thus, the pyramids mechanism cannot be completely discussed in this situation since the publicly held companies are different from unlisted companies. Family businesses especially small and medium-sized family businesses would have difficulties to implement structures as other large-sized family businesses. Most family businesses especially with the name on the brand would prefer to have full control over all the business matters.

The other important ownership is pyramids ownership. The pyramids mechanism in family-owned businesses does not commonly exist in the US,

⁶²⁹ Ibid.

⁶³⁰ Ibid.

⁶³¹ Ibid. 6. "the 21% incidence of dual-class firms that we find in our sample is considerably higher than the average of 17.61% reported by Faccio M and Lang L P H, supra n 610 for founder- or family-controlled firms in Western Europe. It is also higher than the U.K. mean of 18.84%, which is also the median across all 13 countries in their sample." Villalonga and Amit, supra n 610, 33

⁶³² As Villalonga and Amit reported that, "the fraction of founding family members or family representatives on the board is often greater than the percentage of shares owned by the family, and can be even greater than the percentage of votes controlled by the family, thus enhancing family control over and above its voting control." Villalonga and Amit, supra n 611, 39.

even though the indirect ownership is common.⁶³³ The finding of La Porta, López de Silanes, and Shleifer showed the samples that, with one or more control-enhancing mechanisms, there is no sample company with “pyramids and cross-shareholdings” within the 20 largest US firms. However, the family votes are “only 19.65% which is lower than an average ownership stake that required to control 20% of the votes of only 19.65%, the second lowest among the 12 countries they classify as having high shareholder protection”.⁶³⁴ Furthermore, Morck’s research showed similar result of the pyramids mechanisms, which was found in the US based on arguments and historical evidences.⁶³⁵

However, Gadhoun, Lang, and Young proved that pyramids mechanism disappeared in the 1930s from the US⁶³⁶, for the reason of “inter-corporate dividend taxation and other tax reforms that rendered them prohibitively costly”.⁶³⁷ In contrast, Villalonga and Amit found that pyramids mechanisms had really high rate in Europe.⁶³⁸ Controlling shareholders prefer to choose the mechanism of pyramids because it is an important way to separate cash flow ownership and their control rights, this mechanism can be used by controlling

⁶³³ Meanwhile, they pointed out, “the dynamics of pyramiding via unlisted entities may be entirely different from pyramiding via public corporations” Villalonga and Amit, supra n 611, 28.

⁶³⁴ La Porta, López de Silanes, and Shleifer, supra n 559, in Villalonga and Amit, supra n 611, 33

⁶³⁵ Morck, supra n 49.

⁶³⁶ Gadhoun Y, Lang L H P and Young L, “Who Controls US” (2005) 11 (3) *European Financial Management*, 339–363, in Villalonga and Amit, supra n 610, 52 “8.46% of U.S. corporations in 1996 were controlled through pyramids by their controlling shareholders at the 10% control threshold, which not only include families. (A 10% control threshold would eliminate 13 of the 56 firm-years controlled via pyramids in our sample, including all seven years for one firm, so the fraction of our sample that is comparable to Gadhoun *et al.*’s is 1.4% of all firm years or 1.9% of all firms.)

⁶³⁷ Villalonga and Amit, supra, n 610, 34

⁶³⁸ *Ibid.* According to their result, the rate of pyramids mechanisms is “13.81%, plus 3.22% of firms with holdings through multiple chains”.

shareholders to let present shareholders pay the costs but not share all of the benefits of a new venture.⁶³⁹ Wolfenzon recommended this pyramids mechanism to the countries that with poor performance on minority shareholder protections.⁶⁴⁰ There is a trend for Asian family businesses especially the fast growing ones in the global environment to prefer to apply pyramidal structures. The richest families in Hong Kong apply indirect ownership to maintain a form of founding family ownership. This practice has further expanded to China's wealthiest families which find these controlling ownership methods work well at present.

Corporate governance legislations have different impacts because of the political determinants and cultural influences. Also, governance mechanisms of family businesses are taken to action in different countries. Therefore, combined with stated above discussions, depending on the different contexts in countries, the ownership mechanisms should be used individually and wisely. There should be careful and individual consideration for the firms.

5.6.2 Succession

Succession issue has been recognized in academia and practice as one of the most crucial issues in family business study and for family business operation. Succession relates closely with family controlled businesses in terms of business performance and longevity.

⁶³⁹ As La Porta, López de Silanes, and Shleifer, *supra* n 557, 500

⁶⁴⁰ Almeida H, and Wolfenzon D, "A Theory of Pyramidal Ownership and Family Business Groups" (2006) 61 *Journal of Finance*, 2637–2681.

Succession is a Complex Issue in Family Business Study

Succession is a result of combining different aspects. From macroeconomic perspective, it is a product of social culture in a society; from microeconomic perspective, it is a product of mixing a family culture or tradition and an enterprise culture. Therefore, I think it is important to examine succession issue under the general social cultural environment, but also put it into every individual family business case, which contains a family and a business, to consider and apply succession planning based on individual culture.

Succession and Corporate Governance

Morck and Steier have indicated in their research that family businesses are commonly the ones that are more successful and more important enterprises compared with others, especially in the countries that grow rapidly.⁶⁴¹ In the context of China, Faure, Choi and Morck and Steier proved that Chinese businesses are strongly influenced by their families. It is very rare to have separation between management and the control of equity, which means it is rare to apply corporate governance in the context of family businesses. Therefore, the disputes of succession and its solutions appear as a very urgent issue in such contexts.

However, succession issue does not only have difficulties to apply because of the lack application of corporate governance, but also the impacts of internal and external influences, which are the family members in a family business and

⁶⁴¹ Morck R K and Steier L, supra n 50, 8.

the social contexts that a family business operates in. In other words, the family members who are in ownership for the moment (the “incumbents” in the research of Sharma, Chrisman, Pablo and Chua⁶⁴²), the successors themselves, other family members, and non-family members are all parts of the factors that internally effect succession process; Meanwhile, the family business operates in a social context, the country, the nation, the market, the policy and other economic, political and legal environments are the external influences for succession process.⁶⁴³

Succession in Family Businesses and Non-Family Businesses

Are family businesses different from non-family businesses? With the debates of family business definition, family businesses are different from non-family businesses has been discussed among scholars. Many researchers hold the opinion of there is no obvious difference between them; some agree that the differences might be on specific characteristics, such as firm growth⁶⁴⁴. However, Ibrahim *et al.* indicate that succession is seen as a fundamental distinguishing factor for family businesses and non-family businesses.⁶⁴⁵ Succession intention

⁶⁴² Sharma P, Chrisman J J and Chua J H, “Predictors of satisfaction with the succession process in family firms” (2003) 18 *Journal of Business Venturing*, 667-687, 668.

⁶⁴³ Ibid. Sharma P, Chrisman J J, Pablo A L and Chua J H, “Determinants of initial satisfaction with the succession process in family firms: A conceptual model” (2001) 25 (3) *Entrepreneurship Theory and Practice*, 17-36. They developed a model on succession satisfaction in family firms, and proposed there are five factors closely relates to the succession satisfaction, it is depending on the incumbents, the successors, the agreement among family members’ support, acceptance of their roles, and planning for succession. And they also pointed that different research has shown that many important factors are disagreed between incumbents and successors. In summary, that the main conflicts for succession process are in the internal environment of a family business that author mentioned above.

⁶⁴⁴ Daily C M and Thomson S S, “Ownership structure, strategic posture, and firm growth: An empirical examination” (1994) 7 (3) *Family Business Review*, 237-249.

⁶⁴⁵ Ibrahim N A, Angelidis J P and Parsa F, “Strategic Management of Family Businesses: Current Findings and Directions for Future Research”, (2008) 25 (1) *International Journal of Management*, 95-110.

is also seen as one of the factors that distinguish family business and non-family business by Chrisman *et al.*⁶⁴⁶ Others include but are not limited to the ownership⁶⁴⁷, management⁶⁴⁸, perceptions of environmental threats⁶⁴⁹ and corporate governance⁶⁵⁰. Moreover, their research found that small family businesses consider succession issue more serious and more important, but not many of them have prepared for succession planning.⁶⁵¹

It might be worthy to consider, many small businesses are actually focusing on the business performance and profit margins, it is likely taking a long time for family founders and successors to realize the importance of having succession planning in early stage. From psychological perspective, it is not comfortable for incumbents to consider the absence of themselves. However, the importance of such process takes time to prepare, yet it is a lot of efforts for a family business. Therefore, it would be an educational matter for all family businesses, especially small ones. Also, considering succession as an interpersonal skill for entrepreneurs would be a possible solution for the awareness of having succession planning on board.

⁶⁴⁶ James J. Chrisman, Jess H. Chua, and Lloyd P. Steier, "The influence of national culture and family involvement on entrepreneurial perceptions and performance at the state level" (2002) 26 *Entrepreneurship: Theory and Practice*, 113-130. Nabil A. Ibrahim, John P. Angelidis, and Faramarz Parsa, *supra* n 646.

⁶⁴⁷ *Ibid.*

⁶⁴⁸ *Ibid.*

⁶⁴⁹ James J. Chrisman, Jess H. Chua, and Lloyd P. Steier, "An introduction to theories of family business". (2003) 18 (4) *Journal of Business Venturing*, 441-448.

⁶⁵⁰ Trond Randøy, Sanjay Goel, "Ownership structure, founder leadership, and performance in Norwegian SMEs: implications for financing entrepreneurial opportunities", (2003) 18 *Journal of Business Venturing*, 619-637.

⁶⁵¹ Nabil A. Ibrahim, John P. Angelidis, and Faramarz Parsa, *supra* n 646.

In order to maintain or gain the satisfaction of succession process, and with the consideration of the benefits that corporate governance mechanisms provide to a business, the trend of having certain mechanisms for ensuring succession planning succeed is implanting. With the family involvement in a family business, it is different from other corporation forms in terms of the governance structures. Neubauer and Lank raised the importance of having a governance structure for a family in family business⁶⁵², family councils and committees are similar to the business corporate governance structure. From personal point of view, it is not easy to apply the governance structure within a family business, and it would be difficult to operate as strict as business structure in other corporations. Therefore, their applicability is possibly in doubt, though they are often suggested by family business advisors in the UK and used by their clients.

For family businesses, successors should be strong and get ready to take over the business, meanwhile, the strong family involvements are needed, according to Neubauer and Lank.⁶⁵³ The reason could be, the nature of businesses comes from the owning families. As some researchers reported their studies, some factors of families would be helpful for businesses, such as the commitment among family members⁶⁵⁴.

Furthermore, the effective ways in practice so far would be family institutions; they may prevent the conflicts of management in family businesses.⁶⁵⁵ In detail,

⁶⁵² Neubauer F and Lank A G, supra n 483.

⁶⁵³ Ibid.

⁶⁵⁴ This factor has been identified as the fundamental factor, other characteristics can be built base on this factor, reported by N. Stinnett and J. De Frain, *Secrets of Strong Families*, (Berkeley Books 1985).

⁶⁵⁵ Many family businesses disappeared because of the conflict among family members, as the example of Fairfax family, which is one oldest and wealthiest business in Australia. It had 147 years history but was destroyed within one year; the reason was the conflict among family members, Neubauer F and Lank A G, supra n 483, 78-80.

family institutions include: family meeting⁶⁵⁶, family assembly⁶⁵⁷, the family council⁶⁵⁸ and others⁶⁵⁹. In addition, for family businesses, the family statements should be paid more attention, which is crucial to avoid many disputes. It would be helpful for all family members to obey the rule. Neubauer and Lank provided the successful business case of Machine Tools S.A. (MTSA), to show how a multi-generational family business succeeds through succession process.⁶⁶⁰ Although the case is rare, it can be an educational case study for other family businesses. The key of success is to have a right attempt and having the best interests of the family and the business as the goal.

⁶⁵⁶ Family meeting is the most common institution type in family businesses. It was mostly built by controlling owners, as Neubauer and Lank supra n 483 introduced, in the controlling owner or entrepreneurial stage. The family meeting normally is not very formal, it builds the culture of family and their value system, and also it only includes founder and his family members to discuss affairs informally. However, even though it is not a very formal institution, family meeting put all agendas that family and business need on the table, it provides a chance that make everyone discuss the ownership or other issues of business, also it is a path that make potential successors learn business management and join the business. This family meeting could last for three or four generations according to Neubauer F and Lank A G, supra n 483, 81.

⁶⁵⁷ With the development of family businesses, when there are more branches appeared, the family meeting change to “family assemblies” or “family forums”, Neubauer F and Lank A G, supra n 483, 81. This institution is very important for family businesses when they enter into the stage of cousins’ confederation. Neubauer F and Lank A G, supra n 483, 81. It used to avoid the negative forces, which could be from “larger shareholder group”, “multiple branches” and “active and non-active shareholders”, Neubauer F and Lank A G, supra n 483, 81. However, this type of institutions is not very common yet, it may more common in the US, but based on the report of Neubauer F and Lank A G, supra n 483, 81, it is becoming common in Europe, Australia, Latin America and other countries. Actually, the purpose of this institution is getting family members together and discuss issues they have. The business develops bigger, the separation of family members is not rare and surprising, thus, it is necessary to have a chance to get them all together. That is why normally the rule of family assembly will be held once or twice a year Neubauer F and Lank A G, supra n 483, 81.

⁶⁵⁸ Family council can be called in different names, such as “family supervisory board”, “inner council” and “family executive committee”, Neubauer F and Lank A G, supra n 483, 83.

⁶⁵⁹ There are various other family institutions, such as family shareholders committee, family nominating committee, family educational committee, family recreational committee, family offices that provide services, employment committee, family’s charitable trust or family foundation, and even the constitution committee Neubauer F and Lank A G, supra n 483, 85, actually there are many institutions created by families, it is not necessary to have specific institutions by rules, families can create as long as they need. Just as “the constitution committee” is the one that created by Bettys and Taylors, which is a British company with the third generation. Neubauer F and Lank A G, supra n 483, 85.

⁶⁶⁰ Neubauer F and Lank A G, supra n 483, 137-142.

Chapter 6 Social Cultural Mechanism – Analysis of Guanxi

6.1 Introduction

There has been intense attention paid to the cultural phenomenon of guanxi from academic research and practitioners in recent decades. Especially in the past decade due to the impact of the open Chinese economy, more attractive investment opportunities, economy politics and law reform in China. Regarding the interests from academia, it has been examined by many scholars in the fields of economics, sociology and history studies, due to its value as demonstrated in organisations, which is expressly stated by Yang and Wang in the institutional and economic contexts.⁶⁶¹

The chapter aims to discuss guanxi, as a soft mechanism in business operation in China; one important challenge in the society that family businesses face; a factor that relates to the performance of family businesses, needs to be overcome by setting up appropriate mechanisms within family businesses, especially small and medium-sized family businesses. Having guanxi as a soft mechanism in society along with the legal framework is not an excuse for not fostering good corporate governance norms. Although guanxi is a crucial aspect that influences the performance of firms, it does not significantly increase the internal operations of businesses. Therefore, to improve business performance internally and externally, it would be more beneficial for firms to use corporate

⁶⁶¹ Yang Z L and Wang C L, "Guanxi as a governance mechanism in business market: Its characteristics, relevant theories, and future research directions", (2011) 40, *Industrial Marketing Management*, 492-495.

governance mechanisms systematically to maintain their performance in the long term.

Due to the research on guanxi not being conceptualised in studies, and with the lack of evidence and sources in practice, the analysis is conducted based on personal experiences and literature research, the debates in this chapter are intended to lead to further studies in the future.

6.2 Current Guanxi Research

There are many debates concerning guanxi, due to its recognition as a crucial element in the Chinese context, as well as in stated in Western context and everywhere else.⁶⁶² The debates are involved with its definition, its structure (or so named “guanxi model”).⁶⁶³ In the context of the origin of guanxi, it is directly interpreted from pronunciation in Chinese Mandarin, which is spelled as “guan xi” in Chinese pinyin, and is written as “guanxi” in English. In terms of its meaning, many scholars have tried to clarify in to English, but personally there is no equal phrase or term in English that could literally reflect its use in the Chinese context. This leads to more debates about its definitions. With the development of understanding this concept, it has been recognised as a particular term and used as guanxi in its English context. Some English terms, such as “network” have been widely used to reflect its meaning. From my perspective, which based

⁶⁶² Park S H and Luo Y D stated that guanxi is “an important cultural and social element in China”. Park S H and Luo Y D, “Guanxi and Organizational Dynamics: Organizational Networking in Chinese Firms”, (2001) 22 *Strategic Management Journal*, 455-477. Yang Z L and Wang C L, supra n 661.

⁶⁶³ Fang T and Luo Y D name it as “guanxi model”. Luo Y D, *Guanxi and Business*, (World Scientific Publishing Co. Pte. Ltd 2000).

on the content of this chapter, the closest term in English would be “connections”⁶⁶⁴. Further discussions of debate will be presented in subsequent sections.

Guanxi has developed from Chinese social and personal life to business, which was demonstrated by firms.⁶⁶⁵ It has been seen to have a great impact on business operations and performance, therefore it is said to be crucial to firms’ survival.⁶⁶⁶ Park and Luo find that guanxi has great impacts based on a survey of 128 firms from their findings that were collected in central China.⁶⁶⁷ They conclude that guanxi has direct connection towards better firm performance (market expansion).⁶⁶⁸ They also indicate that guanxi helps firms to expand their markets, and help to make firms competitive, but does not really work well for improving business operations internally.⁶⁶⁹ The relations and impacts of guanxi will be discussed in subsequent sections.

In academic research, guanxi could be recognised as a concept, but has not been proved to be a theory at present. Scholars examined guanxi based on other theories. For instance, Park and Luo conducted an empirical study based on the framework that developed with organisational and strategy theories.⁶⁷⁰

⁶⁶⁴ Gold T, Guthrie D and Wank D (eds.) *Social Connections in China: Institutions, Culture, and the Changing Nature of Guanxi*. (CUP 2002).

⁶⁶⁵ Park S H and Luo Y D, supra n 662. “Although guanxi is embedded in every aspect of Chinese social life, companies demonstrate different needs and capacity for guanxi cultivation.”

⁶⁶⁶ Ibid. “Chinese firms develop guanxi as a strategic mechanism to overcome competitive and resource disadvantages by cooperating and exchanging favors with competitive forces and government authorities.”

⁶⁶⁷ Ibid.

⁶⁶⁸ Guanxi has impacts on sales growth but only to a certain extent, it has much less impacts to profit growth.

⁶⁶⁹ Park S H and Luo Y D, supra n 662. “Guanxi benefits market expansion and competitive positioning of firms, but do not enhance internal operations.”

⁶⁷⁰ Ibid.

To conduct research on guanxi in this framework, it needs to be done according to the characteristics of guanxi - the setting of “institutional, strategic, and organisational factors”.⁶⁷¹ Research result shows that these three factors are critical in the concept of guanxi.⁶⁷² However, Chinese firms use guanxi to different extents.⁶⁷³ Guanxi has different types within the individual level and organisational level, government relations and company relations; therefore, as mentioned in the research, government relations in guanxi is most likely to relate to the two settings - institutional and strategic factors.⁶⁷⁴

6.2.1 Theories of Guanxi

As a characteristic of Chinese culture, guanxi influences every aspect of people’s lives; now it obviously raises the attention for theorising it and its utilisation with the evidence that it influences business relationships with government and other institutions in China, which certainly includes family businesses. Guanxi firstly and originally use to describe the relationships at an individual level, such as the relationships among friends and family members. With the development of society, people found its use in business operations helps to improve market competition, which expands to the organisational level.

From the perspectives of its meaning, it could be summarised into individual life and business practice. In individual life, guanxi normally is explained as a mix of several aspects: *ganqing* (emotions), *renqing* (favours), *mianzi* (face matters)

⁶⁷¹ Ibid.

⁶⁷² Ibid.

⁶⁷³ Ibid.

⁶⁷⁴ Ibid. The guanxi with government authorities is a strategy of the firm.

as some scholars such as Ying Fan mentioned that is included in the “helper guanxi” aspect⁶⁷⁵, or as Yi Zhang and Zigang Zhang expressed as a reciprocity in a general guanxi context discussed in the paper⁶⁷⁶; In business practice, guanxi appears to be a positive factor for firm’s performance to a certain extent, for instance, as mentioned the market expansion. According to Park and Luo’s research, “... guanxi is more important in establishing external relations and legitimacy and positioning competitively in the market...”,⁶⁷⁷ but does not have much contribution to firm’s net profit.⁶⁷⁸ Furthermore, they concluded that the impacts of guanxi does not apply to internal operations in businesses.⁶⁷⁹ In other words, guanxi only helps on the firm performance (market expansion), but the issues that firms have internally are not solved with guanxi.⁶⁸⁰ To solve these internal operation issues, structures and setting of the firms should be applied. In other words, corporate governance structures could help to improve internal firm performance. However, due to the fact that many firms look at improving marketing profit instead of dealing with internal problems, this solution has been omitted by many firms. Meanwhile, maintaining guanxi is costly for firms, but it is perceived as crucial for firms to do so. Therefore, many firms still spend a certain amount of income to maintain it. The reason is that the business results guanxi brings to the market expansion are more obvious to firms in the short

⁶⁷⁵ Fan Y, “Questioning guanxi: definition, classification and implications”, (2002) 11 *International Business Review*, 543-561, 552.

⁶⁷⁶ Zhang Y and Zhang Z G, “Guanxi and Organizational Dynamics in China: A Link between Individual and Organizational Levels”, (2006) 67 (4) *Journal of Business Ethics*, 375-392. <http://www.jstor.org/stable/25123884> (accessed 21 October 2015).

⁶⁷⁷ Park S H and Luo Y D, supra n 662, 473. “...the high costs to cultivate and maintain guanxi, which to some extent offset the benefits from market expansion, such as through operational inefficiencies.”

⁶⁷⁸ Ibid.

⁶⁷⁹ Ibid. “...the high costs to cultivate and maintain guanxi, which to some extent offset the benefits from market expansion, such as through operational inefficiencies.”

⁶⁸⁰ Ibid.

term.⁶⁸¹ Nevertheless, we still have a limited understanding towards the marketing that guanxi has effects on.⁶⁸²

As stated above guanxi is divided into individual level and organisational level. In the context of social norm and culture level, two theories are related to this organisational level of guanxi, which are institutional theory⁶⁸³ and legitimacy theory⁶⁸⁴. In the context of social networking, social networking theory⁶⁸⁵ and organisational learning theory⁶⁸⁶ are relevant to guanxi. Luo raised transaction cost theory, organisational networks theory, and resource-based strategy theory for understanding guanxi.⁶⁸⁷ Furthermore, guanxi-based governance theory as one body of grand theory has been introduced by Yang and Wang⁶⁸⁸, as these stated above theories help to understand guanxi from different perspectives to various aspects of guanxi. The researchers raised the attention of guanxi-based governance theory is demanding “cross-disciplinary and systematic research efforts” due to the complex nature of guanxi.⁶⁸⁹

⁶⁸¹ Ibid. “...the high costs to cultivate and maintain guanxi, which to some extent offset the benefits from market expansion, such as through operational inefficiencies.”

⁶⁸² Yang Z L and Wang C L, supra n 661, 494.

⁶⁸³ Scott W R, *Institutions and Organizations: Ideas and Interests*, (3rd edn., Sage Publications, Inc. 2008). Xin K K and Pearce J L, “Guanxi: Connections as Substitutes for Formal Institutional Support”, (1996) 39 (6) *Academy of Management Journal*, 1641-1658.

⁶⁸⁴ Yang Z L, Su C T and Fam K S, “Dealing with Institutional Distances in International Marketing Channels: Governance Strategies That Engender Legitimacy and Efficiency”, (May 2012) 76 (3) *Journal of Marketing*, 41-55

⁶⁸⁵ Wank D L, “The Institutional Process of Market Clientelism: Guanxi and Private Business in a South China City”, (1996) 147, *The China Quarterly*, 820-838.

⁶⁸⁶ Ramasamy B, Goh K W and Yeung M C H, “Is Guanxi (relationship) a bridge to knowledge transfer?”, (2006) 59 (1), *Journal of Business Research*, 130-139.

⁶⁸⁷ Luo Y D, supra n 663.

⁶⁸⁸ Yang Z L and Wang C L, supra n 661.

⁶⁸⁹ Ibid. 493. Guanxi as a governance mechanism has caught growing interests in doing business and academic research (Yang Z L and Wang C L, supra n 661, 492) The research of the unique aspects and the effectiveness of guanxi-based governance theory that Yang and Wang concluded is not much examined. Future study of guanxi-based governance is needed, for instance, examination in empirical examination of the interactions among the three elements - qing (emotion or feeling), li (reciprocity) and liyi (utilitarian benefits).

Some scholars raised an interesting argument, which is applying “interpersonal guanxi” to “organisational guanxi”⁶⁹⁰. It is a huge challenge for organisations according to Yang and Wang.⁶⁹¹ They stated that the interaction of “interpersonal trust” and “organisational trust” has been examined on a large-scale, and guanxi appears to contribute differently in different contexts of trust. However, it does not seem to be the right interpretations between “interpersonal guanxi” and “interpersonal trust”, nor “organisational guanxi” and “organisational trust”. Yang and Wang did not have further detailed explanation as to whether the terms are equivalent to each other. Presently, it does not seem to be the right interpretation to conclude that “guanxi” is “trust”, because trust is one of the factors, or foundation of how guanxi is built, but does not lead to guanxi itself.

6.2.2 Trust

Guanxi and Trust

Guanxi has been studied by academia and practitioners, trust as a very fundamental factor of building guanxi, the two terms sometimes come across as the same meaning. It can be said that due to trust being the basis of guanxi, what to gain from guanxi is gained based on trust in general. However, as I expressed earlier in the chapter, the guanxi in China is not exactly the same as the relationships or networks in a Western context. As Yi Zhang and Zigang Zhang stated, guanxi is built on the foundation of long-term and mutual trust, it

⁶⁹⁰ Ibid.

⁶⁹¹ Ibid.

is more complicated than relationships and networks in Western contexts.⁶⁹² Therefore, the use of trust in guanxi is different from the Western understanding. The researchers concluded that guanxi is used under consciousness for both the individual and organisational level.⁶⁹³ When individuals or organisations want to achieve their objectives, they first resort to their Guanxi networks. Meanwhile, the possibility of satisfying their intentions depends upon the distance of the relationships and the degree of trust between them.”⁶⁹⁴ From the relationship between guanxi and trust, it is obvious that guanxi is a social relationship among people, which is not formally stated but built on mutual trust, therefore, it is not able to be stated directly and regulated by an external mechanism - legal system. But to aim to use internal mechanisms such as corporate governance mechanisms in organisations to limit the use of guanxi.

Study of Trust

“The existence of trust is an essential component of all enduring social relationships.”⁶⁹⁵ Trust has been recognised for its nature is changing, in modern societies, it appears to be important for a whole world to understand.⁶⁹⁶ In the analysis of trust, the most fundamental factor that we need to recognise, is that trust has two sides: one side is the trustor, and the other side is the trustee.⁶⁹⁷ This distinction is made due to the reasons and sources of trust. In

⁶⁹² Zhang Y and Zhang Z G, *supra* n 676.

⁶⁹³ *Ibid.*

⁶⁹⁴ *Ibid.* 379.

⁶⁹⁵ Seligman A B, *The Problem of Trust*, (Princeton University Press 1997), 13.

⁶⁹⁶ *Ibid.* 14.

⁶⁹⁷ Nootboom B, *Trust: Forms, Foundations, Functions, Failures and Figures*, (Edward Elgar Publishing Limited 2002), 8.

the relationship between trust and entrepreneurship, the lower the level of trust is, the more it restrains growth and market competition, and the less productive the firms can be.⁶⁹⁸ According to the summary of Höhmann and Welter, if the country's environment favours entrepreneurship, which means the market economies are mature, institutional trust holds a prior position and personal trust is only a role that complements the entrepreneurship; however, if the country's market is not mature, where there is a weak institutional framework, which happens in many emerging markets, such as China, personal trust comes as a priority.⁶⁹⁹

In 2001 to 2003 the research of trust in entrepreneurial behaviour in Western and Eastern Europe formed the concept of trust and its measurement, to investigate entrepreneurial behaviour of small firms in differing cultural and institutional settings across Europe, assuming that trust has a decisive impact on entrepreneurship, as it determines ways into, and forms of, entrepreneurship as well as entrepreneurial behaviour.⁷⁰⁰ Explanation of trust in business and in culture determines analysing different levels of trust.⁷⁰¹

Thus, the concept of trust has been recognised by economists but has not been put into the framework of theories.⁷⁰² We know now that trust has an interpersonal side and an institutional side, which need to be examined in a

⁶⁹⁸ Höhmann H H and Welter F, (eds.) *Trust and Entrepreneurship – A West-East Perspective* (Edward Elgar Publishing Limited 2005), 2.

⁶⁹⁹ *Ibid.*

⁷⁰⁰ *Ibid.* 1.

⁷⁰¹ *Ibid.* 2.

⁷⁰² Nootboom B, *supra* n 697, 8.

systematic way.⁷⁰³ The argument that trust is in the people's interaction usually is a more accurate way of describing trust in my opinion, but there are debates in trust studies and relationships.⁷⁰⁴ The reason for this argument is that, in this argument, trust needs a process to achieve. The interaction is the part that is crucial to build trust.⁷⁰⁵ There is also another argument worth mentioning, which is trust requires four elements – trust, the object that trust is put in, the respect, and the conditions.⁷⁰⁶ These four elements mean a lot to guanxi in China's context.

China and Trust

China has become the nation that international businesses would not risk to avoiding. China became the largest FDI recipient in 2002 for US \$52.7 billion.⁷⁰⁷ It increased by US \$53.5 billion in 2003. Fang stated the statistics of “a total of 465,277 foreign-funded enterprises, including more than 400 of the Fortune Global 500, were operating on the Chinese soil”⁷⁰⁸. China has been on the front line of global business operations since joining WTO and a series of world famous international events. China is known for its Chinese style of doing business. This approach is named as “one China, one style”⁷⁰⁹. It was once the method by which Western companies operated businesses in China, until they realised that there are a variety of approaches in doing business in China -

⁷⁰³ Ibid.

⁷⁰⁴ Ibid.

⁷⁰⁵ Ibid. Six F, *The Trouble with Trust: The Dynamics of Interpersonal Trust Building*, (Edward Elgar Publishing Limited 2005), 4.

⁷⁰⁶ Ibid.

⁷⁰⁷ Fang T. “Chinese business style: A regional approach” in Brown D and MacBean A (eds.), *supra* n 3.

⁷⁰⁸ Ibid. 1.

⁷⁰⁹ Ibid.

guanxi is one of them. We are in an era of so much desire to understand how to do business in China or with Chinese enterprises. In other words, to understand how guanxi works in company performance.

In general, the Chinese approach of doing business is recognised as relationship oriented. Other characteristics include hardworking, face-conscious, bureaucratic, bargaining-oriented and harmonious.⁷¹⁰ As a Chinese culture, this relationship was examined by Fang in his research, and he brought up the varieties of Chinese business style. Furthermore he expressed the use of “etic cultural dimensions” for his research of this culture - which is a four dimensional framework.⁷¹¹ One of the dimensions “deal focused” people has been described as task-oriented and transaction-minded, it is opposed to “relationship focused” people who are more relationship-minded.⁷¹² This latter group of people prefer to do business with family, friends and his familiar circle, in other words, the people he trusts.⁷¹³ They are the ones that do not prefer to do business with strangers. Trust is very crucial for them even prior to doing business. In contrast, the former group of people prefer to rely on written agreements in doing business.⁷¹⁴ This characteristic is also shown when disputes occur. This distinction between these two groups is recognised in the cross-cultural literature and study of trust.⁷¹⁵ It is reflected perfectly by Chinese business

⁷¹⁰ Ibid.

⁷¹¹ Ibid.

⁷¹² Ibid.

⁷¹³ Ibid. Gesteland R R *Cross-cultural business behavior: Marketing, negotiating, sourcing and managing across cultures* (3rd edn., Copenhagen Business School Press 2002).

⁷¹⁴ Ibid.

⁷¹⁵ Ibid. Fukuyama F, *Trust: the social virtues and the creation of prosperity* (Penguin Books 1995).

behaviour, also as Graham and Sano named “non-task sounding”⁷¹⁶ describing that the relationship focused people give enough time before business engagements (as long as it takes) to build trust. Li Ka-shing and other famous Chinese billionaires are known for this type of behaviour.

The business mind-set in China is often described as driven by Confucianism⁷¹⁷, which is the moral standard in Chinese society. It includes Chinese and overseas Chinese people in this context. As the details described by Fang, “moral cultivation, importance of interpersonal trust and guanxi, family-orientation, respect for age and hierarchy, avoidance of conflict and need for harmony, and the concept of face” are Confucian traditions.⁷¹⁸ Therefore, the interpersonal trust and guanxi is rooted in Chinese culture for thousands of years, and emphasis on harmony and the concept of face has been too. They are important for a Chinese person in his life regardless of the absence of him or herself.

Traditionally, where China was before this decade, Chinese culture was very much regulated by moral standards of “placing high value on trust and sincerity on his own part and that of the other party” as Fang stated.⁷¹⁹ He stated that being a Chinese businessman acting according to the mutual trust and benefit is very important, and it is more common to seek win-win situation for both parties to succeed. Since the rapid development and penetration of some

⁷¹⁶ Ibid. Graham J L and Sano Y “Business negotiations between Japanese and Americans” in Ghauri P N and Usunier J C (eds.) *International Business Negotiations*, 353-367. (Pergamon 1996)

⁷¹⁷ Ibid.

⁷¹⁸ Ibid. 9.

⁷¹⁹ Ibid. 10.

western culture into China in the last decade, people have learnt from and been affected by western culture of relying on contracts. Therefore, in the difficult market competition, some Chinese businessmen have lost the moral standard and are chasing profit at all costs. For this change in the society, people are more cautious in doing business with strangers. It has been shown in the society that people would rather go to someone that friends or families recommended, which has higher cost than other possible contacts. It appears that “trust” has been valued higher than ever, ironically, as a result of losing trust in society.

Fang sees “trust is the ultimate indicator of Chinese business style”.⁷²⁰ Hong Liu also describes that trust in Chinese term is “*xinyong*”⁷²¹, its closest translation into English would be “reputation”. This is not just used for maintaining the business reputation in Chinese daily life, it is a useful tool in reducing transactional costs and obtaining reliable information about the reputation and credit-worthiness of certain individuals.⁷²² This trust is mainly built through contact in person, since when it comes to the time people meet in person, the relationship knowledge will be considered superior to other forms of communications. That is also the reason that Chinese businessmen start many business deals from meeting up.

The “social uses of kinship” of Pierre Bourdieu, brings the old to new in analysing trust and *guanxi* in terms of economic activity. *Guanxi* reflects as a type of promise-keeping to a certain extent in China. Grotius considered that keeping

⁷²⁰ Ibid. 11.

⁷²¹ Liu H, “Old linkages, new networks: The globalization of overseas Chinese voluntary associations and its implications” (1998) 155, *The China Quarterly*, 588-609.

⁷²² Ibid. 598.

promises is regulated by natural law, and Kant states promise-keeping is the linkage among people in a moral community.⁷²³ This usage of kinship or connection from same origin have been applied to perfection in social circle of the Fujian area. *Huaqiao* (overseas Chinese) and *tongxiang* (same origin) have been widely used well in overseas business.⁷²⁴ The overseas Chinese from the Fujian area formed various social organisations, such as the author heard about “Fu Qing Bang” in the UK (a named organisation for those people originally from Fujian province). The organisation helps overseas Fujian people to live and settle into new environments. In addition, as Hong Liu introduced, Fujian and Guangdong provinces are more traditional, they apply the Chinese connection circle even outside of China, especially in South-East Asia.⁷²⁵ There are a numerous number of networks organised by *shetuan* (organisations, clubs, societies in English).⁷²⁶ The Second Fujian World Convention was held in Langkawi Malaysia, hosting 2,500 representatives in 1996.⁷²⁷ The *shetuan* became the entity that linked people together overseas, and the trading among them also was bonded by *shetuan*.⁷²⁸ Hong Liu has described that *shetuan* formed the regional trading networks.⁷²⁹ Taking an example of the networks of trade (clan associations), which formed close business ties among Fujianese in Japan, allowed Chinese set up Chinese businesses in South-East Asia.⁷³⁰

⁷²³ Seligman A B, supra n 695.

⁷²⁴ Liu H, supra n 721, 583.

⁷²⁵ Ibid. 584.

⁷²⁶ Ibid. 586.

⁷²⁷ Ibid.

⁷²⁸ Ibid. 589.

⁷²⁹ Ibid. 588.

⁷³⁰ Ibid. 589. Lin T C, *The Man Crossing the Bridge: An Autobiography of an Overseas Chinese through the Turbulent Years* [in Japanese] (Epic Press 1997), 147, 199. Personal interview with Lin Tongchun in Kobe. Shoujie shijie Fujian tongxiang kengqing dahui shilu (Records of the First World Fukienese Associations' Convention) (Southern-California Fukienese Association 1994), 9.

Apparently, the common usage of trust and support the Fujianese used among them won them a great success in Asia. It shows that many overseas Chinese retained their cultural and social norms and ideology outside of China, and use it to its advanced level to gain success. This type of regional networking overseas has been established over decades.

Trouble of Trust

There are other issues that is important in trust. Objects of trust can be people but also organisations, institutions, and socio-economic system.⁷³¹ Commonly we are familiar with the concept of trust between people; system trust, however, appears to be too general to consider in relation to people's trust. System trust can be the source of people's trust.⁷³² In other words, the trust in the organisation will influence the trust in its people within it. As Nootboom summarised "we need system trust as part of the basis for personal trust".⁷³³ The worth of this analysis is in the agency theory of family firms in my opinion. From the sociology to managerial analysis, from understanding trust to the reason of why and how family firms choose their professional management team instead of family members, or not to choose to hand out the ownership at all. It seems that if the trust in an organisation exists, the people in this organisation will appear to be more trustworthy among themselves. Therefore, when someone from outside of the family comes in to the organisation as a potential successor, it is more likely for the family to trust his/her profession. Of course, it

⁷³¹ Nootboom B, supra n 697, 8. Six F, supra n 705, 4.

⁷³² Ibid.

⁷³³ Ibid. 8.

comes with interactions in the process of building trust, but it is achievable with the interaction being embraced.

In contrast with the above analysis, many cases are low-trust work relations, which shows that the trust is difficult to build and maintain.⁷³⁴ On sides of having problems, trust do help organisations survive in complex situations, especially in taking risks.⁷³⁵ But the organisational trust cannot separate from interpersonal trust, and *vice versa*.⁷³⁶ Thus the trust at an organisational level that affects company performance shall also be considered as the effect from interpersonal trust within the organisation. Trust is fragile and based on exchange of expectations, and mostly the expectations are not solid, which is why people need the assurance and strong faith through the pre-interaction in between to build up the confidence for later exchange.⁷³⁷

Limitations of the Research

There are various limitations on trust studies, such as, how to gain evidence from empirical research? And how to take the measurements?⁷³⁸ They are the challenges that exist in the research of relationship between trust and business. There is an existing definition of trust in the literature, but the measurements and research methods are enamoured with empirical research of trust. Commonly, the methodology of research has been quantitative, which brings a

⁷³⁴ Six F, supra n 705.

⁷³⁵ Ibid. 1.

⁷³⁶ Ibid. 4.

⁷³⁷ Seligman A B, supra n 695, 70.

⁷³⁸ Höhmann H H and Welter F, supra n 698, 2.

disadvantage to the research. In addition, targeting regions during the research could be difficult, as some regions are over conservative and dislike to share the “secret weapon” (guanxi), worrying that it will bring out more questions in how exactly they use it in the business. The answer to that question would not be beneficial to the business reputation.

6.3 Future Research of Guanxi

The concept of guanxi appears to be very complex through how many debates of guanxi and researchers’ proposals on future research. The proposals lead to many different angles of guanxi. Yang and Wang raised the finding of Chen, Chen and Xin in terms of effect that guanxi has on trust.⁷³⁹ The finding is in the institutional level, guanxi effects trust negatively, but shows the opposite in the individual level. Therefore, the calling of examining the negative effects and the legitimacy of personal guanxi in organisations are raising.⁷⁴⁰

In addition, the approach to guanxi is another area of future research. In between of the individual level and organisational level of guanxi, the dynamic is the challenge to manage in guanxi concept. The culture and context are varying among institutions. Therefore, the approaches that including proactive and passive ways would need more attention.⁷⁴¹

⁷³⁹ Chen C C, Chen Y R and Xin K, “Guanxi Practices and Trust in Management: A Procedural Justice Perspective”, (2004) 15 (2), *Organization Science*, 200-209. Yang Z L and Wang C L, supra n 661, 494.

⁷⁴⁰ Yang Z L and Wang C L, supra n 661.

⁷⁴¹ Ibid.

Furthermore, the area of how firms “initiate, build, and use guanxi networks”⁷⁴² needs further studies.⁷⁴³ The companies that are in early stage of development commonly employ experienced and widely connected senior staff in their management team. In other words, by using guanxi in an organisation, to bring in more profit and win competition in market. However, this level of using guanxi is in the interpersonal level, and it is doubtful that the guanxi network in this level will progress to the organisational level of guanxi. It might be because guanxi networks of individuals is a key value, and it is more important to protect this value at the individual level from being controlled by others or their organisations. The fact is the senior staff would rather control the network in their own hands, rather than sharing it and handing it to the organisations. They will bring their personal guanxi net to their next employers when they move for career planning. Without the guanxi net, they will lose their value to employers. There are posts or articles recently posted on social media platforms with regards to such matters, it appears that nowadays the value of people is assessed by how much guanxi network they have personally in the institutions they work for. It also means that the knowledge of managing guanxi network in marketing is limited and further studies are needed. Other researchers brought up varying topics

⁷⁴² Chen X P and Chen C C, “On the intricacies of the Chinese Guanxi: A process model of Guanxi development”, (2004) 21(3), *Asia Pacific Journal of Management*, 305-324.

⁷⁴³ Yang Z L and Wang C L, *supra* n 661.

that relate to guanxi, such as contract drafting effectiveness⁷⁴⁴, transaction cost advantages⁷⁴⁵ and so on.⁷⁴⁶

Finally, there are many issues which have been listed on the future research agenda.⁷⁴⁷ For instance, further studies on guanxi's complex concepts, especially the theoretical and systematic studies are needed.⁷⁴⁸ There are some papers which have examined the differences and proved that guanxi as a particularity of Chinese culture has impacts over family businesses, which is worthy examination systematically. According to Yang and Wang, they selected some research papers that contained different aspects of guanxi research, which include 1) the various elements that scholars recognised as mechanisms of guanxi - *renqing* (relationship or commitment), *mianzi* (face), *ganqing* (emotional commitment) and *xinren* (trust); 2) guanxi and firm performance; and 3) guanxi as a strategy.⁷⁴⁹ Apparently, the different views of research in guanxi need to be compared in future studies in order to gain an in-depth view of guanxi.

⁷⁴⁴ Wuyts S and Geyskens I, "The Formation of Buyer-Supplier Relationships: Detailed Contract Drafting and Close Partner Selection", (2005) 69 (4), *Journal of Marketing*, 103-117.

⁷⁴⁵ Standifird S S and Marshall R S, "The transaction cost advantage of Guanxi-based business practices", (2000) 35 (1) *Journal of World Business*, 21-42. "guanxi-based business practices offer certain transaction cost advantages over existing structural alternatives identified in transaction cost theory. Where the *guanxi* network is well developed, the transaction cost advantages of *guanxi*-based exchange are sufficient to warrant the integration of *guanxi*- and market-based exchange mechanisms."

⁷⁴⁶ Yang Z L and Wang C L, supra n 661, 494

⁷⁴⁷ Ibid.

⁷⁴⁸ Park S H and Luo Y D, supra n 662, 474. Park and Luo stated that guanxi is "an important cultural and social element in China". Park and Luo stated the limitation for guanxi in their research is the theories and empirical exploration in guanxi studies with over time. To understand the importance of guanxi it is critical to conduct comparative studies due to the fact that guanxi has impacts over different contexts and what types of ties and utilisation of guanxi in various culture.

⁷⁴⁹ Yang Z L and Wang C L, supra n 661, 494.

6.4 Guanxi and Family Businesses

Guanxi has many aspects within its concept when comes to its understanding. One core in guanxi is the relationships of families, and this relationship among family members is named as kinship. Kinship also has different definitions, depending on the contexts of culture and other social factors. One of the formats of kinship is blood ties, and this is mainly the one that is recognised as family ties in the context of China. Kinship is indeed very critical in terms of family businesses. As Ruskola commented, compared with Western culture, the fundamental norm of businesses in China is kinship rather than the norm of contract in Western contexts.⁷⁵⁰ It is the factor that ties people together as a unity that owns the controlling voting shares or property. To explain further, the result leads to the ownership structure, which is as most scholars agreed on, the one feature of determining a family firm is the ownership structure.⁷⁵¹ Therefore, the connection between guanxi and family businesses is important. As the voting shares or property percentage are the core of the controlling rights in family firm, as one of the crucial factors – kinship, which affects the percentage has been recognised subconsciously when decisions are made in regards with business operation in the context of China and other countries.⁷⁵²

⁷⁵⁰ Lawton, supra n 589, 256. Ruskola T, supra n 246.

⁷⁵¹ Howorth C, Rose M and Hamilton E, "Definitions, diversity and development: key debates in family business research" in Casson M, Yeung B, Basu A, and Wadeson N (eds.) *The Oxford Handbook of Entrepreneurship*, (OUP 2006)

⁷⁵² Ibid.

6.4.1 Guanxi Impacts and its Importance in and outside of China

As Balfour mentioned, the first thing that businessmen learn when they arrive in China is how to do business with Chinese businesses, and guanxi is one aspect that firstly fascinates them.⁷⁵³ Although it might be similar elsewhere, but the forms of guanxi have been used to its maximum extent in China. According to Chu and Ju's research (a survey in the PRC) cited by So and Walker, that guanxi is considered as very important in economic activities in society with over 42% responses, while nearly 50% is either important or somewhat important.⁷⁵⁴ However, guanxi is not only for foreign businesses to learn when they firstly enter to China's market, domestic businesses also use it daily and still use it to its maximum, especially when the businesses face difficult challenges.⁷⁵⁵ Balfour expounded that residence in Shanghai, as one of the largest and luxurious cities in China, they know guanxi is a key to everything. From business operating permissions to making a deal, and mediation treatment.⁷⁵⁶ It is shown clearly from the above statement that how important guanxi is for businesses and people's daily life.

The importance of guanxi has been widely recognised by both Chinese people and non-Chinese businessmen as well as investors from elsewhere. Chinese businessmen have done business with guanxi for centuries. As researchers find that in a Philippine city, Chinese businessmen used more social connections in

⁷⁵³ Balfour F, supra n 232.

⁷⁵⁴ Chu G C and Ju Y N, *The great wall in ruins: communication and cultural change in China*, (State University of New York 1993) in So Y L and Walker A, *Explaining Guanxi: The Chinese business network*, (Routledge 2006), 1.

⁷⁵⁵ Ibid.

⁷⁵⁶ Balfour F, supra n 232.

their business and were more successful than those who did not use guanxi. They found that there is no overseas businessman working in China, nor the other major Chinese business communities of Hong Kong and Taiwan who could afford to fail to be aware of the term guanxi but few understand it.

Meanwhile, the relationship between buyers and suppliers is an important connection as one aspect of guanxi. Wuyts, and Geyskens precisely described guanxi in contract effectiveness of buyers and suppliers, “contracting becomes effective only when a non-close partner is selected and when the focal relationship is embedded in a network of close mutual contacts.”⁷⁵⁷ Certainly the rapid increase of China’s economy and its influences on the world, the way that guanxi and business relations are paid more attention recently.⁷⁵⁸

Apparently, guanxi is unique and important for Chinese businessmen, it is also a crucial role to overseas Chinese businesses in terms of firm performance. Further to provide understandings for non-Chinese businessmen to deal and trade with Chinese businessmen, also to provide deeper understandings for Chinese businessmen to operate businesses.⁷⁵⁹ Balfour also highlighted that guanxi had been special and mysterious for foreign investors.⁷⁶⁰ All in all, guanxi is not the only reason of Chinese entrepreneurs become successful, but it has played an important role in the business environment in China. In addition to the

⁷⁵⁷ Wuyts S, and Geyskens I, supra n 744,

⁷⁵⁸ Chu G C and Ju Y N, supra n 754.

⁷⁵⁹ Ibid.

⁷⁶⁰ Balfour F, supra n 232.

influences that *guanxi* creates to the business sector, it has an incredibly strong influence on the whole economy.⁷⁶¹

People in China also realise the importance of networks in its contribution to the development of the economy. As Yang Yuanqing (the chairman of the Chinese famous computer manufacturer – Lenovo Group) emphasised and discussed by Balfour, Chinese who studied or worked abroad know how to build networks, they noticed the importance of networking in and out of China.⁷⁶² Also, as the founder of another famous online website in China - Tudou, which functions similar to YouTube, Gary Wang said when he gave a speech in Shanghai, that he probably could not create this successful online video website without knowing all the people who helped him.⁷⁶³ There are many other examples like this in the business area and different successes built on different “connections” or “relationships” (*guanxi*). Thus, *guanxi* has become important and even crucial for local and foreign businesses.

Among various changes of China, *guanxi* might be the only thing that has not been changed much for Chinese and foreigners. It is remaining difficult to get the norm of *guanxi* and it is persistent in China for foreigners to understand.⁷⁶⁴ Thus the situation for foreign firms is that it is easier for them to find some connections inside of China in order to help them in expanding the market, some rules applied to Chinese businesses when they tend to expand cross-regions. Chinese businesses are more experienced and under the impacts of

⁷⁶¹ Chu G C and Ju Y N, supra n 754.

⁷⁶² Balfour F, supra n 232.

⁷⁶³ Ibid.

⁷⁶⁴ Ibid.

globalisation, they are also looking for foreign partners or connections in order to step into foreign markets. As the chief representative of Viacom in China said, the Chinese firms are also looking at how strong guanxi networks foreign partners have.⁷⁶⁵ Therefore, the general environment has been changing for foreigners and Chinese individuals. There are deeper connections among Chinese and foreign businessmen as individuals. That is a new format of guanxi, truly is a “connection”. It may be debatable by Westerners that “guanxi” exists everywhere, not just in regions of China. However, the application of “guanxi” could not be the same between Chinese and Westerners. Furthermore, guanxi is a term of Chinese language. Although it is translated to other languages in other contexts, the terms cannot replace what guanxi is. In this sense, translating guanxi into a different language is merely a way to help people to understand what it represents. Therefore, guanxi is not a universal term for the world.

6.4.2 Enterprises and Guanxi

Family businesses have been driving economies growing in countries, for instance, Italy and the US.⁷⁶⁶ In international scope, family businesses have many differences in theory, and the social contexts they are operating; however, their similarities can outweigh the differences in varying jurisdictions. In terms of governance process, there are differences among family businesses and many challenges they face in individual countries. Especially in the context of

⁷⁶⁵ Ibid.

⁷⁶⁶ Astrachan J H, and Shanker M C, supra n 259, 211-219.

China or other countries that are emerging markets, elements of a political constitutional system and other changing matters in societies. In the period of rapid development, guanxi in the context of China could affect fairness in business operations.

Majority of family businesses are small and medium-sized businesses, which puts them at a disadvantageous position in comparison to large corporations. Therefore, they rely on personal ties to bring more business profits than other businesses, to prevent loss of their fortune and wealth. Most owners of family businesses build trust with their partners in order to avoid unnecessary risks. So, we call the personal trust and this kind of connections “Guanxi Capital”⁷⁶⁷, similar opinions can also be found in the paper of Yang.⁷⁶⁸

The fact is guanxi exists within a family business and out of a family business. In the case of “within a family business”, trust people is very difficult without any guanxi,⁷⁶⁹ which is why normally the successors come from the same families, at least from the same family roots. Generally, owners do not trust outsiders (*wairen*), so they would keep this tradition by choosing family members as successors within the families, which is the connection between guanxi and succession issue of family businesses. Guanxi is the direct reason that family business owners in China prefer family members instead of other outsiders. The

⁷⁶⁷ David L. Wank, *supra* n 685.

⁷⁶⁸ Yang M H, “The resilience of guanxi and its new deployments: a critique of some new guanxi scholarship” (2002) 170, *The China Quarterly*, 459-479.

⁷⁶⁹ Guanxi is not only for the relationship in business area, guanxi is everything, such as all kinds of relationship, connections, or even acquaintances in China’s context. Also, some scholars claimed that guanxi is “owe someone a favour”. Here, guanxi means close ties, like blood ties, or marriage, or other the closest and strongest ties than any other relationship within a family.

share of family blood is “kinship”, which is a basic form in guanxi. As Ruskola stressed that kinship is the fundamental norm in Chinese businesses⁷⁷⁰, naturally, this has affected the development of family firms in China. It can even potentially damage the performance of companies. Particularly during the process of succession, many businesses have been damaged even bankrupted because of it.

As a classic topic in anthropology, anthropologists proposed an update of the changes occurring in kinship theory, these go beyond the context of China.⁷⁷¹ In my view, although kinship changes, as one typical form of guanxi, other forms of guanxi have unique influences on succession of family businesses. This is relevant to every aspect of families and businesses in family businesses. Could we minimise the negative influences for family businesses and manage the family businesses with only the positive affects? It is possible with the governance mechanisms. Thus, it may be possible that the whole family business can be formed as a “family”, further to make succession procedures easier and proper.

Guanxi is so critical to family businesses. Family firms are the entities in this guanxi network for many different reasons, and businesses rely on this. The relationship of business partners and connections of government officials are some aspects that matter for firms surviving. As Wank criticised, “patron-client ties are productive by connecting entrepreneurs to the overarching bureaucratic

⁷⁷⁰ Ruskola T, supra n 246.

⁷⁷¹ Brandtstädter S and Santos G D, “Introduction: Chinese kinship metamorphoses”, in Susanne Brandtstädter and Gonçalo D. Santos, (eds.) *Chinese Kinship: Contemporary Anthropological Perspectives*, (Routledge 2009).

structure”.⁷⁷² Thus guanxi is crucial for family businesses, they connect each other tightly through it and it directly influences the performance of family businesses. In other words, guanxi is seen as protecting family businesses from troubles and help them to profit better in practice. However, this protection would not protect the internal operation but market competition only. This is where guanxi affects the performance of family firms - business competition. This type of competition is normally held for stimulating the suppliers market. The department or the buyers need to sign the contract with the winner in the competition, it does not only happen between the government departments and firms, but also in all of the departments (*danwei*) – hospitals, universities and so on. Normally the amount of this type of trade is enormous, so it would be beneficial if the firm could win in the competition.

Guanxi could be operated differently from region to region. According to the survey that provided by Wong and Stone⁷⁷³, cited by Fang – “Chinese regional stereotypes”⁷⁷⁴, which shows the differences of guanxi among Beijing, Shanghai and Guangzhou. The result is in the aspects of “relationship-focused”, “bureaucrat” and “importance of face” among these three major cities in China, the data of Beijing is higher than the Shanghai and Guangzhou.⁷⁷⁵ Based on the experiences, guanxi and networks are indeed more important for businesses in the northern part compared with the southern China.

⁷⁷² David L. Wank, *supra* n 685, 823.

⁷⁷³ Wong G Y Y, and Stone R J, “Chinese and Western Negotiator Stereotypes”, in Jan Selmer (ed.) *International Management in China: Cross-Cultural Issues*, (Routledge 1998) 207-222.

⁷⁷⁴ Fang T, *supra* n 707, in Brown D H and MacBean A (eds.), *supra* n 3, 156-172.

⁷⁷⁵ *Ibid.*

There is a possibility that the owners may ignore the importance of the governance structure by using guanxi. However, it could result difficulties when they try to achieve greater purposes. Thus, guanxi is a crucial part of doing better businesses, but not the only nor main drive. Doing better and performing better is more reliant on the abilities of owners and the corporate governance systems of family businesses. Governance structure and mechanisms along with legal framework as one mixed mechanism in the society to balance and regulate all potential unfairness, faces many challenges in its process. Guanxi performs in society as a soft mechanism, and it helps only when certain circumstances occur. It seems that guanxi is special because of its use in critical situations that firms face, and it is also the one factor that never disappears. Even when rules and regulations are becoming more effective and strict, it still exists in its use to overcome difficulties for firms. However, it is a question that whether guanxi has been over emphasised in business environment. It is worth thinking especially for business owners. By using corporate governance mechanisms, family businesses could overcome the social effects and challenges in business operations. Over emphasising guanxi could cause more attention to use guanxi but neglect unfairness in economic activities.

Large Publicly Listed Companies and Guanxi

In fact, many publicly listed companies are family owned in most countries, such as in South and East Asia, Western Europe.⁷⁷⁶ Claessens *et al.* express that

⁷⁷⁶ Chakrabarty S, "The influence of national culture and institutional voids on family ownership of large firms: A country level empirical study" (2009) 15 *Journal of International Management*, 32-45.

“approximately 2/3 of firms are owned by families or individuals in Asian countries.”⁷⁷⁷ Globally, family businesses are significant. La Porta *et al.* reported that 30 per cent of firms are family-controlled while 36 per cent are widely held.⁷⁷⁸ Showing that in Asian countries, family firms are the predominant format in business sector. Hong Kong city is a classic example of this situation. In the US where it is thought that the ownership of companies does not assemble, Anderson and Reeb find that “around 35% of companies in the S&P 500 are familial.”⁷⁷⁹ In contrast, family firms are not the predominant ownership in the UK from Faccio and Lang research.⁷⁸⁰

In the context of China, most public listed companies are SOEs. The managers and senior team members are Central Party Members. So naturally their connections are to the central government, and local government; state owned banks, local banks; even other businesses in general. The benefits of being SOEs are in various areas including financing, market competition, employment, reputation. Therefore, they have a lot of advantages compared with small and medium sized family businesses and even large sized family businesses.

⁷⁷⁷ Claessens S, Djankov S and Lang L H P, *supra* n 272.

⁷⁷⁸ La Porta R, Lopez-de-Silanes F and Shleifer A, *supra* n 557; Isakov D and Weisskopf J P “Family Ownership, Multiple Blockholders and Firm Performance” (2009) Finance International Meeting AFFI – EUROFIDAI, available at SSRN: <http://ssrn.com/abstract=1484574>. (accessed 28 September 2016), 1.

⁷⁷⁹ Anderson R C and Reeb D M, *supra* n 260, 1301-1327.

⁷⁸⁰ “family firms are the predominant ownership form in Western Europe except for the UK and Ireland” Faccio M and Lang L P H, *supra* n 610.

Small and Medium-Sized Enterprises and Guanxi

Less attention has been paid to issues of corporate governance in SMEs that is, in enterprises whose shares are neither sold to the public nor traded on the securities markets. The guanxi in SMEs is more crucial to the performance than to public-listed corporations. In the context of China, guanxi creates a crucial business environment for family businesses, since most of them are not strong enough to encounter many SOEs and other large corporations.

6.4.3 Culture Guanxi and Family Businesses

Culture is defined as distinguishing one human group from other groups through its mutual mind, even ideology.⁷⁸¹ Guanxi is a direct reflection of a society culture in China.

Culture of A Nation and Family Businesses

National culture includes collectivism and power-distance. Members of families or groups have the high collectivism, so the family firms as entities that contains such collectivism strongly effected by a national culture.⁷⁸² The high collectivism brings benefits to the relationships of families and groups, but not to professional

⁷⁸¹ Hofstede G, *Culture's Consequences: International Differences in Work-related Values*. (Sage Publications 1980), 25. Chakrabarty S, supra n 776, 33.

⁷⁸² Gudykunst W B, Matsumoto Y, Ting-Toomey S, Nishida T, Kim K and Heyman S A M, "The influence of cultural individualism-collectivism, self construals, and individual values on communication styles across cultures." (1996) 22 (4) *Human Communication Research*, 510-543. Chakrabarty S, supra n 776, 33.

managers whom are not in such collectivism culture.⁷⁸³ According to the research, the literature suggests that having professional managers can help to hold family ownership further, therefore, protect family business legacies better.⁷⁸⁴ It has been proved by Chilean and Nicaraguan family-owned business.⁷⁸⁵ It also reflects that family businesses have had a great contribution towards societies in general. The literature has suggested that the entities as families that have high level of collectivism could retain ownership of their businesses.⁷⁸⁶ The value they hold and the customers-oriented ideology are a great contribution towards public.

Culture with power-distance, which are defined as “where a socio-economic class/status system prevents the upward mobility of certain sections of society, and where disparities exist in availability of opportunities and distribution of wealth and power”⁷⁸⁷, has been demonstrated in countries where economy is unique. In other words, China is a Confucian country, it has grown to an

⁷⁸³ Chakrabarty S, supra n 776, 33. It says in research that one type of institutional void is in agency contracting, where there is not enough institutional norms and regulations for monitoring contracts. Therefore, it causes the difficulties and distrust between owners and professional top management positions. Agency theory economists strongly raised the need of hiring professional management team for the efficiency in economic activities. Fama E F, “Agency problems and the theory of the firm” (1980) 88 (2) *Journal of Political Economy*, 288-307, 288. Obviously, it is not very acceptable for family firms as the owners are not comfortable with monitoring non-family managers, such as Italy. And Jensen M C and Meckling W H, supra n 273.

⁷⁸⁴ Chakrabarty S, supra n 776, 33. Gomez-Mejia L R, Nuñez-Nickel M and Gutierrez I, “The role of family ties in agency contracts” (2001) 44 (1) *Academy of Management Journal*, 81-95. Gudykunst W B, Matsumoto Y, Ting-Toomey S, Nishida T, Kim K and Heyman S A M, supra n 782.

⁷⁸⁵ Khanna T and Palepu K, “The future of business groups in emerging markets: long-run evidence from Chile” (2000) 43 (3) *Academy of Management Journal*, 268-285. Chakrabarty S, supra n 776, 33.

⁷⁸⁶ Ibid. “The literature suggests that cultures with high collectivism display reduced opportunistic behavior, reduced costs of transactions within the family/group, and greater attempts to retain ownership of their businesses within their dynasty. Gudykunst W B, Matsumoto Y, Ting-Toomey S, Nishida T, Kim K and Heyman S A M, supra n 782.

⁷⁸⁷ Markus H R and Kitayama S, “Culture and the self: implications for cognition” (1991) 98 (2) *Emotion, and Motivation Psychological Review*, 224-253. Chakrabarty S, supra n 776, 33.

economy with a mix of socialism and capitalism features is included into the culture with power-distance.⁷⁸⁸ Sociologists therefore have suggested the relation between market and culture in such contexts. They argued that economies react differently with cultures and societies, therefore, culture has been become a fundamental cause for society and economies in their structure.⁷⁸⁹ This is the basis of guanxi impacts to market and further to economic activities. In the debate of the effects to economic and business structures, institutional economists argue that institutional voids affect economic and business structures, whereas cultural sociologists debate that culture implants the structures, which is culture in a country can shape the structure models.⁷⁹⁰

National culture is one of the influences that affect family-ownership pattern in the world.⁷⁹¹ Based on the research of Subrata Chakrabarty, the two factors –

⁷⁸⁸ Chakrabarty S, supra n 776, 33. The research suggests that high power distance in culture lays in the countries or societies that driven by power and social status, and in literature, such culture aspect happens among classes of wealth and power, such as China, that the people in more powerful position or wealthy status would use their connections to achieve more. Researchers found that it has been demonstrated in the countries with history of bazaar economies, Confucian economies, fiefs and clans. Markus and Kitayama, supra n 787. Geertz C, *The Interpretation of Cultures: Selected Essays* (Basic Books 1973). Dore R, "Goodwill and the spirit of market capitalism", (1983) 34 (4), *The British Journal of Sociology*, 459-482. Boisot M and Child J, "From fiefs to clans and network capitalism: explaining China's emerging economic order" (1996) 41 (4) *Administrative Science Quarterly*. Ouchi W G, "Markets, bureaucracies, and clans", (1980) 25 (1), *Administrative Science Quarterly*, 129.

⁷⁸⁹ Swedberg N S R (ed.) *Culture and Economy. Handbook of Economic Sociology*. (Princeton University Press 1994), 27-57, 28. Chakrabarty S, supra n 776. Research has stated that cultural sociologists argued that "markets are cultural arenas where various "categories of economic action are culturally variable and socially constructed" and hence a country's cultural dimensions are an underlying root cause that influence the existence and dominance of social and economic structures of a country.

⁷⁹⁰ Chakrabarty S, supra n 776, 33. Biggart N W and Delbridge R, "Systems of exchange", (2004) 29 (1), *Academy of Management Review*, 28-49. Fligstein N, "Markets as politics: a political-cultural approach to market institutions", (1996) 61 (4), *American Sociological Review*, 656. Swedberg R, "New economic sociology: what has been accomplished, what is ahead", (1997) 40 (2), *Acta Sociologica*, Taylor and Francis Ltd, 161-182. Zelizer V A, "Beyond the polemics on the market: establishing a theoretical and empirical agenda", (1988) 3 (4), *Sociological Forum*, 614.

⁷⁹¹ Chakrabarty S, supra n 776.

national culture and institutional voids⁷⁹², affect family ownership patterns, and these two encounter each other in terms of the influence. In addition, Fama and North hold similar opinion that a country's culture has a strong influence towards family ownership.⁷⁹³ Although the research is stated based on the large publicly listed firms that owned by family, but the similarity between the large public listed family firms and SMEs over this culture influence is undeniable.

Guanxi and Family Businesses - Financing

Financial credit availability in institutional void is where financial banking institutions are not functioning or not efficient enough in the economy.⁷⁹⁴ Institutional void includes financial credit availability and deficiencies of agency theory models⁷⁹⁵, which is a typical form that large corporations apply, also recognised as efficient in corporate governance is agency theory – hire professional agents (managers) – who are not connected to the families that own the firms.⁷⁹⁶ Lack of agency theory, as one type of institutional void would cause difficulties between family ownership and non-family managers.⁷⁹⁷ As the research found, Italy lacks such institutional void, and owners would like to control management ownership, giving Italy one of the largest population of

⁷⁹² Institutional voids are defined as “the lack of institutional facilities, norms, and regulations needed for a well functioning economy...” North D C, *institutions, Institutional Change, and Economic Performance* (CUP 1990).

⁷⁹³ Chakrabarty S, supra n 776. Fama E F, supra n 783. North D C, supra n 792.

⁷⁹⁴ Chakrabarty S, supra n 776.

⁷⁹⁵ Ibid. Fligstein N, *The Transformation of Corporate Control* (Harvard University Press 1990). North D C, supra n 792.

⁷⁹⁶ Chakrabarty S, supra n 776; Fama E F, supra n 783, 288.

⁷⁹⁷ Ibid. Jensen M C and Meckling W H, supra n 273.

family businesses.⁷⁹⁸ The lack of agency theory is common among family businesses, and many family businesses have struggled to decide whether to apply the theory not. But comparing immediate financial pressures with the long-term positive results that agency theory brings to family businesses, the former appears more direct and harmful, especially for the small and medium-sized family businesses.

In the context of financial banking institutions are not functioning or not efficient enough, regulation is a very important tool that drives banking institutions to function, further to improve financial credit. In the context of China, financing is a very crucial and difficult issue for family businesses. Traditional banking system is not considered very helpful in terms of small and medium-sized family business lending. Which is why the national culture, here is guanxi, means so much to family businesses. The businesses or senior management team that have connection (network – guanxi) would most likely to gain funds through traditional banking system. Those do not have guanxi network would suffer from the fact that they have to rely on themselves. Therefore, many family businesses have learnt to maintain internal cash flow through years of building up their wealth. And many have only used their own cash flow in extending their businesses. From the financial crisis, shadow banking appears globally and it has been opening a new channel for consumers, especially family business. The details will be discussed in the following section.

⁷⁹⁸ Chakrabarty S, supra n 776, 33. Bianchi M, Bianco M and Enriques L, "Pyramidal groups and the separation between ownership and control in Italy", in Barca F, Becht M (eds.) *The Control of Corporate Europe*, (OUP 2001), 154-187.

However, because of this cash flow method, many family businesses are stable, strong, and less affected by economy crisis. In the paper, the research suggests that, although public suffer from the lack of access to credit as a result of institutional void in general, in financial credit availability, family businesses use their own cash flow so mostly likely they are not much affected.⁷⁹⁹ Such use of internal cash flow can be found in Korea, India and Chile.⁸⁰⁰ Moreover, research shows that if the societies have cultural power distance inequalities and financial credit absence, they provide a great environment for family businesses and their families.⁸⁰¹ Only if institutional void in financial credit availability would encounter with such factors and make investors and entrepreneurs turn against the use family businesses.⁸⁰² That provides a foundation of building up the structures and create the environment for family businesses to grow in general.

Recently, the investment methods have rapidly grown across the globe. This strongly shows the interests from China, particularly small and medium-sized family businesses' interests. The ones that are capable of expanding are looking to grow in international context, therefore, there are more potential opportunities in merger and joint venture forms coming in the next decades. However, the risk is that they might be facing the difficulties such as financing and remaining as family controlled firms. Many of them will be taken advantages of by large firms that develop strong corporate governance mechanisms and strong financial

⁷⁹⁹ Chakrabarty S, supra n 776, 33. Khanna T and Palepu K, supra n 785.

⁸⁰⁰ Ibid. Khanna T, Rivkin J W, "Estimating the performance effects of business groups in emerging markets" (2001) 22 (1), *Strategic Management Journal*, 45.

⁸⁰¹ Chakrabarty S, supra n 776, 34. The research suggested that "a combination of cultural power distance inequalities and a lack of financial credit availability in society can give business families tremendous power and deprive marginal players. However, if institutional void in financial credit availability is overcome, then investors and entrepreneurs can compete against elite business families despite any cultural power distance inequalities."

⁸⁰² Ibid.

power. Thus, the requirement of having unique family business characteristic mechanisms within small and medium-sized firms will potentially reduce such risks, and help small and medium-sized family businesses face challenges and welcome new opportunities in globe.

Shadow Banking

Obtaining financing from traditional banking is one of the challenges family businesses face. With the global development of the finance industry, alternative investment, which is debatable currently and cannot be avoided is “shadow banking”. The newly developed system has challenged traditional finance industry and legal framework. Shadow banking system is taking a decent proportion of global financial system and even half of the total global banking assets.⁸⁰³ There is a difficulty in estimating the size of shadow banking, since government regulators do not have details nor reports in the organisations who operate as shadow banks.⁸⁰⁴ The conclusion is shadow banking provides alternative channels and options in finance investment for current financial system and consumers.⁸⁰⁵

Shadow banks in the West are different from Chinese ones. This is due to Chinese credit limits being strictly controlled.⁸⁰⁶ Compared with the US, where

⁸⁰³ Shen W, “Shadow banking system in China – Origin, uniqueness and governmental responses”, 2013, 1, *Journal of International Banking Law and Regulation*, 20-26.

⁸⁰⁴ Kodres L E, “What Is Shadow Banking?”, (June 2013) 50 (2) *Finance and Development* <http://www.imf.org/external/pubs/ft/fandd/2013/06/pdf/basics.pdf> (accessed 28 September 2016).

⁸⁰⁵ Shen W, supra n 803.

⁸⁰⁶ Ibid.

one of the largest shadow banking system operates⁸⁰⁷, China's finance sector is slightly under-developed yet rapidly growing. 81 billion yuan of domestic deposits are in risky entities⁸⁰⁸, and SMEs have borrowed 2 thousand billion yuan through the shadow banking system due to the difficulty of gaining finance support from traditional banking⁸⁰⁹. It shows clearly it has become an issue in recent years,⁸¹⁰ yet the situation could turn worse if the bubbles in asset explodes, such as real estate.⁸¹¹ All professionals from all sectors in globe are paying attention to this issue, due to the risks that shadow banking system might bring to finance security, and also because of the influence China's economy may affect the world.

The research of shadow banking is fairly in the early stage for all academia worldwide, especially for China due to the latest investment practices China has been experiencing – bubble style investment practice.⁸¹² There is not yet a single precise definition of shadow banking due to the following two main reasons: the research and understanding has not been conducted systemically, and it is involved with huge and critical changes in banking regulation system for all countries.⁸¹³ The Financial Stability Board in the US “defines the shadow banking system as “credit intermediation involving entities and activities (fully or partially) outside the regular banking system” or nonbank credit intermediation in short”.⁸¹⁴ In contrast with the US where shadow banking appears after

⁸⁰⁷ Kodres L E, supra n 804.

⁸⁰⁸ Shen W, supra n 803.

⁸⁰⁹ Ibid.

⁸¹⁰ Yan Q M and Li J H, *Regulating China's Shadow Banks* (Routledge 2016).

⁸¹¹ Shen W, supra n 803.

⁸¹² Ibid.

⁸¹³ Yan Q M and Li J H, supra n 810.

⁸¹⁴ Errico L, Harutyunyan A, Loukoianova E, Walton R, Korniyenko Y, Amidži G, Abushanab H, Shin H S, *Mapping the Shadow Banking System Through a Global Flow of Funds Analysis*,

financial crisis, and according to scholars that it is caused by financial crisis, Yan and Li stated that shadow banks in Chinese context are different from the foreign ones that recently caused financial crisis.⁸¹⁵ The director of the Chinese Academy of Social Sciences Institute of Finance and Banking, argues that “shadow banking” is defined as “only business related to debtor-creditor relationships and activities outside bank balance sheets should be considered shadow banking”.⁸¹⁶ Whereas, another definition is recommended by Yuan Zengting, who is deputy director, focusing on bank products and business lines.⁸¹⁷ To be specific, the business lines and banks’ wealth management products are normally referred as “shadow banking”, such as entrusted loans, loan pools and other products that are generated from the collaboration between banks and trusts.⁸¹⁸ Furthermore, the director of the institute’s financial lab suggested there are unregulated securitisation activities in banks and unregulated private finance.⁸¹⁹ In the urgency of having regulations against shadow banking, after the warning from International Monetary Fund (IMF) and the act of admitting the existence of “shadow banks” in China made by People’s Bank of China Governor Zhou Xiaochuan, “shadow banks” is the aim of next step for the China Banking Regulatory Commission, in terms of its content, function, size, structure, and risk.⁸²⁰ The China Banking Regulatory Commission

International Monetary Fund Working Paper, January 2014.
<https://www.imf.org/external/pubs/cat/longres.aspx?sk=41273.0> (accessed 28 September 2016), 4.

⁸¹⁵ Yan Q M and Li J H, *supra* n 810.

⁸¹⁶ *Ibid.* Chapter 3.

⁸¹⁷ *Ibid.*

⁸¹⁸ *Ibid.*

⁸¹⁹ *Ibid.* “The former is mainly embodied in bank-trust cooperation, but also includes entrusted loans and intermediation from saving to investment performed by micro-loan firms, guarantee companies, trust, finance companies, and financial leasing firms. The latter includes underground banks, private lending firms, and pawnshops.”

⁸²⁰ *Ibid.* Chapter 3.

(CBRC) has also warned banks in China of one form of shadow banking – “personal-to-person” lending platform and its risks.⁸²¹ CBRC aims to remove this type of shadow banking from China eventually.⁸²² It means a great step if the regulatory authority does so, and it brings the light to the future of banking system in China. But presently, it is under intensive scrutiny.

Although the definition debates are continuing in the in academy worldwide, other definitions are discussed by varied institutions. There are debates in what exactly should be included in shadow banking: for instance, 1) bank-like organisations and their operations; 2) financial institutions that operates outside of any regulatory framework are considered as shadow banks; 3) as most scholars agree, it is all financial institutions that are excluded from commercial banks.⁸²³ All in all, the definition of shadow banking is not concluded, and caused debates in China, which is difficult to find solutions and regulated by law and regulations.

Currently in China, there are several behaviours in financing: 1) regulated ways for bank lending; 2) illegal and unregulated ways of financing; 3) other institutions and businesses that issue hidden loans.⁸²⁴ Because they are still unregulated, and they have much easier standards to permit loans, they have been permitting loans for SMEs. According to Shen, person-to-person platform, which users use online platforms rather than traditional financial institutions

⁸²¹ Shen W, supra n 803.

⁸²² Ibid.

⁸²³ Yan Q M and Li J H, supra n 810. chapter 3.

⁸²⁴ Ibid.

have grown rapidly in China as a form of shadow banking.⁸²⁵ Many consumers use this platform and are mainly SMEs badly in need of financial support.⁸²⁶ In the short term, there will be regulations and laws to regulate relevant activities, so the financing for SMEs would be a new challenge again in China. In the long term, the environments in politics, economy and law are needed for encouraging SMEs growing in this particular emerging market.

In terms of regulatory improvement, it needs to be look closely and enforce rules based on the reality. We can see that China's market has experienced rapid growth in shadow banking due to the difficulty of gaining loans from state controlled banks, and many wealthy families use the channels to gain more assets, further to embrace their businesses. However, the lack of regulation will put customers and their businesses at huge risks. Then how to regulate shadow banking system and implement future regulations? In dealing with the debt crisis, the State Council and CBRC offered 5 per cent of non-performing loan ratio to the loans borrowed by SMEs.⁸²⁷ IMF suggested that having a set of policies might control the size of shadow banking, or guide financial intermediation with new regulatory practices might help.⁸²⁸ Which is one of the fast and efficient way of solving issue in the short term. It also might be worth learning from Western practises in the sense of considering some elements: 1) before creating the proper framework for regulating shadow banking, systemic information is needed. As suggested by Adrian and Shin, systemic information needs to be

⁸²⁵ Shen W, *supra* n 803.

⁸²⁶ *Ibid.*

⁸²⁷ *Ibid.* 24.

⁸²⁸ Errico L, Harutyunyan A, Loukoianova E, Walton R, Korniyenko Y, Amidži G, Abushanab H, Shin H S, *supra* n 814, 4.

gathered from a wider scope of entities, including hedge funds, 2) regulators will need to maintain a focus while enforce rules.⁸²⁹ These two elements are supported at London G20 meeting, and they will be guideline for future regulatory framework.⁸³⁰ However, most important is the Chinese government's need to consider reform the lending system and create more appropriate and regulated financial products to solve the issue completely.⁸³¹ Such as Wenzhou, has been a "special financial zone" trying to legalise shadow banking locally.⁸³² It encourages new small financial firms, buying and investing other financial products, easier loans, capping interests rates in lending, and other ways in order to crack down on loan sharks and unregulated shadow banks.⁸³³ While the goal of creating a framework or making new policies, while building regulated banking framework, the possibilities of providing long-term savings, mutual fund or pensions, and bonds might be solutions.⁸³⁴ State-owned banks will also have to change their practices in lending to compete with shadow banks, and potentially improve lending policies and procedures to SMEs. Due to the policies and central government's guidance, SOEs still gain a lot more loans than SMEs in China. However, rarely they return the loans on time or they are not able to return at all. In contrast, some SMEs are able to return loans and drive economy growing in China while the policy and experiments favourable in my opinion.

⁸²⁹ Adrian T and Shin H S, "Shadow Banking System: Implications for Financial Regulation", *Federal Reserve Bank of New York Staff Reports* (July 2009) 382 https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr382.pdf (accessed 28 September 2016), 15.

⁸³⁰ Ibid.

⁸³¹ Shen W, *supra* n 803.

⁸³² Ibid. 25.

⁸³³ Ibid.

⁸³⁴ Ibid. 24.

6.5 Guanxi and Social Capitalism

Luo claimed that the business level of guanxi network is not heritable, nor a formal inter-organisational tool.⁸³⁵ It is not a formal way of operating business in the network, which Luo was correct on that statement. However, guanxi network has been proved to be heritable in the context of family business. Family business owners or founders have been passing over the network resources to their successors⁸³⁶.

Regarding guanxi in business level is not a formal way of organisational operations, Luo expressed that “guanxi helps a firm overcome its resource problems so that it can grow while avoiding the substantial bureaucratic costs which come from internalising operations”⁸³⁷, and Fang recognised guanxi is one of the organisational forms.⁸³⁸ If guanxi helps firms to “overcome its resource problems” and “grow avoiding the substantial bureaucratic costs”, then as Fang stated that it builds a characteristic institutional form - “network capitalism” in the context of China. Especially during the time of reform for Chinese enterprises.⁸³⁹

⁸³⁵ Chakrabarty S, supra n 776. Fang T, Book Review, Institute of International Business (IIB), Stockholm School of Economics, (18 January 2001) *Journal of Asian Business*.

⁸³⁶ Dou J and Li S, “The succession process in Chinese family firms; A guanxi perspective” (2013) 30 *Asia Pacific Journal of Management*, 893-917.

⁸³⁷ Luo Y D, supra n 663, 44.

⁸³⁸ Fang T, supra n 835, 1.

⁸³⁹ Fang T, supra n 707.

6.6 Guanxi in the United Kingdom and China

Guanxi can be traced back to the philosophy of Confucianism, according to Luo⁸⁴⁰ and Fang⁸⁴¹. Fang has pointed out that Luo has thoroughly analysed and published the guanxi model in the literature study of guanxi for the first time.⁸⁴²

It was also noticeable that the guanxi concept was compared between China and Western in terms of networking aspect in the book.⁸⁴³ The differences of the aspect of networking in guanxi concept, are described and compared by Luo in the book:

1. Guanxi is mainly a personal relation, as in social capital; West mainly use in “commercial-based, corporation-to corporation relations”.⁸⁴⁴
2. In business practice, Chinese businesses consider guanxi as ultimate important; Western businesses enforce contracts and details in such concept.⁸⁴⁵
3. People in the context of China in the business operation lie their faith and trust in to personal trust to a substantial level; Where Westerns lie their faith and trust in the system.⁸⁴⁶

It is worthy to point out that the UK and China have different understanding from the perspective of personal experience and understanding in two contexts. Firstly, trust is built with time in both contexts, but it is easier to build in the UK rather than in China in terms of time. In other words, it is not necessary to do

⁸⁴⁰ Luo Y D, supra n 663, xiii, 342.

⁸⁴¹ Fang T, supra n 707.

⁸⁴² Ibid.

⁸⁴³ Luo Y D, supra n 663.

⁸⁴⁴ Ibid.

⁸⁴⁵ Ibid.

⁸⁴⁶ Ibid.

something first for one party in the UK context; but the situation in China is that one party must prove he/she is harmless and sincere. Secondly, after trust is built, it is still fragile in both contexts; in the UK, the trust is not easily broken, unless it is people's reputation is challenged as it is an extremely important factor in the UK. In China, trust is sometimes easy to be broken for attempting desires, mostly financial benefits. Thirdly, in the UK it is easier to build connections with strangers, and consider it is as network (guanxi in Chinese); but guanxi in China is mostly used for people in the closer relationship circle, it takes a very long time and interactions before entering into the circle of guanxi networks for people. Often when British mention guanxi, it is not the guanxi term that specifically used in China in my opinion.

6.7 Conclusion

Family businesses face many corporate level challenges, one of these with guanxi brings family businesses competitions in market, competitions in gaining guanxi and extend guanxi network, further to gain more business opportunities especially the ones with larger enterprises, SOEs and local governments. However, it also brings the side effects such as losing business opportunities when the guanxi network is broken, significant expenses used for maintaining guanxi network, risks of breaking a set of regulations and so on. From economic perspective, it may break the balance in the market, unfairness in trading, and potentially damage the law enforcement and business operation internationally.

The fundamental factor of guanxi is trust, which runs in all aspects of “guanxi model” as named.⁸⁴⁷ The description was expressing “a model of guanxi is constructed to hold together guanxi’s philosophical, sociocultural and socio-political dimensions, business-economic activities, and Chinese society and economy”.⁸⁴⁸ However, I think that guanxi does not have a particular model, perhaps it can be understood as “aspects” or “formats” rather than a model. The reason of this is in practice it is a way of doing/behaviour of Chinese nation rather than having guidance of how to operate it. A model would be a fixed operative method, but in reality, guanxi is so varied that people have no guidance of doing but more often they find themselves doing it without thinking. Therefore, there is no certain protocol to follow, nor book to keep, it merely is a feeling and instinct that guide people to act. In this sense, guanxi seems to be more difficult to be examined systemically.

Although it is more difficult to be examined systemically, it is still crucial to gain systemic information to try to conceptualise this unique social phenomenon for literature review in future. To understand the behaviour in individual and organisational levels, it is important to have the literature and theories to assist the understanding and practice. It also benefits to understand the challenges these soft mechanisms bring to business operation, then to further overcome the challenges with appropriate solutions. That is the purpose of the research in this thesis. It is a long way to achieve the proper solutions for each individual

⁸⁴⁷ In Tony Fang’s book review, he mentioned that the Luo’s research was the “first comprehensive guanxi model ever published in the literature”. Fang T, *supra* n 835.

⁸⁴⁸ *Ibid.*

enterprise, especially in family businesses, but with the continuing efforts in the area of research, it will eventually be accepted for family firms in general.

One of the crucial solutions would be building up the appropriate mechanisms. Having realised the benefits and weaknesses guanxi network might bring for business and the general economy, it might be possible to create some policies in this field such as an external risk prevention mechanism. Meanwhile, to build up internal corporate governance mechanisms for businesses and/or families to evaluate, maintain, conduct decision making process for social challenges like guanxi would be helpful. Family and business can have meetings setting up for procedures and discussions on how business performance is under the certain proportion guanxi network brings, and what shall be done with no influences of guanxi. This is also an opportunity for controlled family members and professional management team to work on the best for business. For small family businesses, it might provide an opportunity for owners to gain advice from other family members. It will further create an environment of professional and less family influential operation for family businesses. Certainly, it takes time to gain understanding and acceptance from family businesses, but with the research and practice developing in recent years, it will not be long before family businesses create appropriate mechanisms.

Chapter 7 Conclusion

This thesis examined the corporate governance challenges from a comprehensive level and an integrated manner for family businesses through a comparative approach between the UK and China, an angle which is a rarity in comparison to other studies. In the meantime, it examined China's legal framework in a managerial and social context. Corporations grow through the stages of SMEs, some survived but most do not. During the development of SMEs, corporations grow by stages, from one to the next stage, the corporations experience a lot of changes in ownership and management. These changes are the weakest time of the corporations. Ownership and management changes mostly bring risks to shareholders. Family business owners are the large shareholders in the firms, where they protect their rights over small shareholders' rights. Countries have tried to protect small shareholders' rights and minimise the damage caused. However, it is a very challenging issue for China.

Modern China does not provide a friendly environment for SMEs, most of the development especially GDP rate has been pulled up by SOEs. Therefore, the emphasis on SOEs' development has always been the task of central government. However, in the last five to ten years of central government's policies and economic development started to show that SMEs have been put under consideration more than before. Examined in second chapter, the new Company Act of China has shown encouraging SMEs to make individual changes and recognising the rights created within the firms. It also recognised the value of micro level firms. It exhibited that China's legal reform has

progressed one step further and reaching out to the advanced level with other advanced legal systems.

An old proverb says from rags to riches and back again in three generations. This is very true for family businesses. The reasons of failure are varied, but understanding the challenges is to overcome the difficulties. Majority of SMEs are family businesses, which means if knowing the analysis of challenges that family businesses face, then finding solutions for longevity will not be an issue. However, challenges come differently in varied contexts. Comparative study like this thesis could benefit family businesses to play the advantages and bypass the disadvantages in globalisation.

China has a political system with socialist characteristic, a socialist economy with market economy characteristic, a legal system with political characteristic, a social context with Confusion ideology and a mind-set which praises trust between parties. Whereas UK holds a democratic political system, an advanced case law system with “think small first” policy to encouraging SMEs, a concept of individualism which bonds parties by contracts. The family businesses in these two contexts show different characteristics, therefore, the corporate governance challenges differ from one to the other. For instance, Chinese family businesses especially the small to medium-sized firms heavily rely on guanxi network to maintain firm’s performance, whereas British family businesses mostly apply management strategies in managing firms and legally binding contracts in trade. As another example, the general policy environment also

brings different support to family businesses. British policies are more beneficial for family businesses compared with China's policies.

The existing studies in family business field normally examine one discipline that relates to family businesses. This thesis analysed several disciplines that are related to family businesses. In my view, corporate governance mechanisms and models need to be localised to specific context. The specific context includes a country's economic environment, political system, legal system and social context. Without analysis of the environment, it could be wrongfully applied to businesses. Therefore, it is necessary to analyse challenges at a more comprehensive level in relation to corporate governance of family businesses in China.

Chinese culture has educated public that each person holds several roles in society. In the case of the family business, we often see Chinese family business owners behave as fathers and the bosses in the families; they behave as bosses and fathers to their successors in the businesses. It is a very patriarchal system. British culture in contrast, tends to teach citizens to have separate roles and non-conflicting responsibilities. The separation of being fathers in families and being bosses at work is clear. The unseparated responsibilities make Chinese family businesses more difficult than British family businesses. In the meantime, British family businesses have shown better corporate governance mechanisms acknowledgement and acceptance than Chinese ones.

The family business form is a crucial business type for the economy. They exist everywhere in globe and the majority of family businesses worldwide are SMEs. The countries with advanced legal system generally create SMEs friendly environments. In contrast, the countries with less advanced legal system which have a lot of political controls do not, such as China. Family businesses face a variety of challenges in this context. China is a country with a legal system that is under reform and is under strong control of central government. Chinese legal system is not yet “rule by law” in any of the senses understood in the West. This has led to a less protected and supportive environment for family businesses. Thus, to understand the challenges for corporate governance in family businesses, the thesis explored the source of the challenges. This thesis also explained and analysed each perspective that brings challenges for family businesses in details.

This thesis is a research conducted from a macro level to lay out the challenges for family business study and find a new angel for researching family business corporate governance. Furthermore, this thesis hopefully suggests considerations for law makers and scholars in China to find corporate governance mechanisms for family businesses. It also suggests to family business scholars to conduct research on varied dimensions when examining family businesses. However, it would be more beneficial to have first-hand materials from Chinese small to medium-sized family businesses in discovering their opinions towards corporate governance, difficulties in existing legal framework, unfairness compared with large corporations and the like in China’s context. In my view, with the completion of legal framework reform,

implementation of “rule by law”, change of family businesses owners’ mind-set, guanxi and further exploration of applying legal framework to limit effect of guanxi will be found. The range of research conducted on Chinese family business is another great challenge, since China has 34 provinces and province level administrative zones. Each administrative zone has great differences in custom, behaviour and dialect, it leads to great challenges in research.

This thesis brought a new insight of understanding the challenges for family businesses through a comparative approach. Through examining business history, legal framework, political interference, managerial challenges, social and cultural obstacles, this thesis gives a comprehensive level of understanding the challenges family businesses are facing. This thesis examines the challenges for family businesses in several sections. Chapter 1 covers the research background and purpose of the thesis. It also explained the research methodology for the thesis and research limitations. In chapter 2, the examination identified business history as a new angle to research the family business field. Through the lens of business history in comparison of the UK and China, it indicates that family businesses as a crucial type of enterprises have existed in the history of business for a very long time. It raised the necessary approach to study family businesses is the comparative research as well. In the meantime, the examination of business history in a comparative approach shows that family businesses have lessons to learn from the past. It provides family business study a foundation in research that is different from other methods in the family business study. Through the lens of business history

studies, new theories and frameworks could be developed for corporate governance, family businesses, and guanxi by looking at the past.

The chapter 3 examined two different legal frameworks of the UK and China, as well as its correlation with corporate governance and the social impacts of guanxi in China. The British legal framework is built on democracy, but Chinese legal framework is built on political planning and interfering through CCP meetings. During CCP meetings, the government set tasks and goals in reforming economy and law. Transplantation was done by learning from other jurisdictions and is associated with the economic reforms in China. Discussing the policy making process, economy and legal reforms as well as the correlation is useful to understand the legal framework in China, further to understanding why China's legal system is very different. Chinese socialist politics and law are tighter in relationship than other countries, which is not very helpful for family businesses as the government has been focusing on SOEs for decades, the new amendments of Company Act 2005 and 2013 might be the turning point for SMEs. The structure of Chinese law and its features led to a later discussion of Company Law and corporate governance regulations for businesses. Furthermore, this chapter helped to discover the balance between law and soft mechanisms in society - guanxi, which strongly affects Chinese businesses' daily operation. Guanxi is also the foundation of the research as it is one of the biggest challenges that less complete legal framework needs to face. Chinese context including social cultural challenges, such as guanxi, combined with less advanced legal framework and strong political interference, is not helping SMEs particularly family businesses in market competition.

The chapter 4 examines corporate governance and mechanisms. Although corporate governance started to change for the last two to three decades in China, the legal framework and general environment is not favourable. CCP has been under pressure of embracing GDP growth rate, which means the focus has been on SOEs for pulling up the GDP rate. Therefore, even though the government announced to build a socialist country with Chinese characteristics, reforming legal framework to more advanced status and economic environment, corporate governance mostly changes among SOEs whereas in private sector it still faces tremendous challenges. Another solution for the SMEs (recalling that the majority of SMEs are family businesses) is using guanxi to compete in the market. The theories in family business study show the needs of having proper corporate governance. The corporate governance mechanisms if adapted in the family businesses could help family businesses to solve many challenging issues. In comparison of the UK and China, corporate governance in legal framework shows different source of setting: UK has developed a mind-set of “think small first” behind the law making whereas China does not. Understanding the mechanisms of corporate governance and the legal vehicles could lead to the development and longevity of family businesses. This fourth chapter also provides an extended discussion of the previous chapter - Chinese legal framework.

The chapter 5 examined family business theories and ownership. In family business theories, agency theory and ownership is examined since it is closely related to corporate governance. Yet the definition of family business is not unified, which remains to be defined. The ownership structures in the UK and

China are under strong influences from the US. Therefore, there is a brief American ownership description. Furthermore, life cycle theory in family business study is examined due to its relationship to minority shareholder protection. Family businesses have development cycles which scholars defined as life cycle theory. Many minority shareholders' rights were omitted and damaged in between the life cycle stages passing over. Large shareholders in the family business which are mainly holding families would protect the assets and their own rights over minority shareholders'. Therefore, it is necessary to understand the theories and conflicts in family businesses to determine corporate governance mechanisms. The chapter further examined corporate governance mechanisms existing in family businesses in advanced countries, hope to bring an insight for Chinese family businesses in future operation. At last, there are research findings show that although the family business is ubiquitous, cultures and contexts affect corporate culture and business strategies, especially in China's context. Knowing the advantages and disadvantages of the family business is not widely accepted in China. Family business theories and practice is also not widely accepted. The minority shareholder protection issue remains as a challenge although the government has had intention to encourage private sector by improving legal framework in the recent years. It is difficult to find a unified solution at an international or national level. Recent changes in Company Act 2013, have given more monitoring power to the public. The ongoing reforms in legal framework and application of corporate governance mechanisms, would hopefully provide the solutions to the challenge highlighted above.

The chapter 6 focuses on a soft social mechanism for businesses. Guanxi exists in all types of business operations and personal activities. It is so common for the public; however, it has strong side-effects for businesses because it is so widely and deeply influencing people's lives. In terms of family businesses, one feature of guanxi – kinship, is the foundation of family businesses. One feature of guanxi – networks, gives great advantages for family businesses in and out of China for decades. It also brings businesses trustworthy and long-lasting business partners. There are many benefits of having guanxi in business and personal activities. However, in long term, it is a challenge for China to become a “rule of law” country. For instance, some lawyers win cases or gain less level of punishment due to the close relationships with judges. It is also an obstacle for applying corporate governance mechanisms and for the fair competition in market. It is undeniable that guanxi is a long-lasting custom over thousands of years. It helps with businesses' competition in market. The chapter presents study of guanxi, more insights of guanxi and the importance of conducting further studies on guanxi because guanxi is more complex than it is understood in Western contexts. For example, guanxi in China is inherent and systematic, its application updates with rapid development of China. Guanxi is more widely used in society these days with economic, legal and social changes in new PRC.⁸⁴⁹ It affects businesses more than ever due to the current strong competition in market. Guanxi might have been seen in Western contexts as networks. However, it is used deeper and wider in China. Guanxi in China has long term effect and sometimes are not in place for both parties to be mutually beneficial. It has a function similar to debt in people's lives. In other words, there

⁸⁴⁹ Li Y Y, Parnell M F and Hawkins N, “*Guanxi*, relationship marketing and business strategy” in Brown D H and MacBean A (eds.) supra n 3.

is an additional understanding with future favours and payback once someone uses his or her guanxi network. Because of such function of favours, it can give businesses something normal methods cannot. For example, guanxi has been used to help SMEs gain fundings. Due to banking system is not well-designed to help SMEs, they seek strong favour from banks and other funding resources. Therefore, the area of shadow banking was examined in this chapter, as a result of guanxi network. There are some scholars and CCP committee members have noticeably raised the need of setting better banking system or forming better support for SMEs, there will be changes in future. Although guanxi is not a well-defined concept or theory in academia; it is changing and necessary to discover and update constantly. There have been updates since the past studies were conducted and continuing works on guanxi are needed. Guanxi needs to be balanced with appropriate legal framework and mechanisms in order to help family businesses overcome the obstacles. One solution would be to approach the issue from organisation level and apply individual corporate governance mechanisms in the context of China.

The thesis has brought insights to each of the main challenges that family businesses face in China, explored the reason of examining these challenges and the correlations of these challenges. In addition, it provided insights for future studies to conduct a combined examination over family businesses. Most importantly, the comparison of macro environments in the UK and China and further analysis of each challenge, forms the basis of learning and development of family businesses to potentially overcome the challenges. The comparison could help China to create another Chinese characteristic socialist market

economy with a better legal framework and corporate governance mechanisms for family businesses in China to overcome challenges in unique social context (especially in guanxi network) from an organisational level.

After referendum of Brexit, UK and China both need regulations on large corporations and work on encouraging SMEs. Since the financial crisis in 2008, banks have had difficulties to fund SMEs in the UK, whereas China has been growing but lack of good policies and regulations to support SMEs. SMEs benefits employment, GDP growth and stability of the economy. Chinese law makers have raised the importance of having banks support SMEs' funding sources, hopefully there will be actions taken towards funding difficulties. It also appears that there has been less flexibility for SMEs in the UK whereas China is opening individual legal flexibility for SMEs and less monitoring control from central government. With time, hopefully China will create a good corporate governance environment for family businesses, good policies to support SMEs and positive mind-set of developing family businesses.

There are remaining aspects that wait for future research. For instance, developing applicable mechanisms for family businesses in China that could overcome the influence of guanxi network and the complex background. Meanwhile, controlling or balancing the use of guanxi within legal framework, changing mind-set of family business founders and family members in China, conducting empirical research of Chinese family businesses in aspect of corporate governance mechanisms are the most desirable research in the near future. Despite the social context influence with family business study, the

connection between family business and other corporation types will be helpful to improve legal framework. In the meantime, the definition and the characteristics of family businesses which are normally examined in management science are also deserve further examination. These examinations are useful in regulating and protecting shareholders' rights in regulations.

The research of life cycle theory needs further examination as the theory needs to be updated, refined and shall be examined within individual context. Chinese legal reform remains under changes, law makers shall still learn and improve, learn from the advanced countries but avoid mistakes to catch up with the rest of the world quickly. This has been demonstrated by recent developments in legal framework in China. More importantly, the mind-set of Chinese family businesses is very much in needs of changes. It is necessary to be changed as soon as possible in order to comply with the legal reform in China.

END

Appendices

Appendix 1 There are meetings of CPC Central Committee and NPC Standing Committee held that relevant to important decisions made on legal reforming:

Time	Meeting	Highlight
18 th December to 22 nd December 1978	the 3 rd Plenary Session of the 11 th CPC Central Committee Meeting	<p>The meeting was held right after the “Cultural Revolution” and was the beginning of the "Reform and Opening Up" policy. This meeting was also seen as the beginning of the modern China starting a different path in the world stage, and it was also the political career of Deng Xiaoping, as a paramount leader of <u>China</u>, guided Chinese people to a unique journey in history.⁸⁵⁰</p> <p>In addition, there are other important rules that CPC raised during the Plenary Session. Such as, raising the importance of the principles of “rule of law”; “There must be laws to follow; these laws must be observed and strictly enforced; and lawbreakers must be prosecuted”, “From now on, legislative work should have an important place on the agenda of</p>

⁸⁵⁰ At the meeting, Deng Xiaoping replaced Hua Guofeng and continually led China and government to the socialist country with Chinese characteristics. He was the Chairman of the Communist Party of China until 1981.

		the National People's Congress and its Standing Committee.” ⁸⁵¹ Thus, this committee meeting has been seen as the initial point where China raised the importance of legislation and put “rule of law” on the agendas of the National Congresses of the CPC.
20 th October 1984	the 3 rd Plenary Session of the 12th CPC Central Committee Meeting	The decision of reforming economy was adopted, which was shown that Deng Xiaoping's leadership was determinate to pursue the economy changes and development for China. Thereafter, in 1985, the plan and goal was further completed during the 4 th Plenary Session.
9 th March to 12 th March 1990	the 6 th Plenary Session of 13th CPC Central Committee Meeting	the economic reform was exciting, at the same time it was also noticeable that the bureaucracy and corruption started along with the development as well. The Central Committee denounced that the growth of the situation. The situation was not difficult to predict, as the corruption and the ideology of using personal connections were hesitated from social and historical environment. In modern

⁸⁵¹ Zhu J W, “The Socialist Legal System with Chinese Characteristics: Its Structure, Features and Trends” (2011) XXXII (3), *Social Sciences in China*, 89.

		China, it is so-called “guanxi”.
25 th December to 30 th December 1990	the 7 th Plenary Session of 13 th CPC Central Committee Meeting	“Program of the National Economy and Society Development Decade” and guidelines was adopted, further to develop the economy of China.
5 th March to 7 th March 1993	2 nd Plenary Session of the 14 th CPC Committee Party Meeting	further approved some aspects of economic measures, a program for institutional reform was raised on agenda as well.
11 th November to 14 th November 1993	3 rd Plenary Session of the 14 th CPC Central Committee Meeting	adopted “A Decision of the CPC Central Committee on Certain Issues in Establishing a Socialist Market Economy System” and fostered the establishment of private enterprises. As commented and emphasised, this was mainly for the “Southern Trip” that Deng Xiaoping made in 1992. Further to confirm the economic reform progress even when other paramount leaders criticised about the slow economic reform. It was not difficult to see the doubts and criticism among the leaders at the time, but Deng Xiaoping and his policies was confirmed the efficiency later.
12 th October to 14 th October 1998	3 rd Plenary Session of the 15 th CPC Central Committee Meeting	reviewed the economic reform in the past 20 years and set the goal of

		establishing new rural towns
19 th September to 22 nd September 1999	The 4 th Plenary Session of the 15 th CPC Central Committee Meeting	discussed the “modern enterprise system” which was regarding the reform of the State-owned enterprises.
9 th October to 11 th October 2000	the 5 th Plenary Session of the 15 th CPC Central Committee Meeting	Zhu Rongji, who was the Premier of PRC, and a very tough administrator who believed the continued double-digit growth of Chinese economy, delivered a report and proclaimed “modernization, opening up and technological progress” as the basic goals.
24 th September to 26 th September 2001	the 6 th Plenary Session of the 15 th CPC Central Committee Meeting	when the CPC was established for 80 years, capitalists were allowed to join the Party. That certainly showed that the Party was not only developing the economy with Chinese characteristics but also from the governing leadership to accept new attendees to bring in the ideas in order to help to the unique path that PRC decided to work on. The determination and efforts that CPC made was the drive that economic reform and legal reform established.
11 th October to 14 th October 2003	3 rd Plenary Session of the 16 th CPC Central Committee meeting	the Party stated some issues that concerning the socialist market economy system. Also,

		calling for the regulations to foster private enterprise. ⁸⁵²
8 th October to 11 th October 2005	5 th Plenary Session on the 16 th CPC Central Committee meeting	The Party aimed to promote "social harmony" and stressed on the "building of democratic rule of law, justice, sincerity, amity, vitality, stability and order" ⁸⁵³
9 th October to 12 th October 2008	the 3 rd Plenary Session of the 17 th CPC Central Committee meeting	Hu Jintao delivered the report regards the rural reform and development goals for rural reform by 2020. Considering the agriculture sector has always been seen as the basis of the economy in China, and as the foundation of the people from the historical perspective. The report and the goal would only be beneficial for economy reform and meanwhile, would encourage agriculture labours in general. Thereafter, series of laws and regulations came into force to foster the development of the agriculture development.
15 th September to 18 th September 2009	the 4 th Plenary Session of the 17 th CPC Central Committee meeting	Hu Jintao (former president and chairman) delivered a report that Xi

⁸⁵² CPC People official website, in Chinese language, 中国共产党历次全国代表大会数据库. <http://cpc.people.com.cn/GB/64162/64168/64569/> (accessed 17 November 2013). Jiang Zemin's full report on the 16th CPC Central Committee meeting, which published by Xinhua News, http://news.xinhuanet.com/ziliao/2002-11/17/content_693542.htm (accessed 17 November 2013).

⁸⁵³ Ibid.

		<p>Jinping (current president and chairman) submitted, regards the major issues on improving the Party's strengths and building under new circumstances. The report emphasised the continue persistence on reform and opening up. Therefore, we could say that under the new circumstances that China in, and in the world stage, that China has achieved initial success on creating an unique path for economy and legal reform, thereafter, the Party is aiming to build and adjust itself to the new environment, meanwhile, to continually improve and maintain the leadership. This is a proof that the political, legal and economic aspects are interacted with each other, meanwhile, all the aspects developed all together with the Chinese characteristics – planning market economy with socialist society – but truthfully is the market economy merged or transplanted to socialist society and under the plan and interfere of the government.</p>
<p>15th October to 18th October 2011</p>	<p>the 6th Plenary Session of the 17th CPC Central Committee meeting</p>	<p>the Deepening Cultural Reform and Promoting Development of Socialist Culture issues were</p>

		raised. Thus, we could see that the Party deeply understood the importance of the cultural and social society building, which was important for building the ideology, further to develop economy and law aspects for the modernization.
26 th February to 28 th February 2013	the 2 nd Plenary Session of the 18 th Central Committee meeting of the CPC	the plan of aiming to restructure to a “simpler and decentralized administration” was raised. Xi Jinping’s leader team aims to improve the CPC’s work, and to further boost the economic development, and further modernize China.
9 th November to 12 th November 2013	The 3 rd Plenary Session of the 18 th CPC Central Committee meeting	Highly commented the success and achievement since opening up revolution in the past 35 years. Facing the challenges, the government is determined to continue on a path to a harmony society. Legal reform and taxation incentive are still the main focus from this meeting. ⁸⁵⁴ The legal reform is raised as “comprehensively rule the country according to the

⁸⁵⁴ The 3rd Plenary Session of the 18th CPC Central Committee Meeting (中共十八届三中全会公报全文), BBC China, 12th November 2013, http://www.bbc.com/zhongwen/trad/china/2013/11/131112_183rdannualplenum (accessed online on 29 July 2017).

		law” as the latest update of legal reform. ⁸⁵⁵
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⁸⁵⁵ Li, Anthony HF, “Centralisation of Power in the Pursuit of Law-based Governance: Legal Reform in China under the Xi Administration”, *China Perspectives*, (2016) 2: 63-68. <https://search-proquest-com.ezproxy.lancs.ac.uk/docview/1802729558?accountid=11979> (accessed online on 29 July 2017).

Appendix 2 The details of changes in Company Act 2013 set as follows⁸⁵⁶:

Before amendments	After amendments
<p>第七条 依法设立的公司，由公司登记机关发给公司营业执照。公司营业执照签发日期为公司成立日期。公司营业执照应当载明公司的名称、住所、注册资本、实收资本、经营范围、法定代表人姓名等事项。公司营业执照记载的事项发生变更的，公司应当依法办理变更登记，由公司登记机关换发营业执照。</p> <p>Article 7 The company registration authority shall issue a business license to a company incorporated according to law. The date on which the business license is issued shall be the date on which a company is incorporated. In the business license of a company shall clearly be stated such items as the name, domicile, registered capital, actually received capital, scope of business and name of the legal representative of the company. Where the items stated in the business license of a company are altered, the company shall have the alterations registered according to law, and the company registration authority shall renew its business license.</p>	<p>第七条 依法设立的公司，由公司登记机关发给公司营业执照。公司营业执照签发日期为公司成立日期。公司营业执照应当载明公司的名称、住所、注册资本、经营范围、法定代表人姓名等事项。公司营业执照记载的事项发生变更的，公司应当依法办理变更登记，由公司登记机关换发营业执照。</p> <p>Article 7 Company registration authorities shall issue business licenses of companies to the companies established under the law. The date of issuance of the business license for a company shall be the date of establishment of the company. The business license of a company shall state therein such matters as the name, domicile, registered capital, business scope, and the name of the legal representative, etc. of the company. Where any of the matters stated in the business license of a company is changed, the company shall go through the formalities for change of registration in accordance with the law, and the relevant company registration authority shall issue a</p>

⁸⁵⁶ Companies Law of People's Republic of China 2006, DATABASE OF LAWS AND REGULATIONS, The National People's Congress of the People's Republic of China, www.npc.gov.cn (accessed on 18-19 July 2017). Company Law of the People's Republic of China 2014, (English and Chinese versions) http://www.hfgip.com/sites/default/files/law/company_law_of_the_people_s_republic_of_china_2014_english.pdf, http://www.hfgip.com/sites/default/files/law/company_law_of_the_peoples_republic_of_china_2014_chinese.pdf (accessed online 17-21 July 2017)

	new business license to replace the old one.
<p>第二十三条 设立有限责任公司，应当具备下列条件：</p> <p>（一）股东符合法定人数；</p> <p>（二）股东出资达到法定资本最低限额；</p> <p>（三）股东共同制定公司章程；</p> <p>（四）有公司名称，建立符合有限责任公司要求的组织机构；</p> <p>（五）有公司住所。</p> <p>Article 23 The following conditions shall be met for the incorporation of a company with limited liability:</p> <p>(1) The number of shareholders conforms to the statutory number;</p> <p>(2) The capital contributions of the shareholders reach the statutory minimum amount of capital;</p> <p>(3) The shareholders have jointly formulated the articles of association;</p> <p>(4) The company has its name and has established an organizational structure in conformity with the requirements for a company with limited liability; and</p> <p>(5) The company has its own domicile.</p>	<p>第二十三条 设立有限责任公司，应当具备下列条件：</p> <p>（一）股东符合法定人数；</p> <p>（二）有符合公司章程规定的全体股东认缴的出资额；</p> <p>（三）股东共同制定公司章程；</p> <p>（四）有公司名称，建立符合有限责任公司要求的组织机构；</p> <p>（五）有公司住所。</p> <p>Article 23 To establish a limited liability company, the following conditions shall be satisfied:</p> <p>(1) The number of shareholders meets the quorum;</p> <p>(2) The capital contribution subscribed to by all shareholders meets the requirements of the company's articles of association.</p> <p>(3) The shareholders jointly formulate the company's articles of association;</p> <p>(4) The company has a name, and its organizational structure meets the requirement for a limited liability company; and</p> <p>(5) The company has a domicile.</p>
<p>第二十六条 有限责任公司的注册资本为在公司登记机关登记的全体股东认缴的出资额。公司全体股东的首次出资额不得低于注册资本的百分之二十，也不得低于法定的注册资本最低限额，其余部分由股东自公司成立之日起两年内缴</p>	<p>第二十六条 有限责任公司的注册资本为在公司登记机关登记的全体股东认缴的出资额。法律、行政法规以及国务院决定对有限责任公司注册资本实缴、注册资本最低限额另有规定的，从其规定。</p>

<p>足；其中，投资公司可以在五年内缴足。</p> <p>有限责任公司注册资本的最低限额为人民币三万元。法律、行政法规对有限责任公司注册资本的最低限额有较高规定的，从其规定。</p> <p>Article 26 The registered capital of a company with limited liability shall be the amount of capital contributions subscribed for by all of its shareholders, as is registered with the company registration authority. The amount of the initial capital contributions made by all of the shareholders of the company shall be not less than 20 per cent of the company's registered capital, or not less than the statutory minimum amount of the registered capital either, and the remainder shall be paid for in full by the shareholders within two years from the date the company is established; and in the case of an investment company, it may pay for the remainder in full within five years. The minimum amount of the registered capital of a company with limited liability shall be RMB 30,000 yuan. Where a greater amount is provided for by laws or administrative regulations, such provision shall prevail.</p>	<p>Article 26 The registered capital of a limited liability company shall be the amount of capital contribution subscribed to by all shareholders as registered with the relevant company registration authority.</p> <p>The provisions otherwise prescribed by laws, administrative regulations and the decisions of the State Council on the actual payment of registered capital and the minimum registered capital of a limited liability company shall prevail.</p>
<p>第二十七条 股东可以用货币出资，也可以用实物、知识产权、土地使用权等可以用货币估价并可以依法转让的非货币财产作价出资；但是，法律、行政法规规定不得作为出资的财产除外。对作为出资的非货币财产应当评估作价，核实财产，不得高估或者低估作价。法律、行政法规对评估作价有规定的，从其规定。</p>	<p>第二十七条 股东可以用货币出资，也可以用实物、知识产权、土地使用权等可以用货币估价并可以依法转让的非货币财产作价出资；但是，法律、行政法规规定不得作为出资的财产除外。对作为出资的非货币财产应当评估作价，核实财产，不得高估或者低</p>

<p>全体股东的货币出资金额不得低于有限责任公司注册资本的百分之三十。</p> <p>Article 27 A shareholder may make his capital contributions in currency or do so by contributing such non-currency property as material objects, intellectual property rights and land-use rights that can be evaluated in currency and can be transferred according to law, except for the property that is not allowed to be used as capital contributions, as is provided for by laws or administrative regulations.</p> <p>Non-currency property used for capital contributions shall be evaluated and verified, and shall not be overvalued or undervalued. Where laws or administrative regulations provide otherwise, those provisions shall prevail.</p> <p>The amount of capital contributions made by all of the shareholders in currency shall not be less than 30 per cent of the registered capital of a company with limited liability.</p>	<p>估作价。法律、行政法规对评估作价有规定的，从其规定。</p> <p>Article 27 A shareholder may make capital contributions in the form of monetary funds, or alternatively may make capital contributions with such valuated non-monetary property as physical items, intellectual property rights, and land-use rights that may be valued in monetary terms and may be transferred in accordance with the law, excluding the property that shall not be used for capital contributions as specified in laws and administrative regulations.</p> <p>The non-monetary property that is used for capital contributions shall be valued and verified, and shall not be over-valued or under-valued. The provisions on the valuation of such property as prescribed by laws or administrative regulations shall prevail.</p>
<p>第二十九条 股东缴纳出资后，必须经依法设立的验资机构验资并出具证明。</p> <p>Article 29 After the shareholders have made their capital contributions, such capital contributions shall be subject to capital verification by a capital verification authority set up according to law, which shall issue capital verification certificates.</p>	<p>删去</p> <p>Deleted</p>
<p>第三十条 股东的首次出资经依法设立的验资机构验资后，由全体股东指定的代表或者共同委托的代理人向公司登记机关报送公司登记申请书、公司章程、验资证明等文件，申请设立登记。</p>	<p>第二十九条 股东认足公司章程规定的出资后，由全体股东指定的代表或者共同委托的代理人向公司登记机关报送公司登记申请书、公司章程等文件，申请设立登记。</p>

<p>Article 30 After the initial capital contributions made by shareholders have been verified by a capital verification authority set up according to law, a representative designated by all the shareholders or a proxy jointly entrusted by them shall submit to the company registration authority such documents as a written application for registration of the company, the company's articles of association and the capital verification certificates, in order to apply for registration of the incorporation of the company.</p>	<p>Article 29 After the shareholders of a company have fully subscribed to the amount of capital contribution prescribed by the company's articles of association, the representative designated by all shareholders or the agent authorized by all shareholders shall apply for registration of the establishment of the company by submitting the written company registration application, the company's articles of association and other documents to the relevant company registration authority.</p>
<p>第三十三条 有限责任公司应当置备股东名册，记载下列事项：</p> <p>（一）股东的姓名或者名称及住所；</p> <p>（二）股东的出资额；</p> <p>（三）出资证明书编号。</p> <p>记载于股东名册的股东，可以依股东名册主张行使股东权利。</p> <p>公司应当将股东的姓名或者名称及其出资额向公司登记机关登记；登记事项发生变更的，应当办理变更登记。未经登记或者变更登记的，不得对抗第三人。</p> <p>Article 33 A company with limited liability shall prepare a roster of its shareholders in which the following items shall be recorded:</p> <p>(1) the names or titles and domiciles of the shareholders;</p> <p>(2) the amounts of the capital contributions made by the shareholders; and</p> <p>(3) the serial numbers of their investment certificates.</p> <p>The shareholders recorded in the roster of the shareholders may claim to</p>	<p>第三十二条 有限责任公司应当置备股东名册，记载下列事项：</p> <p>（一）股东的姓名或者名称及住所；</p> <p>（二）股东的出资额；</p> <p>（三）出资证明书编号。</p> <p>记载于股东名册的股东，可以依股东名册主张行使股东权利。</p> <p>公司应当将股东的姓名或者名称向公司登记机关登记；登记事项发生变更的，应当办理变更登记。未经登记或者变更登记的，不得对抗第三人。</p> <p>Article 32 A limited liability company shall prepare and make available a shareholder register, with the following items specified therein:</p> <p>(1) Names and domiciles of the shareholders;</p>

<p>exercise their rights in such capacity on the basis of the said roster.</p> <p>The company shall register with a company registration authority the names or titles of its shareholders and the amount of their capital contributions; and where items of registration are altered, it shall have the registration altered accordingly. Without registration or without registration for alteration, the company shall not act against the third party.</p>	<p>(2) Amount of capital contributions made by each of the shareholders; and</p> <p>(3) Serial number of each capital contribution certificate.</p> <p>The shareholders who are recorded in the shareholder register may exercise the shareholder's rights on the strength of the shareholder register.</p> <p>A company shall register the names of the shareholders with the relevant company registration authority. In the case of change of any registered item, the formalities for change of registration shall be completed. A company that fails to go through the formalities for registration or change of registration shall not set up a defence against any third party.</p>
<p>第五十九条 一人有限责任公司的注册资本最低限额为人民币十万元。股东应当一次足额缴纳公司章程规定的出资额。</p> <p>一个自然人只能投资设立一个一人有限责任公司。该一人有限责任公司不能投资设立新的一人有限责任公司。</p> <p>Article 59 The minimum amount of the registered capital for a one-person company with limited liability is 100,000 yuan. The shareholder shall make the capital contributions in one lump sum as stipulated by the articles of association of the company.</p> <p>A natural person may only make investment for the incorporation of one one-person company with limited</p>	<p>第五十八条 一个自然人只能投资设立一个一人有限责任公司。该一人有限责任公司不能投资设立新的一人有限责任公司。</p> <p>Article 58 One natural person can only establish one one-person limited liability company which is prohibited from investing in the establishment of another one-person limited liability company.</p>

<p>liability. Such a company may not make investment for the incorporation of a new one-person company with limited liability.</p>	
<p>第七十七条 设立股份有限公司，应当具备下列条件：</p> <p>（一）发起人符合法定人数；</p> <p>（二）发起人认购和募集的股本达到法定资本最低限额；</p> <p>（三）股份发行、筹办事项符合法律规定；</p> <p>（四）发起人制订公司章程，采用募集方式设立的经创立大会通过；</p> <p>（五）有公司名称，建立符合股份有限公司要求的组织机构；</p> <p>（六）有公司住所。</p> <p>Article 77 The following conditions shall be met if a company limited by shares is to be incorporated:</p> <p>(1) The number of promoters conforms to the statutory number;</p> <p>(2) The share capital subscribed for and raised by promoters reaches the statutory minimum amount of capital;</p> <p>(3) The issue of shares and the preparations made for incorporation conform to the provisions of law;</p> <p>(4) The company's articles of association are formulated by the promoters, and such articles of association of a company incorporated by means of share offer are adopted at the inaugural meeting;</p> <p>(5) The company has its name, and its organizational structure conforms to the requirements for a company limited by shares; and</p> <p>(6) The company has its domicile.</p>	<p>第七十六条 设立股份有限公司，应当具备下列条件：</p> <p>（一）发起人符合法定人数；</p> <p>（二）有符合公司章程规定的全体发起人认购的股本总额或者募集的实收股本总额；</p> <p>（三）股份发行、筹办事项符合法律规定；</p> <p>（四）发起人制订公司章程，采用募集方式设立的经创立大会通过；</p> <p>（五）有公司名称，建立符合股份有限公司要求的组织机构；</p> <p>（六）有公司住所。</p> <p>Article 76 To establish a company limited by shares, the following conditions shall be satisfied:</p> <p>(1) The number of promoters meets the statutory quorum;</p> <p>(2) The total share capital subscribed to by all promoters or total amount of paid-up share capital raised meets the requirements of the company's articles of association</p> <p>(3) The issuance of shares and the preparatory work are in compliance with the law;</p> <p>(4) The company's articles of association is formulated by the promoters, or is adopted at the inaugural meeting if the company is established by means of stock flotation;</p>

	<p>(5) The company has a name, and has established an organization structure that conforms to the requirements on a company limited by shares; and</p> <p>(6) The company has a domicile.</p>
<p>第八十一条 股份有限公司采取发起设立方式设立的，注册资本为在公司登记机关登记的全体发起人认购的股本总额。公司全体发起人的首次出资额不得低于注册资本的百分之二十，其余部分由发起人自公司成立之日起两年内缴足；其中，投资公司可以在五年内缴足。在缴足前，不得向他人募集股份。</p> <p>股份有限公司采取募集方式设立的，注册资本为在公司登记机关登记的实收股本总额。</p> <p>股份有限公司注册资本的最低限额为人民币五百万元。法律、行政法规对股份有限公司注册资本的最低限额有较高规定的，从其规定。</p> <p>Article 81 Where a company limited by shares is incorporated by means of promotion, its registered capital shall be the total amount of the share capital subscribed for by all the promoters, as is registered with the company registration authority. The initial capital subscriptions by all the promoters of the company shall be not less than 20 per cent of the registered capital and the remainder shall be paid in full by the promoters within two years from the date the company is incorporated; in the case of an investment company, it</p>	<p>第八十条 股份有限公司采取发起设立方式设立的，注册资本为在公司登记机关登记的全体发起人认购的股本总额。在发起人认购的股份缴足前，不得向他人募集股份。</p> <p>股份有限公司采取募集方式设立的，注册资本为在公司登记机关登记的实收股本总额。</p> <p>法律、行政法规以及国务院决定对股份有限公司注册资本实缴、注册资本最低限额另有规定的，从其规定。</p> <p>Article 80 Where a company limited by shares is established by way of promotion, its registered capital shall be the total amount of share capital subscribed to by all promoters as registered with the relevant company registration authority. The said company is not allowed to offer shares to others for subscription before the shares subscribed to by its promoters are fully paid up.</p> <p>Where a company limited by shares is established through stock flotation, the registered capital thereof shall be the actual total paid-up share capital registered at the</p>

<p>may do so within five years. Before the money is furnished in full, the company shall not offer shares to others.</p> <p>Where a company limited by shares is incorporated by means of share offer, its registered capital shall be the total amount of the actually received share capital as is registered with the company registration authority.</p> <p>The minimum amount of the registered capital of a company limited by shares shall be 5,000,000 yuan. Where the minimum amount of the registered capital of a company limited by shares is greater than the said amount, as is stipulated by laws or administrative regulations, the provisions there shall prevail.</p>	<p>relevant company registration authority.</p> <p>The provisions otherwise prescribed by laws, administrative regulations and the decisions of the State Council on the actual payment of registered capital and the minimum registered capital of a company limited by shares shall prevail.</p>
<p>第八十四条 以发起设立方式设立股份有限公司的，发起人应当书面认足公司章程规定其认购的股份；一次缴纳的，应即缴纳全部出资；分期缴纳的，应即缴纳首期出资。以非货币财产出资的，应当依法办理其财产权的转移手续。</p> <p>发起人不依照前款规定缴纳出资的，应当按照发起人协议承担违约责任。</p> <p>发起人首次缴纳出资后，应当选举董事会和监事会，由董事会向公司登记机关报送公司章程、由依法设定的验资机构出具的验资证明以及法律、行政法规规定的其他文件，申请设立登记。</p> <p>Article 84 Where a company limited by shares is incorporated by means of promotion, each of the promoters shall, in writing, subscribe for the full portion of the shares to be subscribed for by him as stipulated by the company's articles of association; if a promoter</p>	<p>第八十三条 以发起设立方式设立股份有限公司的，发起人应当书面认足公司章程规定其认购的股份，并按照公司章程规定缴纳出资。以非货币财产出资的，应当依法办理其财产权的转移手续。</p> <p>发起人不依照前款规定缴纳出资的，应当按照发起人协议承担违约责任。</p> <p>发起人认足公司章程规定的出资后，应当选举董事会和监事会，由董事会向公司登记机关报送公司章程以及法律、行政法规规定的其他文件，申请设立登记。</p> <p>Article 83 Where a company limited by shares is established by way of promotion, its promoters shall subscribe, in writing, to all shares that they are required to subscribe to under the company's articles of</p>

<p>offers to pay the subscriptions in a lump sum, he shall do so immediately; and if a promoter offers to pay the subscriptions by instalments, he shall immediately pay for the first instalment. Where a promoter invests with non-currency property, he shall go through the formalities for the transfer of his property rights according to law.</p> <p>Where a promoter fails to pay the subscriptions in accordance with the provisions of the preceding paragraph, he shall be liable for the default in accordance with the promoters' agreement.</p> <p>After the initial payment of the subscriptions by the promoters, the board of directors and the board of supervisors shall be elected. The board of directors shall submit to the company registration authority the company's articles of association, the capital verification certificate issued by the capital verification authority, which is set up according to law, and the other documents specified by laws or administrative regulations, in order to apply for registration of the incorporation of the company.</p>	<p>association, and make capital contributions pursuant to the company's articles of association. Where capital contributions are made with non-monetary assets, the promoters shall go through the procedures for transfer of property rights pursuant to the law.</p> <p>In the event of a promoter's failure to make capital contributions in accordance with the preceding Paragraph, the promoter shall bear the liabilities for breach of contract pursuant to the promoters' agreement.</p> <p>After the promoters have fully subscribed to the capital contribution prescribed by the company's articles of association, the board of directors and the board of supervisors of the company shall be elected, and the board of directors shall apply for registration of the establishment of the company by submitting the company's articles of association and other documents prescribed by laws and administrative regulations to the relevant company registration authority.</p>
<p>第一百七十八条 公司需要减少注册资本时，必须编制资产负债表及财产清单。公司应当自作出减少注册资本决议之日起十日内通知债权人，并于三十日内在报纸上公告。债权人自接到通知书之日起三十日内，未接到通知书的自公告之日起四十五日内，有权要求公司清偿债务或者提供相应的担保。</p> <p>公司减资后的注册资本不得低于法定的最低限额。</p>	<p>第一百七十七条 公司需要减少注册资本时，必须编制资产负债表及财产清单。公司应当自作出减少注册资本决议之日起十日内通知债权人，并于三十日内在报纸上公告。债权人自接到通知书之日起三十日内，未接到通知书的自公告之日起四十五日内，有权要求公司清偿债务或者提供相应的担保。</p>

<p>Article 178 Where a company needs to reduce its registered capital, it shall draw up a balance sheet and a detailed inventory of assets.</p> <p>The company shall, within 10 days from the date a resolution on reduction of its registered capital is adopted, notify its creditors of such resolution, and shall make an announcement in the newspaper within 30 days therefrom. The creditors shall, within 30 days from the date they receive the written notice, or within 45 days from the date the announcement is made in the case of those who have not received such written notice, have the right to claim full repayment of their debts or provision of a corresponding guarantee from the company.</p> <p>After reduction of the capital, the amount of the company's registered capital shall not be less than the statutory minimum.</p>	<p>Article 177 Where it is necessary for a company to reduce its registered capital, it shall prepare the balance sheet and a list of property.</p> <p>The company shall notify its creditors within ten days after the resolution on the reduction of the registered capital is made, and shall publish an announcement in newspapers within 30 days. The creditors shall, within 30 days upon receipt of the written notice, or in the case of the failure to receive the written notice, within 45 days after the public announcement, be entitled to request the company to repay the debts or provide the corresponding guaranty.</p>
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