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# Family Business in China, Volume 2

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Challenges and Opportunities

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Ling Chen · Jian An Zhu · Hanqing Fang

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# Family Business in China, Volume 2

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# 1

## Introduction

The People's Republic of China<sup>1</sup> has been established for over 70 years, but the history of its private enterprises goes back only a little more than 40 years. Most of these private enterprises were established after the launching of reforms and the opening up of the economy in 1978. Forty years later, the entire society of China has become more dynamic and creative due to the efforts of a large group of innovative, wealth-creating entrepreneurs who created new combinations of the production factors that have made China a powerhouse in the world economy.

In March 2011, *The Economist* magazine attributed the power that has driven China's economic take-off to "Bamboo Capitalism." It is not the state-owned enterprises that are changing China, but the private enterprises whose average return on investment is 10% higher than that of state-owned enterprises. Thanks to the gradual deregulation of the economy, entrepreneurial activities have sprung up like after-the-rain mushrooms. But entrepreneurial activities in China are not "equally distributed geographically." In general, the coast areas have more

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<sup>1</sup> Family business, family firm, and family enterprise are interchangeably used in this book.

entrepreneurs as well as a greater degree of privately-owned enterprises compared to inland, and the south has more than the north.

Most of China's private enterprises start from scratch and scale up gradually from small to large. They have made great contributions to the smooth progress of economic reform by providing sustained, stable, and healthy growth in the national economy. China's private enterprises can be roughly divided into three categories: (1) those that were allowed to start up after the reforms of 1978, (2) derivative enterprises that were formerly state-owned, collectives, or township, communal, and brigade enterprises, but were transformed into privately-owned firms, and (3) foreign private enterprises that have been established and developed through foreign capital and Sino-foreign joint ventures. With the passage of time, the differences between the three types of enterprises have gradually declined. They all face challenges that are similar to those faced by Western enterprises, including survival and development, succession issues (especially for family businesses), innovation, and localization/internationalization.

## 1.1 Family and Family Business in China

Thousands of years of political, economic, and cultural factors have stamped a deep "family stigma" on the current social and economic organizations' operating management. The great cornerstone of Chinese culture always comes back to the concept of family, which plays an important part in the cycle of self-cultivation, family harmony, country governance, and peace of the world. The family unit, not the individual, is the most basic cell in Chinese society.

In fact, one important reason why the State of Qin was able to unify China in 221 BC was due to the launching of the Shang Yang Reform<sup>2</sup> in its early stage. One of the core contents of the reform is to use family

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<sup>2</sup> Shang, Yang (390–338 BC) introduced several social, economic, and legal reforms that fundamentally strengthened the power of the State of Qin. These reforms included implementing a legal system that treated all citizens equally, favoring agriculture over commerce, encouraging the cultivation of unsettled lands, privatizing land to farmers, assigning free land to soldiers, and rewarding farmers who exceeded quotas.

household as the unit to recruit soldiers. Also, in order to ensure sufficient tax revenue, fathers, sons, and brothers were not allowed to live together after adulthood. Such early legal requirements for family separation led to the later miniaturization of Chinese families (“grown tree gets branches, and grown adult gets independence”).

For the Chinese society, a regular nuclear family is often formed by a husband and wife and minor children. Also, for an “ideal” family in China, it is expected that all family members share love, trust, and altruism. One substantial difference between Chinese and Western societies is that there is almost no dominant religious belief in China. Instead, it is the worship of family ancestors that fulfills the function of religious belief by regulating family members’ behaviors. People often worship during a traditional predetermined period such as the anniversary of the death of ancestors, the Spring Festival, Tomb-Sweeping Day, or the Winter Solstice, among others. For Western society, under the influence of the universality of Christianity, the idea that “everyone is a child of God” weakens the ethical relationship between generations within a family. If the long run of history counts, then the five thousand years of family cultural heritage and ethical rules in China might have more profoundly affected the development and inheritance of enterprises than in any other country.

Among the private enterprises that have been born since the reforms of 1978, the majority are owned and managed by entrepreneurs and their families, although some of them do not claim to be family businesses, nor do they express the hope that they can be inherited across generations. This is partly due to the prevailing dislike of the term of “family business” in China and also partly due to survival pressure that is created by market competition. In fact, business operations are like sailing in the counter-current, and Chinese entrepreneurs are so worried about their survival that they dare not plan for the next ten or twenty years. As a result, most of them have not formally thought about the relationship between the family and the business. According to data from the State Administration for Industry and Commerce of China, 21.6 million new enterprises were established in the five-year period from 2013 to 2017, so it seems that China’s entrepreneurship is in full swing. However, the average life

span of a private enterprise is only 3.7 years, and for entrepreneurs and business owners in China, business survival is still the top priority.

Many successful entrepreneurs worry that the title “family business” is not good for them because family private ownership may be seen as politically contrary to the economic system of a socialist country. For a long time in China, family involvement in business has been synonymous for “obsolete” and “outmoded.” The 40-year history of the development of Chinese private enterprises has continuously influenced family businesses, and the sector has increasingly felt the need for traditional family businesses to change in the direction of being more modern corporate enterprises.

Although most family businesses cannot yet be called “modern” and “high-level,” they should not be seen as “low efficiency” and “backward” (e.g., Chandler, 1990). Indeed, the large numbers of family businesses and their rapid growth show they must be doing something right. This combination of family ownership and management, aligned with a long-term focused orientation, gives family businesses a unique competitive advantage demonstrating rapid decision-making, high accountability and strong resilience. At the same time, when corporate leaders, successors, and important executives come from the same family system, a closed family human resource pool may limit the development of enterprises, and complex family relationships can also hinder the growth of enterprises.

In China, family businesses differ from other types of organizations such as state-owned enterprises in terms of their goals and objectives, strategic planning processes, ownership structures, and firm performances. In order to grow their businesses, many entrepreneurs take the initiative and choose the family governance model where the family provides the entrepreneur with financial, human, social, and patient capital. The family holds a high proportion of shares, and many family members participate in operations to share the benefits of entrepreneurship. Also, the relationship among family members can have a very synergistic effect, reducing agency costs and improving organizational performance.

At the same time, faced with the scale discrimination and ownership discrimination from state-owned banks and other government institutions, family businesses often choose to use a pyramid control structure in order to hide the true identity of the family. Also it is common for family businesses to develop political and social relations in order to mitigate the strong risk and uncertainty stemming from the discriminations mentioned before. Controlling families may also encroach on the interests of small and medium shareholders, which might bring in additional agency costs to the businesses.

## 1.2 Challenges and Opportunities in Chinese Family Business

At the moment, Chinese family business owners are focusing on both business development issues (growing the business and prospering in a highly competitive environment) and family succession issues (who will be the next generation leader of the business). Transforming and upgrading are necessary to address these two important issues and to achieve long-term survival of the business.

Passing the business on from one generation to the next is the ultimate goal because that will help to maintain the social and emotional wealth of the family members. With increasing pressure from factors such as financing difficulties and labor shortages, small and medium-sized enterprises with thin profit margins cannot survive. They must improve their competitive advantage by improving their technical and market capabilities and engage in higher value-added economic activities.

As it happens, many second generations members of the owning family have studied overseas or have work experience with broad international exposure. This increases the chance that the two generations can cooperate to solve inheritance issues and achieve transformation at the same time. But assuring an effective transition is not easy. Some Western studies suggest that the probability of success in passing the leadership baton from the first to the second generation is only 30%, and from the second to the third generation is only 10% (Lansberg, 1999). Such a



“succession dilemma” may be more pronounced in China compared to Western countries.

In fact, according to the “China Family Business Development Report 2011,” only about one-fifth of the first-generation entrepreneurs of the family business surveyed were willing to hand over control to a next generation that was actually willing to take control. About four-fifths of families have a mismatch during succession attempts. In addition, inheritance is a process, not a single event on the day when the scepter is handed over. Many business owners do not understand this, and most Chinese families do not have a clear succession plan. One of the reasons for this is that all private-owned enterprises were started after the 1978 reform, and they did not have experience related to trans-generational family business succession. This contrasts with the experience of the “old shops” that have run for hundreds of years in foreign countries, especially Japan, the United States, Germany, and the UK.

### 1.3 What This Book Is About

In this book, we address several significant issues related to opportunities and challenges in Chinese family businesses since 1978.<sup>3</sup> In Chapter 2, we provide an overview of family business in contemporary China—its prevalence, shared features, and contribution to economic development. In Chapter 3, we discuss features and characteristics associated with entrepreneurship and business ventures in China after the 1978 economic reforms. Chapter 4 focuses on the unique succession challenges that face family businesses, such as de-familization. Chapter 5 examines succession planning in Chinese family businesses, including “vague” and implicit planning, and planning for the one-child family business. Chapter 6 draws attentions to the governance structures in Chinese family businesses, while Chapter 7 discusses Chinese family

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<sup>3</sup> Family business in China before 1978 has been discussed in *Family business in China, Volume 1: A historical perspective*.

businesses in Southeast Asia. Chapter 8 provides a conclusion to summarize the whole book.

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