

Succession and the Transfer of Social Capital in Chinese Family Businesses



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an der Universität Witten/Herdecke



Xing Ke

Succession and the Transfer of Social Capital in Chinese Family Businesses

Understanding Guanxi as a Resource – Cases, Examples and Firm Owners in Their Own Words

With 9 figures

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Preface

At present, possibly no other economic region attracts as much attention as China. Certainly, it would be redundant to list all topics of note, from growth rates to governmental control, from patent protection to spending power. And yet, some topics so far remain barely examined. One of this “blind spots” is the issue of family businesses. The reason for that neglect might be that commonly no one thinking about China takes into account family firms. When mentioning China, the public – especially in Western countries – might rather think of state-controlled or state-influenced companies. However, there are indeed family-businesses in China; in fact, there are a lot of them.

Xing Ke from Chongqing in China, author of this book, states: “[U]ntil April 2015, there were about 19.3 million registered enterprises, of which 85.6 % are private enterprises, and about 51.4 million registered individual industrial and commercial businesses. Together a population of ca. 260 million is currently employed in the private sector (SAIC, 2015¹). The majority of the private firms and almost all the individual businesses are family-owned and managed. Not only small to medium sized firms are commonly owned and ran by families, but also are some large publicly traded firms controlled by families. According to Forbes China’s Chinese Family Business Survey carried out in July 2014, 58.7 % of the 2528 firms listed on China’s A-share market are private enterprises, of which 50.3 % are family businesses².”

Nowadays Chinese family firms see themselves confronted with a challenge very well known to their counterparts in other countries: the issue of succession. It is in the nature of things that Chinese family firms sail into uncharted waters now: The ascent of private entrepreneurship after the Great Leap Forward and the Cultural Revolution as well as the economic restrictions of that period implicates that the firms now are situated in their first phase of succession in the firm’s history.

1 <http://www.saic.gov.cn/zwgk/tjzl/zhtj/xxzx/201505/P020150520619283729167.pdf>.

2 <http://gb.cri.cn/45731/2014/09/17/7493s4695306.htm>.

This should not be understood as if there has never been any family firm in China before. The expression *bainian laodian* (百年老店) points to the existence and the prestige of family-owned businesses in the past. The author explains: “This is a Chinese word describing a store, a brand or a business that has been operating for at least one hundred years. Traditionally, a *bainian laodian* was passed on from generation to generation based on the mode of *zicheng fuye* (子承父业, son succeeds father). Thus, the business was continuously operated by the descendants, or in some cases by disciples and followers of the founder, who were supposed to inherit the skills and secrets from the founder, in order to preserve the key merits of the products. As an emblem for business achievement, reputation and pride, making the business a *bainian laodian* might represent the highest goal and a key value of traditional Chinese business families. It is still a dream of many Chinese entrepreneurs and succession, therefore, has been a central concern.”

The goal of economic policy in China, manifested in 1992, to establish a socialist free-market economy was the starting signal for an unprecedented economic development. Family firms had a significant stake in this new highs and still contribute a big, not to be underestimated share to this upgrowth.

One cannot stem the tide: the time for hand-over has come. However this process takes place in an economic, but also cultural context that could not be more different from the frame conditions known and common in Western societies. One feature is of paramount importance to the management of succession within a Chinese family business: the one-child-policy, in effect since the end of 2015. Needless to say, this directive has an impact and implicates very specific constraints.

A second feature which determines how Chinese family-entrepreneurs handle succession-issues involves the practice and the transfer of “*guanxi*”. The expression, in Western societies often rashly misconceived as sleaze, clique or nepotism, denotes a concept that is essential for successful or unsuccessful succession. More neutrally translated as “network” or rather understood as “social capital”, this characteristic has high importance also in non-Chinese family-businesses. However, operating in a surrounding shaped by weak political institutions and underdeveloped regulatory systems, “*guanxi*” is much more than good contacts, a network or a cartel. “*Guanxi*” is a resource, it ensures a firms’ continuity. Elaborated skills are required to build up and preserve each “*guanxi*”. It is comprehensible that the founder-generation often is perplexed or feels snubbed when the next generation – in many cases educated in Western countries – does not understand the concept of “*guanxi*” or even declines it.

Chinese family firms and their arrangements for succession can only be understood in the context of Confucian tradition. Even today, this tradition determines the dealings beyond social distinctions and generational boundaries.

What seems puzzling or old-fashioned to the Western observer – or business-partner – is more than simple variety: it determines how the majority of processes in the country are realized. Or vice versa: Without a certain knowledge and understanding of Confucian tradition, China – even China in the 21st century – cannot be decoded. Often enough we feel irritated simply by having a look beyond our national borders at our neighboring countries and by the peculiarities and differences in the mentality found there. Even stronger is a feeling of strangeness and non-understanding across a far-stretching cultural distance. China is the prime-example for a Western-influenced appearance with strong cultural subsurface-streams.

It is the remarkable achievement of Xing Ke having investigated the succession-arrangements in Chinese family-businesses in an ambitious study. Xing Ke from Chongqing in South-West China has submitted a unique case-study with her PhD thesis “Chinese Family Business Succession: A Social Capital Approach”, written at Witten/Herdecke University in Germany 2016, supervised by Professor Dr. Carsten Herrmann-Pillath and Professor Dr. Rudolf Wimmer. The author has compiled a wide scope of opinions, proceedings and problems evolving around succession – gathered by interviews, discussion groups and media research. The cases and the original quotations are of high relevance showing the similarities as well as the differences in handling succession-matters. Her respondents showed great frankness in sharing their considerations and experiences with her.

For all readers willing to look behind the scenery of economic news and statistics – may it be for sheer interest or clear business considerations – this book as part of the publication series, edited by the Witten Institute for Family Business (WIFU), offers authentic contributions, rarely to be found. Not less than 63 firms compose the data groundwork for Xing Ke’s research.

In favor of the practical relevance, characteristic for the Witten Institute for Family Business (WIFU), this book diverges from the thesis and emphasizes different aspects. Firstly, the book is supposed to place emphasis on the historical, cultural and theoretical frame-conditions the businesses are operating in. Secondly, it focuses on the portraits of and interviews and discussions with Chinese entrepreneurs and their successors. The author has kindly agreed with shortening her thesis to some degree in favor of accentuating certain aspects, as mentioned. This revision is only justifiable because the thesis is accessible in the original and the reader may refer to it for a deeper understanding of the author’s scientific and theoretical approach.

The Witten Institute for Family Business (WIFU) hopes to raise the reader’s awareness for issues concerning business succession and it also hopes to contribute to a deeper understanding of success and failure factors for the handover of a family-business. In this sense, this publication may represent an enrichment.

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Part I.
The Question in Focus

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Chapter 1. Introduction

1.1 The Rise of Family Business in China

The rapid rise of the private sector in China since the launch of the reform in 1978 has drawn the attention of scholars and observers, many of whom also made the effort to ferret out evidences to argue for the importance of private enterprises to the widely recognized fast economic growth in China. Generally, the private economy in China takes two major forms: private enterprises (*siying qiye*, 私营企业) and individual industrial and commercial businesses (*geti gongshanghu*³, 个体工商户). Due to the deficiency of statistics as well as the complexity of firm registration realities⁴, it is an arduous task to gauge the exact scale and structure of the private economy. However, a glimpse of the official data released by the State Administration for Industry and Commerce of the People's Republic of China (SAIC) could enable a touch of the salience of private enterprises in China: until April 2015, there are about 19.3 million registered enterprises, of which 85.6 % are private enterprises, and about 51.4 million registered individual industrial and commercial business. Together a population of ca. 260 million is currently employed in the private sector (SAIC, 2015⁵). The majority of the private firms and almost all the individual businesses are family-owned and managed. Not only small to medium sized firms are commonly owned and ran by families, but also are some large publicly traded firms controlled by families. According to Forbes China's Chinese Family Business Survey

3 Also called *getihu* (个体户, i.e. individual/household business). Individual business is owned and managed by an individual or a family. Historically individual business is limited to no more than 7 employees although many *getihu* grew beyond this formal limit. This limit was abolished in 2011.

4 Some private enterprises register in other forms, e.g. red-hat firms and rented collectives, see Gregory et al., 2000:20.

5 <http://www.saic.gov.cn/zwgk/tjzl/zhtj/xxzx/201505/P020150520619283729167.pdf>.

carried out in July 2014, 58.7 % of the 2528 firms listed on China's A-share market are private enterprises, of which 50.3 % are family businesses⁶.

Family business in China experienced extinction when the grand scale of confiscation and collectivization after 1949 ruined the private sector and re-emerged along with the economic reform, i.e. the "Reform and Opening Up" program which introduced market principles, started in 1978. The family business population expanded rapidly since Deng Xiaoping's southern tour in 1992, which cleared the ideological and political obstacles to the development of private economy and brought the "spring of private enterprises" including a large wave of entrepreneurial activities called "*xiahai*" (下海, literally means go into the sea. It's a metaphor that describes the situation in which people give up the jobs in government, public institution or state-owned enterprise and start their own business). These first-generation entrepreneurs surfing this tide are now approaching their retirement age. Consequently, a lot of family businesses have been or will be facing the challenge of passing the baton to the next generation.

Succession of family business has been regarded as a critical and problematic issue around the world, as many statistics have revealed the high failure rate of intergenerational transition. For instance, there is a widely cited estimation stating that in the US, "only 30 percent of the family firms survive the transition to second generation and only 10 percent make it to the third generation" (Handler, 1994). Especially in the first transition, without any former experience and guidance, and due to the highly complex contexts, the family business stakeholders could easily fail in conducting a satisfying and successful succession that ensures the continuity of the family business. Therefore, numerous studies, having recourse to various theoretical frameworks, have contributed to generate knowledge on family business succession, which, for instance, help to reveal the various determinants of effective or successful succession.

In China, it is impossible to estimate a success rate from the historical records because most family businesses are either just about to face or finding themselves in the middle of the transition from the founder generation to the second one. However, one could speculate that in a transitioning and emerging economy, family business might face a different set of challenges and contextual constraints in the cross-generational transition compared to its counterparts in more developed economies in Europe or the US. Besides, the stakeholders of Chinese family business are inevitably shaped by the distinctive Chinese culture, as many scholars have pointed out, that the Chinese tend to hold different cultural values, with distinctive mental programming as Hofstede (1980) calls it, compared to the Westerners. This suggests that they tend to behave more or less differently from the Westerners or people from other cultures even when they face similar sit-

6 <http://gb.cri.cn/45731/2014/09/17/7493s4695306.htm>.

uations. In other words, the Chinese family businesses might deal with the succession problem differently, which could lead to exclusive outcomes and phenomena. However, a review of the literature reveals that there is still very limited knowledge about the process of family business succession in China and the underlying forces shaping it.

This gap in literature is unfortunate because on the one hand, we fail to fully understand a major sector of the second largest economy in the world and on the other hand, we might miss the important lessons to be learned in either the successful stories or the failed experiences of family business succession in diverse contexts. In fact, scholars have begun to pay more attention to the context in which family business operates, namely, the institutional, organizational, and temporal underpinnings – such as legal infrastructure, economic development, and national culture – which could heavily affect the behaviors, decisions and performances of family firms.

Some scholars have pointed out that the specialty of the Chinese family business in terms of, for instance, the characteristics of entrepreneurs, the organization of business and the Confucian values and business culture etc., all demonstrate the need for incorporating a more comprehensive perspective on the family business in China. That is to say, it must be considered that the succession process of a Chinese family business, as a set of human decisions and behaviors, is embedded in the economic, political, social and cultural contexts that are specific to China.

The rich family business literature contributed by Western scholars based on their study of Western family businesses generally provides a good reference to the researchers and practitioners who want to understand Chinese family business. However, to what extent these Western-molded theories and knowledge are applicable to the Chinese context is questionable.

The overseas Chinese business organization – family business as a central form of it – has attracted a lot of scholarly attention since the 1980s, which has resulted in many insightful findings. Since the Chinese in mainland share the same cultural origin with the overseas Chinese, those findings might be illuminating in terms of understanding the behavioral logics and implications of family businesses in the mainland. However, we don't know yet how far they can apply to the mainland as the economic, political and social conditions there are significantly different.

Therefore, this study aims at filling this gap by examining how the Chinese family businesses handle the succession issue and why they make such decisions.

1.2 “Still largely under-investigated”: The Research Gap

Generally, the literature on family business succession is abundant. As one of the most researched topics in family business literature, succession is treated by scholars as one of the key challenges or problems that family business will inherently face, thus researchers have been highly motivated to figure out the factors that could impact the succession process and outcome. By controlling these factors, the family business might have a better chance to conduct a successful succession and secure the family business continuity. Suggestions were provided accordingly so that the related parties can make the corresponding decisions and conduct the right actions – to make proper plans, to choose the right successor and train them purposefully, and to let go the power etc.

Family business succession has also been viewed as a process of interactions of relevant actors, while interactions involve making decisions regarding different issues at different time points. Some scholars have attempted to explain the key actors' decisions and behaviors in succession process applying various theoretical approaches.

Despite its plentifulness, there are a few deficits in the extant literature on family business succession. There are two major gaps in the management succession research. One gap lies in its lack of theoretical coherence as “although extant work explicitly acknowledges the multi-level nature of family business succession, few if any studies attempt to theorize or test multi-level relationships” (Long and Sharma, 2013).

The other much neglected area in literature relates to the fact that it has mainly focused on the “what” of succession and “tended to ignore the benefits to be found in developing theory aimed at explaining not just the ‘what’ of family business succession but the ‘how’ as well as ‘why’” (ibid.).

Additionally, the problem of embeddedness has received scant attention, as Wright et al. (2014) pointed out, “recognition of the heterogeneity of the contexts in which family firms operate is only now emerging”. The majority of the family business succession literature is based on the study of family businesses in the Western context thus failed to provide enough insights on succession of family business in non-Western contexts such as in China, where the cultural, institutional and social settings are significantly distinctive.

Despite that there are numerous studies addressing the succession issue, the literature gap on Chinese family business succession remains wide and the studies on succession published in Chinese are also scarce. One reason might be that the private sector has been systematically suppressed and under-represented in the economic system until recently. For a period of time, family business was “ideologically discriminated” as demodded and inefficient (Chen, 1998). And more importantly, most of the currently existing Chinese family firms have a

comparatively short history. Therefore, the research on family business in China only dates back to 1990s and began to draw more attention in 2000s. After more than 20 years of development, the Chinese literature in the field of family business research is largely enriched, however, the succession of family business is still largely under-investigated. Comprehensive and in-depth studies are rare.

Alongside its scarcity, the majority of the research on Chinese family business succession is the applications of theories and analytical frameworks developed by Western scholars, thus has on the one hand inherited the deficits of Western literature such as lacking a comprehensive theoretical framework and failed to capture the contextual complexities of Chinese family businesses on the other hand.

1.3 Research Question and Methodology

To fill in the above-mentioned research gaps, the author scrutinizes the topic by asking the following guiding question:

How do relevant parties make decisions regarding family business succession and why so in the Chinese context?

The underlying premise is that the succession process is viewed as the result of decisions and interactions of the stakeholders of the family and the business. The decisions and behaviors of these stakeholders reflect the underlying values, motivations and preferences of the decision makers and are inevitably confined by the specific socioeconomic, cultural and institutional contexts in which the decision makers are embedded.

In order to answer the central question, a few basic “what” (and “who”) questions must be firstly addressed:

- (1) What is family business succession? How to understand it theoretically?
- (2) Who are the key actors, i. e. decision makers?
- (3) What are the major decisions to be made in the succession process?
- (4) What contextual factors could impact these decisions?

The central question can be decomposed into the following sub-questions:

- (1) Why do the decision makers (the founder and the next generation) choose succession or non-succession?
- (2) How does the founder make arrangements for the transfer of ownership and management of the family business to the next generation? What’s her/his rationale?
- (3) How is the management successor selected?
- (4) Whether and how is the next generation nurtured and trained for the successor role?

- (5) How is social capital transferred in the succession process?
- (6) How does the successor deal with the transition, and why so?
- (7) Whether and how are the decision makers confined by the specific economic, cultural, social and political contexts?

1.3.1 A Multiple-Case Study: Why?

In order to answer these questions and generate an in-depth understanding of the family business succession process in the Chinese context, the case study methodology is employed.

Case studies have been the key qualitative methodology in family business research to date, as the case study method lends itself to answering the “how” or “why” questions and is preferred when the focus is on a contemporary phenomenon within some real-life context.

The case study design generally has two variants: the single-case study or multiple-case study. While a single-case study allows the understanding of one unique, extreme or critical case, in a multiple-case study, comparing several cases permits the understanding of the similarities and differences between the cases. The multiple-case study typically provides a stronger base for theory building or explanation. On the one hand, each family business may go through a distinctive process of succession under its specific context; on the other hand, succession is a phenomenon that concerns a large population of the family business thus patterns are also expected.

Therefore, the author chose the multiple-case study, which allows the investigation of the multiple facets of the phenomenon and enables the identification of patterns as well as a more comprehensive understanding of the topic from diverse perspectives.

1.3.2 How Data Has Been Collected

The data of the cases includes first-hand evidences collected through one-on-one, semi-structured interviews (see the interview guideline, 1.3.3), group interviews and direct observations, as well as secondary evidences collected from published entrepreneur biographies, media articles, reports and other online information.

The sample cases include three parts. The first part is made up of 33 Chinese family businesses located in Chongqing, of which the first-hand data was collected through semi-structured interviews conducted by the author.

The interviewees are founders and the second generation of these Chinese family businesses, who were interviewed on a one-on-one basis during a field research trip in Chongqing. The selection of the city Chongqing is based on two reasons. Firstly, as most Chinese family business studies are based on the analysis of firms in the more developed region along the eastern coast, there are very few studies investigating family business in inland China, where Chongqing is the biggest city. The investigation can serve as a beneficial complement, especially when regional differences are expected. The second reason is that this city is the hometown of the author, so that she was able to mobilize her personal social network to recruit interviewees. This was important because except for a few high-profile figures, most entrepreneurs distrust strangers and dislike questions probing into sensitive issues such as firm succession and their family relationships. Very few would accept interviews in particular when they won't get any practical benefits.

When recruiting the interviewees, the author tried to ensure the diversity of the family firms by including firms with different sizes (from small to large) from various industries.

These interviews lasted from 40 minutes to 2 hours, all of which were recorded. In order to make the interviewees feel "safe" to talk about issues that they regard as private or sensitive, it was promised to them that their names and the company names would not be exposed. Therefore, in the presentation of the findings, pseudonyms are used to ensure confidentiality.

The second part of the sample firms consists of 12 family businesses located in Guangdong, Zhejiang and Jiangsu provinces, and Shanghai. The author visited these firms as a member of a visiting group from the Witten Institute for Family Business (WIFU). The information about these family firms and the perspectives of the founders and the second generation were collected through group interviews and discussions. These interviews were not recorded; notes were taken during the group talks and the material was complemented by the information shared by the other WIFU group members as well as secondary data retrieved online.

The third part of the sample is composed of well-known Chinese family firms. Fragmented evidences were collected from difference secondary sources – which include biographies of the entrepreneurs, interview records, journal articles, reports and other online information – and then compiled and analyzed.

In the data analysis, the interviews were firstly transcribed and coded, and categories, patterns, and themes were identified. The three types of cases were generally treated undifferentiated in searching for general patterns as well as extreme cases of phenomenon, despite that the firms might be categorized according to different sizes, ownership structure and management feature etc.

1.3.3 Guideline for the Semi-Structured Interviews

Background Information

1. Firm Information

- Founding year
- Industry
- Business type
- Scale (e.g. number of employees, annual revenue, assets etc.)
- Ownership structure

2. Family Structure Founder:

- Gender
- age

The next generation:

- Gender
- Age
- Occupation
- educational background
- working experience etc.

Questions for the Founder

1. Entrepreneurship

Would you please share with me your entrepreneurial experiences?

Following up questions include e.g.

- Why did you found the business in the first place?
- What are the most important qualities and capabilities for doing business?
- What do you think are the most important qualities for an entrepreneur? (What is entrepreneurship/ what makes you succeed as a business-man?)
- How do you view the contribution of family members, relatives and friends to the founding and development of the business?

2. Management and Leadership Style

What's your management and leadership style?

Following up questions include e.g.

- How do you understand management?
- Who makes the decisions of the firm?
- Are there other family members working in the firm? What are their roles?
- Have you employed non-family managers? Why?
- How is your relationship to the employees?

3. Family Relationships and Guanxi

- Who are your family members?
- How would you describe your relationship with your children?

- Do you think guanxi is important for doing business? What is your opinion on guanxi?
 - Which type of guanxi matters most?
4. Succession
- 4.1 Succession or non-succession
- Whether and why do you want the second generation to succeed the business?
 - Do/did you have a succession plan and how is/was this plan communicated with family members and company stakeholders?
- 4.2 Selection of successor
- Who is your (potential) successor and why do you choose him/her/them?
 - Do/did you make the decision alone?
 - Criteria for successor selection: why him/her?
 - Attitude towards employing professional managers
- 4.3 Ownership arrangements
- How do you divide the ownership between/among your children?
 - Asset arrangements
 - Can daughter heirs get the shares?
- 4.4 Successor development
- What's the training process of the (potential) successor?
 - Founder's role to successor: as trainer, tutor, or other roles?
 - Do you teach her/him personally about the business?
- 4.5 Transfer and transition
- When and how will/did you give control to the successor?
 - When/how is leadership transferred?
 - How is guanxi transferred?
 - What will be your role after the successor takes over?
 - Have you encountered any difficulty in the succession process?
 - Is there any tension or conflict?
 - What is your biggest concern of the succession issue?
 - What are the impacts of succession on family and business?
 - Change of family relationships?
 - Has the successor brought any change to the business?
 - Are you satisfied with the performance of the successor?

Questions for the Second Generation

1. Founder-Successor Relationship
 - How do you describe your relationship with the founder?
 - Communication style and frequency, time spent together
 - Paternalistic or friendly
 - Is there any divergence of values and ideas?
2. Willingness to succeed
 - 2.1 Are you willing to succeed the family business? Why?
 - 2.2 What's the ideal career for you?
 - 2.3 Why did/will you choose to start your own business?
3. Experience and Development
 - What are your educational and working experiences inside and outside the family firm?
 - When did you join the family business?
4. Generational Differences
 - 4.1 Do you have different values and ideas about, for instance, management, family, entrepreneurship, guanxi etc.?
 - Is guanxi important for you?
 - How do you think of your guanxiability?
 - 4.2 Is there any conflict, difficulty in the succession process? How did/do you solve it?
5. Transition and Changes
 - 5.1 What's the leadership style of the founder? How do you like the founder's management?
 - 5.2 Is change of the family business necessary? What have you done to bring changes to the firm?

Part II.
Family Business Succession in Context

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Chapter 2. Family Business Succession

2.1 Defining Family Business

Before investigating the family business succession in China, what exactly is meant by family business must be clarified through a proper definition. However, this is not an explicitly simple task because a widely accepted definition of family business is still lacking, despite that the research of family business has been a fast-growing industry and gaining momentum especially in recent years. In some cases, family business researchers prefer to just leave out the step of providing a clear definition. However, it is recognized that lacking a clear, generally agreed definition may undermine the reliability, reconcilability and consistency of research results.

2.1.1 Ownership, Control and Management

Most studies tend to define family business according to a certain degree of involvement of the family in the business. The interpretations of family involvement, i. e. its components, vary greatly. Researchers are inclined to study family business hinging on their own selection of criteria of components according to their respective fields of study and specific topics that they focus on. Generally speaking, family involvement could have three dimensions:

- (1) family ownership, i. e. the family holds a large share of the firm;
- (2) governance, i. e. the family retains its power to control the firm's direction and secure its interest as shareholder through corporate governance mechanism; and
- (3) management, i. e. the members of the family – usually across generations – hold top management positions.

The fundamental dimension of family involvement is in fact family ownership, which serves as the basis for control, so that family members across generations

could exert their influences on the firm through governance and/or management.

The goal of this book is not to provide a unique or universal definition of family business, but to find an operational definition that helps with the understanding of the family business in the Chinese context. In this regard, the author defines family business as a business controlled by a family.

This seemingly simple definition, however, contains two very complex concepts: control and family. These two concepts are central to the understanding of family business as well as its succession process, but they are subject to heterogeneous interpretations in different socioeconomic and cultural contexts. Despite that the definitions can hardly capture their rich meanings and kaleidoscopic manifestations in the real world, the general meanings are given here:

Family refers to one or more members from the same social group, the members of which are linked by blood, marriage or adoption relationships. The exact boundary and meaning of family may vary across cultures and depend on the group's own interpretation.

Control means having the power to determine or significantly influence the direction, strategy and major decisions of the business.

The right to control the business essentially derives from ownership, but in modern corporations, there can be a separation of ownership from control. Therefore, family control is based on controlling ownership and/or management dominance (managerial control). Controlling ownership usually refers to holding the majority (i. e. over 50 %) of the shares or voting rights. However, in firms with comparatively dispersed ownership structure such as the publicly traded companies or special designs such as Facebook's dual-class share structure or pyramids, control may be achieved with a much less shareholding. Management dominance, irrespective of ownership, means that the family has the power to appoint (by dominating the board) or occupy (by dominating the top management) top management positions, thus dominates the strategic as well as operational decision making. In less common cases, the family could also dominate management without controlling ownership, when, for instance, the controlling owner cedes the right to control to the family. As long as the governance structure allows the family to dominate the strategic and other important firm decisions such as the appointments and dismissals of top management especially the leadership, i. e. the board and/or chief executive officer, it could be said that the family controls the firm.

The first-generation family business is usually controlled by the founder-entrepreneur, who not only owns the majority, sometimes all, of the equity but also dominates the management. The family members of the founder, the spouse, siblings, children etc. are likely to work in the firm management and/or become shareholders. It is a special type or stage of family business when a firm is owned

by the founder while there is no other family member being involved in the ownership and management of it, as empirical evidences showed that there is a high tendency for the founder to pass the ownership of and control over the business to her/his children – a process called family business succession. The succession is primarily a transfer of ownership, by which the next generation family members are entitled to sit in the board or work in the top management.

In small firms where an effective board is absent, control of the business is largely in the hands of the manager. Choosing a family member as the manager helps eliminate the agency problem, aligning the interest of the manager and the owner through family relationship. This is especially the case in the context of transition economy with weak legal and institutional frameworks. Therefore, most families tend to choose a family member to assume the manager position, rendering the firm to be continually family managed.

2.1.2 Family Business Succession: Keep the Control

According to the family business definition adopted in this study, family business succession is essentially the transfer of control over the business from the incumbent generation to the later generation of the family. This transfer is practiced and experienced by many family businesses around the world. It brings changes to both the family and the business. Taking the Chinese context into account, the author mainly focuses on the succession process concerning the transition of the family business from the founder's generation to the second generation of the founder's family.

Intergenerational transition of the family business is a process that naturally happens as the result of the family's will to keep the control over the business when the founder has to hand over her/his control due to changes of her/his life course – aging, sickness or death that will eventually stop her/him from leading or managing the firm any further.

The research on family business succession often links succession to cross-generational continuity. Family business continuity has actually two dimensions: continued existence of the business and continued family control across generations. Therefore, when a family firm gets liquidated or sold in the first generation, it is non-succession. Although the business continues when it is sold to family outsiders – which will turn the business into a non-family business – it is seen as a succession failure since the family loses control. When the selling or liquidation happens shortly after the second generation took over, the succession outcome is also a failure. Therefore, achieving the goal of a successful succession requires the continued existence of the business under the family control, which in turn needs good management by the next generation.

Continuity emphasizes the unchanged aspects of the family business over time, while succession also has a changing part – as the founder of family firm is usually both the owner and manager, succession involves changes or transition in both ownership and management structures. As the shift of leaders could have far-reaching impact on the family business system, the majority of the succession literature has focused on management succession.

2.2 Succession Decisions: A Multi-Stage Process

Family business succession can be understood as an outcome or a status of the family business when the next generation has taken over the control. This outcome, however, is the result of a complex decision making and remaking process by relevant players and a likely long period of interactions among them. Therefore, succession is also the process of decision making and interactions. As Handler (1994) pointed out in her review of researches on family business succession, “succession is not simply a single step of handing the baton; it is a multi-stage process that exists over time, beginning before heirs even enter the business. Furthermore, the effectiveness of succession is not limited to whether a president has been designated; the ongoing health of the firm, quality of life, and family dynamics are critical to the success of the succession process.”

Accordingly, the investigation of family business succession should not be limited to a short span of the life of family business. Moreover, succession should be viewed as an on-going process of decision making instead of a one-off choice and those decisions made by the family and other stakeholders could have a far-reaching impact on the family business.

A few scholars contributed to identify key phases or stages of the process. The identification of phases has a few variations. While different researchers may develop different models of process stages, not every family business experiences the same set of stages or phases. Therefore, the goal of distinguishing stages is not to set standards but to provide tools. Dividing the process into a few phases does not deny that the process is dynamic and consecutive in nature. In fact, the categorizing of phases facilitates the identification of tasks and formulation of targeted strategies to deal with the most critical issues at a specific phase. Employing a process perspective to succession enables us to take into account the temporal variables, which increases the comprehensiveness of the analysis on family business succession.

2.2.1 Key Decision Makers

Key decision makers are those who can significantly influence or even determine the unfolding and the outcome of the family business succession process, i. e. the incumbent, the successor, and the other stakeholders. The most researched key actors in the literature are the incumbent and the successor, with attentions paid to their respective attributes, attitudes, and their relationships and interactions in the succession process.

2.2.1.1 The Incumbent

The incumbent most frequently referred to in the succession literature is the founder of the family business as the majority of the family business successions in focus are the transition from the first generation (i. e. founders) to the second generation of the founding family.

Early studies paid great attention to depict and explain the phenomenon of the founders' unwillingness or resistance to yield control of their businesses to successors. The causes of the resistance include, for example,

- (1) the psychological loss of role and image due to e. g. founder's strong sense of attachment to the business or the lack of other interests;
- (2) uncertain feelings about the managerial abilities of the potential family-member successors; or
- (3) the fear of a possible decline in the business' performance and income.

Other incumbent related factors, which impact the succession process, have also been investigated, for instance the incumbent's strategic commitment to family leadership and to specific offspring, emotions and ideas sharing, relations with offspring, expectations and personal characteristics could all affect the succession outcome. Others argued that when the firm depends excessively on the founder's ownership, management and leadership, it may face the risk of losing social capital and resources in the transition process.

2.2.1.2 The Successor

The literature has recognized that the attitude, personal traits, commitment and capabilities of the (potential) successor can greatly affect the succession outcome. For instance, Chrisman, Chua, & Sharma (1998) identified six categories of the desirable attributes of successors discussed in the literature:

- relationship to the incumbent,
- relationships to other members of the family,
- the role in family,

- competence,
- personality traits, and
- current involvement in the family business.

For example, the literature has provided a long list of personality characteristics such as integrity, self-confidence, aggressiveness, creativity, independence, intelligence and willingness to take risk etc., which are considered desirable in successors. Taking the attribute of commitment as a further example, the unwillingness of the next generation in taking over the family business is observed in some family businesses and could be explained by e.g. the unfavorable or conflicting relationship between the founder and the offspring, the offspring's dis-identification to or lack of interest in the family business, or better career choices.

2.2.1.3 The Professional Manager

The existence of non-family professional managers in the family businesses is normally the result of professionalization. When the formal governance structure is established, the controlling family can choose to delegate managerial control to the professional manager. Thus, some family businesses elect non-family professional managers, internal or external to the family business, as their management successors. In this regard, the commitment of the professional managers, who are usually considered competent, to the family firms could largely affect the decisions of the founders and the next generation family members on the management arrangements.

2.2.1.4 The Family

The incumbent and the (potential) successor's decisions could be largely influenced by the opinions and expectations of other family members. For instance, Poza and Messer (2001) pointed out that the CEO spouse often played an important yet largely invisible role in the succession process. Besides, the family represents a powerful player when it has established certain institutions such as family council, family committee or family constitution that can effectively regulate certain family business related behaviors of its members.

2.2.2 Major Succession Decisions

The literature has investigated the outcome, e.g. firm performance, of succession decisions, the determinants and impediments of successful succession, and how to plan for a succession. Besides, it mainly concentrated on management and leadership succession and paid a dearth of attention to the concurrent ownership transition.

Since succession is seen as a process and the outcome of decision making, what major decisions are made by the above mentioned key decision makers? It must be pointed out that some decision makers of family businesses could answer the key questions and make up their minds easily and swiftly while others must go through a long period of judging and weighing, considering and re-considering and being shilly-shally. This is the result of the complicated programming of each decision maker's personality, experiences, values, position, relationships, and interests etc. With the decision makers interacting with each other – all of whom uniquely shaped – the decision-making process is specific to each family business. Nevertheless, these factors affect how and why they make certain decisions, but hardly change what decisions they have to make in the succession process. The key decisions to be examined in this study are the following:

2.2.2.1 Succession or Non-succession?

The first decision regarding succession for relevant family business stakeholders, mainly the founder in the case of Chinese family business, to make might relate to the question of whether the business ought to be continually controlled by the family after the founder or predecessor steps down. This decision relates to other questions – e.g.:

- Does the business have the potential to develop further?
- Does the founding family want to cash out, sell or close the business?
- Do the decision makers want the family to control the business further?

Other than the wish and expectation of the actual controller of the family business, i.e. the founder, the next generation's willingness to take over the business can also play a critical role in this decision.

When succession is desired, the founder usually has a basic plan about succession, which needs to be further elaborated and developed into a more detailed, feasible and sound one. The necessity of a sound succession planning has been repeatedly emphasized by scholars. Succession planning is essentially the endeavor to smooth the intergenerational transition by pre-arranging and adjusting what needs to be done at a specific time point and how to do it. However,

research reveals that many family firms do not have a succession plan while others only have very vague plans.

2.2.2.2 Ownership and Management

Succession is essentially the transfer of control from the founder to the next generation family members. In the founder generation, control (both the ownership and management) is usually concentrated in the hands of the founder. How to distribute the ownership and management control among the next generation is a critical decision that the founder must make when she/he has more than one child.

In terms of ownership, the founder must decide whether and how to divide ownership among the heirs. The questions such as “are all offspring entitled to ownership?” or “will the ownership be equally distributed?” are to be considered. As control rights are normally automatically ascribed to ownership, the decision on ownership structure can affect the management structure.

In terms of management, the founder must decide whether the next generation only inherits ownership or also takes over management and the next generation family members must decide whether they want to hold managerial control or not. Each choice involves a specific set of tasks as well as the related arrangements.

2.2.2.3 The Selection of Management Successor

The founder has to choose one or more successors from the candidates' pool as the next leader(s) of the family business. The selection of management successor involves two questions: firstly, should the successor be a family member or a non-family professional? Secondly, which candidate is better suited for the role?

The criteria of successor selection may differ depending on the preference of the decision maker. There are many factors (e.g. the candidate's competence, commitment, gender, relationship to the founder, personal characteristics, cultural tradition etc.) that could impact this decision. For instance, some scholars have pointed out that the selection of management successor tends to be gendered and daughters are often neglected or excluded. Besides, some contextual factors such as one child policy have greatly constrained the founder's decision on management successor.

2.2.2.4 The Development of Family Successor

The founder, as the parent of the next generation, could largely influence the development of the family successor. How to prepare the next generation for the leader role is another central concern of the business family.

According to Le Breton-Miller et al. (2004), selecting and nurturing the successor are among the most crucial decisions to be made by the decision makers. Grooming the future successor is critical because an unprepared successor could bring disastrous consequences to the family business after the takeover. Most successors would go through a training process before managerial control is transferred to them. Applying the self-determination theory, McMullen and Warnick (2015) explained how successors can be nurtured as well as groomed to be willing and competent to take over the family business and some scholars have argued for the importance of the transfer of knowledge and social capital from the founder to the successor for sustaining the competitive advantages of the business.

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Chapter 3.

The Chinese Family Business

Scholars have begun to pay more attention to the context in which family business operates. The succession decisions are highly contingent because the decision makers are influenced and constrained by the contexts in which they are embedded. The complex dynamics of interactions in the succession process is shaped by personal interests, preference and attributes of the decision makers, who are inevitably affected by the family context, as well as the wider cultural, economic, political and legal contexts.

Therefore, when scholars try to understand, explain or predict the decisions and behaviors of the family business stakeholders, they usually resort to culture (e.g. cultural norms, values, tradition etc.), institutions (e.g. legal regimes, government regulations, etc.) and state of the economy (e.g. economic development, industry characteristics and market conditions etc.) for answers.

As the world's longest continuous civilization, China has one of the most sophisticated and complex cultures. According to Hofstede (1980), culture is "the collective programming of the human mind that distinguishes the members of one human group from those of another. Culture, in this sense, is a system of collectively held values".

The Chinese culture, according to many cross-cultural studies, differs significantly from North American or European cultures. In other words, the Chinese stakeholders of family businesses might share some values or mindsets that are rarely to be found in people from other cultures, which in term would affect their behaviors.

For instance, a distinctive feature of Chinese culture is the centrality of relationships, especially family relationships, to individuals. The Chinese conceptions of individuality insist on the fundamental relatedness of individuals to each other, contrasting to the Western culture, in which there is "a faith in the inherent separateness of distinct persons. The normative imperative of this culture is to become independent from others and to discover and express one's unique attributes." (Markus & Kitayama, 1991) The way of constructing the self can influence and even determine "the very nature of individual experience,

including cognition, emotion, and motivation” (ibid.), and eventually affect individual’s behaviors such as trusting a professional manager and decisions such as whether or not to succeed the family business.

The construal of self in Chinese culture is closely intertwined with the concept of family, no matter this self is a founder of a family business, or a successor, a father or a child.

3.1 The Chinese Context: Confucianism, Familism and Network

Early works on Chinese family business were mostly based on the study of these located outside the mainland, in e.g. Hong Kong, Taiwan, the US and Southeast-Asian countries.

A main thrust of these researches is that the overseas Chinese family business is characterized by Confucianism, familism, paternalism, nepotism, and relationship-orientation etc., which are key aspects of the traditional Chinese culture. For instance, Redding (1990) coined the notion of Chinese capitalism, a concept that “put together a number of observations on paternalistic leadership, business networking and fundamental social values and related these to a construct of ‘Chinese tradition’ epitomized in Confucianism” (Herrmann-Pilath, 2014). Yan and Sorenson (2006) pointed out that Confucian ideology contributes distinctive characteristics, such as high levels of flexibility, cooperation, frugality, and hard work, sense of mutual obligation and human- and family-centeredness, to overseas Chinese family firms.

Confucianism is regarded by many Western scholars as the source and used as a synonym of the traditional Chinese culture which underlies the business activities of overseas Chinese. Scholars who have a deeper understanding of Chinese culture might reject to equate Chinese culture with Confucianism and argue that its main source actually includes also other schools of thoughts such as Taoism, Legalism and Buddhism as well as popular culture. Nevertheless, it is less contentious that the Chinese culture is heavily influenced by Confucianism.

An important value of Confucianism is the family orientation, or familism. Wong (1985) pointed out that familism had at least three meanings: nepotism, paternalism, and family ownership. According to Chau (1991), familism in the business context incorporates firstly “the familial hierarchical status, authority pattern, and obligatory relationships as models of organizational roles” and secondly “family-like harmony, unity, loyalty, and emotional commitment as means to bond employees to enterprises”.

Scholars researching on Chinese family business have long noticed that the study of the business system should not be separated from the family system, especially the traditional family system that has been deeply rooted in the Chi-

nese culture. Wong (1988) argued that the Chinese family system largely determined the development path of the family business across generations. Li (1998) pointed out that without a deep understanding of the Chinese family system, one could hardly fully capture the development of the Chinese economy, in particular of the business organizations and Chu (2000) confirmed by stating that familial culture was the prominent feature of the traditional Chinese culture, which heavily influenced the family business.

Understanding family culture such as familism and traditions such as equal inheritance system inside the family system which characterizes Chinese families thus is the key to decipher Chinese family business succession. “In Chinese family firms, family structure is translated into the firm’s structure” (Wong, McReynolds & Wong, 1992). Therefore, the next section depicts the Chinese family culture – the traditional family system and familism as well as their involvement in the contemporary time.

3.2 The Chinese Family System

“When we begin to study any kind of social organization in China, we must start with the family system, which forms the basis of the social structure and even the structure of the state in China. It is no exaggeration to say that China as a whole consists of families, and of nothing else” (Tao, 1913).

This assertion made a century ago might have lost validity in the increasingly modernized China; however, many features of the traditional family system do have remained. Family is the one of the two subsystems of the family business. Therefore, the study of Chinese family business, as Tao advised, must start with the Chinese family.

Family is not a recent invention but a way of social organization, which came into being in the early era of civilizations. Since its emergence, family has been the most fundamental socioeconomic unit in all societies. “There is general interdisciplinary agreement about the centrality of the family to social structure throughout the world. Yet the quest for a cross-culturally valid definition of this institution has been elusive, both because of the need to distinguish between the structures or forms of family and household units and the activities they perform and because of the range of variation in family composition and activity throughout the world.” (Thornton & Fricke, 1987)

Indeed, family has never been static; rather, its structure, functions and the norms and values behind have undergone conspicuous changes. From a historical perspective, family in a given society obtains its distinctiveness along the

history of that society which clearly has its own path of evolving. That is to say, family varies vertically through time and horizontally across societies.

Vertically, the traditional Chinese family may be put in contrast to the modern one, which is characterized, by capitalism, liberalism and modernity. However, the current Chinese family system can never cut its link to history and tradition. Horizontally, Chinese family might be quite different from, say, American family or German family because family today in any given society comes to its current configuration as the result of evolvments and changes that are specific to that society.

The answers to the question of whether indeed, how and why family system in China is different from these in other societies must be searched in history, more specifically, in the traditional Chinese family system. Therefore, the following sections are about the past of Chinese family and its evolvment into the current state.

Bearing in mind the highly complex and flux nature of family, it seems to be extremely hard to give it a proper definition that can wholly capture its richness. The most promising definition of family seems to follow Thornton and Fricke's approach to define family as a network of culturally recognized social relationships which are formed based on blood tie and marriage or adoption. This network of family is part of the kin network but it has a clear boundary to separate other kin from the family, although where the boundary line is drawn is a cultural, social and historical issue, or simply a matter of personal definition or viewpoint.

The concept of household could easily serve as the dividing line, which distinguishes the family from the kin network. Therefore, in most studies of family forms and family patterns, the family network has been confined in the household. However, family network could also transcend the household because a son living far away from the household of the parents still belongs to the family. Although residential distance may affect the dynamic and quality of the relationships, what defines a relationship is not physical distance but rather the dynamics of interactions, the mutual recognition of rights and obligations, and the psychological bond behind. In this sense, the study of family is the examination of the configuration of the network and how it is shaped by the underlying economic, social and cultural factors.

3.2.1 The Traditional Chinese Family

Studies of family usually distinguish the traditional form of family, which mainly existed in pre-modern times, from the modern or post-modern family that is characterized by capitalism and modernity. Tradition gives birth to modern. The

similarity of family businesses in different regions may ascribe to the general rules of capitalism and economics; the discrepancy, however, might be the result of culture and tradition. To understand Chinese family, especially, its “Chineseness”, a closer look at the traditional family is indispensable.

The most frequently mentioned characteristics of traditional Chinese family include large household size, common property and common budget system, patrilineal structure, patriarchal power relations, equal inheritance system, and family-oriented value system termed familism. The majority of the families in pre-modern China had shared some of these attributes. The concept of the traditional family is constructed to distinguish an obviously distinctive form of family from what is regarded as common in contemporary time. It can be argued that the main features of traditional family had been roughly consistent in the agrarian China across dynasties in pre-modern times until late Qing period, when modernization began to bring radical changes to Chinese families as it had done to the families in the West.

The core concept to understand Chinese family is *jia* (家, family), which must be understood with the help of three closely related concepts, namely *jiating* (家庭), *jiazu* (家族), and *jiaye* (家业).

Jiating refers to the people who are related by blood, marriage, or adoption and live in the same household. The boundary of *jiating* is clearly drawn because it is explicit whether a person belongs to the household.⁷ This type of family network is mainly composed of immediate family relationships confined inside the household boundary. The literature on Western family has identified a few forms of family according to its different structures. This typology could also be applied to Chinese families. The most fundamental and basic form of family is commonly termed nuclear family or conjugal family, which normally consists of a husband, a wife and their children. A stem family is the nuclear family plus the parents of the husband or in fewer cases the parents of the wife. If two or more married siblings and their spouses and children live together with or without their own parents, they form a joint family. Stem family and joint family are both extended families. All these types of family share at least two features in common. The first is co-residence, namely all family members live as one household at the time of concern so that they inevitably share some resources. The other is that the family network consists of direct consanguineous, marital or adopting relationships.

7 Noting that household is not always equivalent to family. Rich families might have living-in butlers and servants in the households who are important to the running of the families but not considered family members.

3.2.1.1 Co-residence and Common Budget – a Corporate Unit

The traditional *jiating* typically comprises three or more generations of the same bloodline, forming a stem or joint family. One of the most important features of traditional family is common living and common budget (*tongju gongcai*, 同居共财).

Jiachan (家产, family properties) are commonly owned by the family as a whole. In traditional China, the notion of individual property rights is absent while the ownership unit of property is always a family instead of an individual. The commonly owned family properties – be it land, house or means of production – provide the basis for the survival and wellbeing of all family members. The family is a fundamental economic institution in traditional agrarian society, where the majority of the production of the whole society takes place. The most common occupation of traditional *jiating* is agricultural production, with the purpose of self-consumption or exchange. There are also families that are partly or wholly engaged in other types of production or business such as handicraft, merchant activities, land rent or services. Regardless of its source, incomes are pooled as the budget for the whole family.

The business of the family is called *jiaye* (家业). As the key components of *jiaye* such as means of productions – tools, house, lands etc. – are properties owned by the family, *jiaye* and *jiachan* are sometimes used interchangeably in the Chinese discourse.

Due to the comparatively low efficiency and labor-insensitiveness of traditional production as well as deficient mobility, individuals were largely bound to their family businesses. Ideally, every family member works hard and selfless for their *jiating* in their family business or outside the family, e.g. as artisan. Meanwhile the *jiating* takes care of all family members, providing them with not only materials for survival, but also the basis to realize their psychological longing for sociality, identity and meaning.

3.2.1.2 Patrilineal Boundary of the Family

Most people are aware of who belongs to the *jia* and who does not, namely there is a clear boundary that separates the family from friends, acquaintances and strangers. To distinguish *jiaren* (家人, family members) from *wairen* (外人, non-family members) is crucial because it prescribes rights and obligations between each other and indicates how one should behave. The key criteria are blood tie and marriage. Gender also matters, because in traditional Chinese family, family membership is defined patrilineally, namely only sons are considered descendants who can bring in wives to the family while all married daughters must live in their husbands' families and are no longer considered members of their

natal families. This means daughters are not legitimate heirs to the property of their natal families except for what are regarded as their dowries. Only male descendants are expected to carry forward the family name and the *jiaye*. Deutsch (2006) summarized that, “Daughters, viewed as temporary members who could not contribute to the lineage and drained family resources, were devalued in this patrilineal system (...). As daughters-in-law, they held the lowest status in the household (...).” Only the son is supposed to succeed his father, i. e. *zicheng fuye* (子承父业).

In short, the patrilineal principle setting the boundary of the *jia* and prescribing limits of rights and obligations is a key element of the traditional family system. This patrilineal ideology, when present in the mind of the decision makers of the family business, may lay a barrier between the female offspring and the family business, which keeps the daughters from inheriting the ownership and/or succeeding the management of the family firm.

3.2.1.3 Patriarchal Governance

Another component of the traditional family system is the patriarchal governance system. The eldest male is usually the family head, called *jiazhang* (家长, family head) or *yijia zhizhu* (一家之主, master of the house) who governs the *jia* with his overwhelming patriarchal power. The patriarch controls family property and labor and has the right and responsibility to make ultimate decisions and to deal with other parties such as the government on behalf of the family. The ideology behind the patriarchal governance system is Confucian ethics.

According to Confucian ethics, wives are subordinate to husbands, children are subordinate to parents, and the younger are subordinate to the elder. With related norms and obligations performed, order inside the family is naturally established in a harmonious manner. Based on this logic, the ultimate superior in a family is normally the senior male. It must be noted that the patriarch’s power is also accompanied with obligations. One important obligation is to honor his ancestor by passing on the bloodline perpetually (*chuanzong jiedai*, 传宗接代), therefore he must strive for the continued prosperity of the family. Economic prosperity and business activities are just a by-product and means of this pursuit. A second point is that the authority of the patriarch is usually absolute and unassailable inside the territory of the family. Later generations hardly have any decision-making rights although they might have the right to make suggestions. A classic example is the arranged marriage (*baoban hunyin*, 包办婚姻), in which a daughter/son has no choice but to marry the person she/he has never met or known, absolutely obeying the arrangement of their parents or grandparents.

The key to the patriarchal governance is the submission of children to the parental power and the alleged family interest. In analyzing this phenomenon,

many scholars resort to the nucleus concept of *xiao*, i.e. filial piety. Hamilton (1990) sees filial piety as “a doctrine of sincere submission, a doctrine that prescribes the superiority of the father’s role, as well as the manner of obedience given to the person in that role.” *Xiao* is “a term that can be generalized to all individuals in relation to all roles that they might legitimately occupy” (ibid.).

3.2.1.4 Familism – The Mindset of Cooperation

The bond between individual and his/her *jia* in traditional Chinese culture is so prominent that many scholars apply the concept familism to illustrate the particular centrality of family in traditional Chinese life. The familistic Chinese see their individual interests as embodied in the *jia*, which is the root of their life, their survival and the source of their meaning. Therefore, the Chinese tend to sacrifice their interest for the family’s collective good.

Based on familism, the traditional *jia* functions as a corporate unit where production and distribution are carried out smoothly under the sophisticated system of the *jia*. This system confines family membership through patrilineal principles, empowers the patriarch through filial piety and ancestor worship, and promotes solidarity and internal trust which facilitate cooperation between family members under norms of rights and obligations. Scholars such as Fei Xiaotong (1992) had long recognized that the traditional Chinese families exhibit features of corporate groups, which refer to “groups in which members put their collective interests above those of individual members and work in concert to pursue their collective ends” and such corporate features tend to remain largely intact in contemporary Chinese families.

3.2.1.5 Fenjia (分家)

Because of the familistic values, in traditional Chinese society, it is the dream for most people to have a large *jiating* with several generations living together under the same roof. This ideal was not only embodied in the morals and norms, but also incorporated in law. According to the law of Tang Dynasty, the sons and grandsons will be imprisoned for three years if they live separately when the grandparents and parents are still alive. Successive dynasties generally followed the idea of restricting family division. But in reality, only a few from the richer segments of society were able to remain undivided because the existence of large family requires not only sufficient wealth but also harmonious family relationships. Family division was often ineluctable although it was morally unfavorable.

Family division is called *fenjia* (分家) in Chinese. It happens when the large joint family is not able to sustain itself due to economic pressures or internal family tensions. The issue of *fenjia* is so complicated with regard to its causes,

timing, process and ideology behind that a detailed review is beyond the scope of this book. In short, *fenjia* is essentially the process and mechanism of the re-configuration of family properties as well as domestic power.

An important feature of *fenjia* is the equal inheritance system (*zhuzi jun-fenzhi*, 诸子均分制). Simply put, the previously commonly owned *jiachan* (family properties) such as land and house and often also *jiaye* (family business) are equally divided among sons in the family division process. What this system pursues is in fact not equality but the principle of fairness, the goal of which is to reduce intra-family conflicts and retain family harmony.

Fenjia is irrelevant to only-son families because it is essentially an issue between brothers. In traditional China, division between the brothers could happen before or after their parents passed away, but the equal principal was the norm and guideline which was usually strictly conformed with.

Fenjia has been so pervasive that even in the traditional China, a large joint family with three or more generations living under the same roof was actually a rare case. Researcher found that the most prevalent form of family was the stem family and the average size of all household in traditional China was five to six persons per family.

3.2.1.6 Jiazu (家族) and Lineage

After division, the big *jiating* breaks into several smaller *jiating* which have similar structure and path of development as the old one. In fact, *fenjia* gives birth to new families which may develop into joint families themselves and then get divided again later. These newly formed families have the same origin and ancestor, so that they are called a *jiazu* in Chinese. The several families of the same *jiazu* no longer share the properties; rather, they manage their own properties and organize their lives separately. That is to say, each family has a clear boundary. However, these families may be regarded as one *jia* (一家) because they are brothers who have the same parents and were a family when they were young. In this sense, *jiazu* become an extended version of family, but the content and quality of a *jiazu* tie is different to a family tie.

Whether a *jiazu* can still be called a family depends on the degree of cooperation and entanglement, namely, to what extent does it count as a group. The translation of family business in Chinese is commonly “*jiazu* business” instead of “*jiating* business”.

After a few generations, the links between the new families become much weaker just as the blood of the ancestor gets diluted, although they may still regard themselves as one *jia* or *zu*.

A *jiazu* may be called *zu* (族), translated as lineage. Lineages are according to Faure (1989) “self-professed unilineal descent groups”. “Those people who

considered themselves to make up a *zu* or a *fang* would have considered that as an essential bond among themselves.” The drawing of the boundary of lineage thus depends on the location and recognition of one ancestor from many in the long history of the bloodline. When this ancestor is identified, the lineage is legitimized as one group which provides certain resources to its members.

For instance, it was common for a lineage in Qing Dynasty to be an autonomous governance system with rigorous internal organizational institutions, with ancestral hall (*citang*, 祠堂), land owned by the lineage (*zutian*, 族田), lineage estates (*zuchan*, 族产), a patriarch for the whole lineage (*zuzhang* 族长), and a common genealogy (*zupu*, 族谱). Lineage was the social basis for autocratic governance of Qing regime.

An explanation is that the divided *jiating* usually lived close to each other because their inherited properties such as land were immobile. Therefore, after a few generations, most of the descendants of the original family still live in the same village. As they have the same ancestor, they would participate in some common activities such as ceremonies to offer sacrifices to ancestors, ancestral hall building and genealogy writing. These ancestor worship activities in fact serve the living instead of the dead ancestors because they provide common ground and explanation for cooperation and solidarity inside the *jiazu* or lineage, so that lineage becomes an interest-bounded, mutually supported group when facing external foes or calamities.

Sometimes in the *fenjia* process, a part of the properties such as a piece of land or a house remained undivided as the commonly or corporately held lineage property for organizing some *jiazu*/lineage activities. Besides, some business families would not divide the business and business-related property during *fenjia*.

Lineage estates or properties and business hold the separated families in the *jiazu* together by directly linking their economic interests. In this sense, the *jiazu* or lineage becomes not only a form of political organization, but also still functions as a corporate unit with close cooperation and rigorous organization and its members bonded by mutually intertwined rights and obligations, that is, it is an extended version of *jiating*. Gates (1996) called this corporate organization “patricorporations”.

Zelin (2009) has discussed the lineage trust for managing lineage properties. “Most households were too poor to sequester land as a perpetual trust, but scholars have long recognized the lineage as a fundamental organizing construct in Chinese society. In addition, the lineage with an endowment or trust had an important institution at its disposal for the enforcement of lineage solidarity and the sheltering of lineage wealth.” In her study of Zigong (located in the southern part of Sichuan province) salt manufacturers, lineage trusts were “explicitly formed as a way to amass and incorporate business property and protect it from

the predations of household division, even though the language of formation was that of ritual and ancestral veneration.” She further found that “Zigong produced large-scale investment by households, lineages and business firms with no obvious kinship or other ascriptive ties to their fellow shareholders. By the late nineteenth century many Zigong firms were also using “professional” managers”.

There seems to be regional differences of traditional family and lineage organizations (see Gates, 1996). For instance, the traditional family system and lineage were particularly strong in Guangdong and Fujian. As a native Chongqing (also Sichuanese), the author feels that traditional family and lineage system is comparatively weaker in Sichuan province (including Chongqing), which is evident in the fact that the Sichuanese are not so passionate in ancestor-worship activities such as building ancestral halls or genealogies. Many traditions such as patrilineal principles are not so strictly obeyed.

3.2.2 Inevitable Change

The traditional family was a comparatively stable system, which had undergone very few radical changes for two millennia in pre-modern China. The tremendous changes of Chinese family all happened in the last century. The following sections, then, address crucial questions of the “how” and “why” the Chinese family changed.

3.2.2.1 Modernization

The important phenomenon of modernization such as industrialization, urbanization, capitalization and individualization were often mentioned in the studies on the transformation of traditional family to its current configuration. For instance, the domination of nuclear family structure in modern society was explained as a response to the needs of the modern industrial economy. Chinese scholars generally tended to adopt the Western approach to studying Chinese family. The reasons behind might be that on the one hand, they believe in the universality of modernity and on the other hand, the process of China’s modernization has indeed been strongly influenced by learning from the West in many aspects, for instance, the life style. They found that the change of Chinese family was in many ways similar to the Western one, e.g. the decline of large extended family and increasing domination of nuclear family and the transform of asymmetric relationships – male vs. female and parents vs. children – to more equal ones. But the Chinese family is not necessarily converging to the Western

one. Even if they have in many ways similar manifestations, the content, logic and dynamic may be rather different.

According to Xu's (1992) influential work on the history of Chinese family system, in middle Ming Dynasty, the significant development of commercial economy and incipient capitalism, known as the Sprout of Capitalism in China, the traditional family system began to show signs of decline. This decline was intensified after the Sino-British Opium War, when the invasion of Western powers and Western capitalism brought drastic changes to the Chinese society and the economy. Firstly, capitalism gained momentum under Western stimulation, which crippled the economic basis of traditional family, i. e. family-based production in the natural economy. Secondly, democratic revolution, with the recruit and spread of Western ideologies such as democracy, liberty and equality, placed fierce repudiation on the traditional family system. The traditional imperial state was replaced by the Republic China in 1911, which passed laws that rejected the traditional inheritance system and patrilineal and patriarchal ideology. Since then, the traditional family system lost much of its political foundation and legal protection. However, many aspects of the traditional family system stayed untouched through deeply entrenched values, customs and traditions, especially in rural areas. The bigger blow came in the Maoist era.

3.2.2.2 De-familization and Collectivization

Chinese family system in mainland China may have followed a different path of change compared to Hong Kong, Taiwan and Singapore due to the particular policies of the Party state. After the establishment of the People's Republic of China in 1949, the Party took a set of measurements that heavily attacked the traditional family system, especially in the rural area where the vast majority of population located and the traditional family system most deeply entrenched.

The first was to strip the family of its economic foundation of production by land reform and collectivization. Land reform refers to the expropriating the lands from richer families and redistributing them to the poor on a per capita basis. The consequence of collectivization was that the family property, such as land obtained earlier, family business, and even the labor was collectivized.

The second was to eliminate the cultural foundation of the traditional family system by destroying or confiscating family halls, burning up genealogies to make the blood line relationship loosened and blurred, and promoting the status and rights of women. These activities upsurged in Cultural Revolution.

In short, in Maoist era, the traditional family had taken a heavy blow and the family was out of business. But it is still too early to sound the death knell for the traditional family, as Chu (2000) believed, "although family business disappeared once, familism and pan-familism were never away, even at the heyday

of the planned economy. They survived in disguise or in a latent form.” Similarly, Deutsch (2006) pointed out that “the patriarchy and mutual interdependence of the Chinese family survived the policies of the Maoist Chinese state between 1949 and 1976 and continued through the reform era.”

3.2.2.3 OCP: One Child Policy

Another important change-bringer is the one child policy. The Chinese family planning policy, known as the one child policy (OCP for short) and as the world’s most radical population policy, was introduced in 1979 when policy-makers believed that the strict containment of the overly large population had become an urgent must to economic reform and to an improvement in living standards.

The OCP restricts married couple to have only one child with underpinned penalties for noncompliance including substantial fines, compelling abortion, confiscation of belongings, and dismissal from work etc. In urban areas, this policy has been strictly implemented with less resistance. Although in some rural areas, couples were generally allowed to have a second child upon meeting certain criteria since 1984, a large population born after 1979 are singletons.

This usually strongly criticized policy has brought far-reaching social, economic, and cultural consequences. It directly resulted in the downsizing of family structure, as the most obvious change of Chinese family. Cao, Cumming, & Wang (2015) found that the human capital constraints resulted by the one child policy imposed significant negative impacts on within-family succession.

Moreover, as the family properties and family business will eventually be passed on to the only-child, no matter it’s a son or a daughter, the OCP might have contributed to abate the effect of the patrilineal ideology and gender inequality. The traditional patrilineal inheritance principles might be naturally abandoned by single-child families. As a result, daughters become legitimate heirs and successors in many family businesses.

Furthermore, the OCP, together with modernization and Westernization, has largely shaped the mentalities, values and characteristics of the new generations born in the reform era, some of who are supposed to assume the role of family business successors. The new generation, especially the singletons, tend to reject traditional family values which have molded their parents, and appreciate individualistic values such as freedom, equality, democracy and autonomy. Growing up in a family where there is no siblings’ competition for resources, on the one hand, singleton could enjoy better conditions for personal development such as education; on the other hand, they tend to be self-centered little emperors who are “significantly less trusting, less trustworthy, more risk-averse, less competitive, more pessimistic, and less conscientious individuals” (Cameron, Erkal, Gangadharan & Meng, 2013). All these attributes might have a profound

influence on the founder's as well as the second generation's decisions about succession.

In sum, the above-mentioned issues are only part of the factors that may render the Chinese family at present drastically different from the traditional one and also distinctive compared to the Western family. There has been a general tendency towards the decline of traditional family in terms of e.g. weakening intra-family hierarchical power structure and the abatement of gender inequality in the past century. The obligations associated with relationships have been redefined. The change still goes on.

3.2.3 Family and Family Business

The management and organization of the business owned and run by the Chinese family is generally heavily impacted by the family context, thus are very likely to be influenced by the traditional familism and family culture.

Many scholars have tried to put the Chinese management practices in sharp contrast to the Western management styles. The studies of overseas Chinese family businesses have revealed some features of the Chinese family business management, which include e.g. familism, paternalism, nepotism, human-centeredness, fragmentation and informal management.

Firstly, the leader of the family business is often the head of the family who has absolute power in deciding the operation of the business. Scholars of Chinese business tend to conclude that most Chinese family business leaders are paternalistic. Farh and Cheng (2000) identified three constituent elements of paternalistic leadership: authoritarianism, benevolence and moral leadership.

Secondly, management authority is only delegated to family members and trusted close associates. The stereotypical family business is led by a paternalistic founder who makes all the key decisions based on his experiences and intuition, with all the important positions taken by the founder's family members.

Thirdly, the management of the business is based on relational rules. Formal institutions are either non-existence or not complied with. "For Chinese, the business relationship is always subsumed under the moralistic notion of friendship, loyalty, and trustworthiness" (Sheng 1979, cf. Lee, 1996).

3.3 Other Contexts

Besides cultural distinctiveness, the decisions and behaviors of stakeholders of family business in China are also impacted by the economic and institutional contexts.

3.3.1 Economic Reform

China has grown from one of the poorest into the world's second largest economy since the economic reform, which replaced the centrally planned economy with a market-based one, gradually legitimized private businesses and privatized some of the state-owned enterprises (SOEs) and collectively-owned enterprises (COEs, e.g. township and village enterprises, TVEs). Generally speaking, the economic reform revived the private economy and encouraged its development.

The reform began with the de-collectivization of agriculture and the introduction of the household-responsibility system. Agricultural households were firstly permitted to start individual businesses in rural areas; therefore, the pioneering entrepreneurs are mostly farmers with very limited resources but full entrepreneurial spirit. Since 1992, a large number of former government officials, intellectuals, scholars, teachers, and SOE managers, etc., equipped with much better resources such as higher education and wider connections “went into the sea”, expanding the territory of private enterprises in both the rural and the urban areas. These entrepreneurs quickly became the pillar of the rapidly growing private economy. The booming of startups since the beginning of the reform is argued to have driven China's reform momentum and entrepreneurship has been a key driver of China's economic growth since the reform. In 1998, the state carried out a policy of *Guotui Minjin* (国退民进), namely retreating the state property while allowing market entry of private enterprises in competitive industries. This policy not only led to the establishments of new private firms, but also the privatization of many SOEs and COEs in these competitive industries. Some privatized firms gradually transformed into family businesses through share acquisitions.

The reform so far has not fundamentally changed the dominant role of the state-owned economy. The state has kept strong intervention in the private sector; policy-making and resource allocation have always favored the state-owned enterprises, and consequently suppressed the private economy. Besides, it has been criticized that the reform has been stagnant in recent years. Despite of these obstacles, the rapid growing private economy has developed into a pillar of the Chinese economy. Although there are also giant private enterprises such as Alibaba, Huawei, Wahaha, Wanda, etc., the vast majority of the private enterprises meet the criteria of SMEs, most of which are family owned businesses.

3.3.2 Institutions

Being in an era of transition is a double-edged sword because on the one hand, the enormous unsatisfied demands created vast entrepreneurial opportunities in various industries with easy market entry. Besides, business activities could take advantage of the institutional voids to make windfall profits. On the other hand, doing business is much riskier and unsecured compared to developed markets. Despite the fruitful progress the reform has made so far, it has not resulted in a market environment comparable to developed Western ones in terms of formal institutional infrastructures as well as entrepreneurship supporting policies.

In a transition and emerging market, business activities could be disrupted by underdeveloped formal institutional systems such as private economy unfriendly government regulations and intervention, unclear property right, underdeveloped credit system, weak contract enforcement resulted by inefficient judicial systems and information asymmetry due to the paucity of mechanism enforcing transparency. These formal institutional voids might be partly filled by informal mechanisms such as traditional norms and culture. Despite that efforts have been made to improve regulatory and legal frameworks, informal mechanisms still play an important role. Personal connections have been functioning as substitutes for formal institutional support and means to obtain resources or protection not otherwise available.

For example, the financing difficulties of small and medium-sized enterprises (SMEs) have been documented and discussed by many scholars. Although SMEs in developed markets could also have difficulties in financing, those in China have confronted even larger impediments to financial access. As Liu (2008) puts it, "Lack of financial support is a major stumbling block to SME development in China. In particular, SMEs are beset by poor credit guarantee system, dearth of financial institutions supporting SMEs, extremely high stock market threshold, and inability to obtain bank loans owing to imperfect management and poor accounting system that discourages banks from lending to them". The big state-owned banks are reluctant to grant credit to SMEs, while the small financial institutions are scarce and usually demand very high interest rates. So, SME entrepreneurs have to rely on informal finance such as shadow banks, usury and private lending from their family and friends. Chinese entrepreneurs' political connections, as another example, become crucial in getting not only bank credits, but also important information, protection and other resources that are critical to the development of their enterprises.

The above-mentioned aspects are just examples of the context in which the Chinese family business operates. Each of them, among other aspects of the Chinese context, could potentially constrain or guide the decisions and behaviors

of the family business stakeholders, and consequently affect, to a greater or lesser extent, the unfolding and outcome of the succession process.

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Part III. Some Theoretical Remarks

Please note: Differing from the original thesis the following part III has been shortened for the reader's convenience. You will find two additional chapters explaining the theoretical framework in the appendix.

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Chapter 4.

The Chinese Construct of Social Capital

As represented by the widely witnessed phenomena of globalization, an economic system apparently has no boundary because money has no nationality. Economists thus are ambitious to identify universally applicable economic rules. Social capital arises from a certain structure of the social system. This structure varies itself in different societies with distinctive culture, values, norms and institutions. Therefore, social capital clearly has nationality and is inevitably sculptured by the social context where it finds itself. This makes the insights on social capital in Western societies not necessarily applicable to East Asian societies, especially China where the social, cultural and political contexts are to a large extent particularistic. Accordingly, a social capital approach to research on family businesses in China must be calibrated and localized to the Chinese context.

4.1 Three Dimensions of Relationships

As social networks are the source of social capital, the nature of social relationships – the content, structure and underlying process – determines the nature of social capital.

A person could possess various types of social relationships which can be classified into three categories:

- (1) relationships ascribed by birth, blood, or marriage e.g. family, kinships, in-laws etc.;
- (2) happened relationships, e.g. neighbors, classmates or alumni, teacher-student, co-workers, colleagues etc.; and
- (3) acquired or achieved relationships, e.g. friends, business partners, etc.

In the Chinese context, as will be discussed below, social relationship and social capital seem to be rather different from the Western constructs. The character-

istics of Chinese social relationships are mainly manifested in the *lunli*-centeredness, relation-orientedness and the pervasiveness of *guanxi* practice.

The centrality of relationships in Chinese life roots in the ancient philosophies, especially the Confucianism which has dominated the Chinese culture and governance systems for more than 2000 years. Confucianism holds that human beings are fundamentally relationship-oriented and that building a strong and orderly hierarchy of relations is the key to social order.

The literature on social relationships in the Chinese context has distinguished three dimensions of relationships: the normative, sentimental and instrumental dimension.

4.1.1 Normative: *Lunli* (Confucian Ethics) and *Yi* (Obligation)

The normative dimension is about the underlying norms and values, mostly derived from the tradition, that are governing people's relational behaviors and actions. These norms and values in Chinese society are generally based on *lunli* (伦理, Confucian ethics), where *lun* means human relations with hierarchical order and *li* means norms to conform to in dealing with human relations. Confucian *lunli* defines human relationships (*renlun*, 人伦) and interprets *yi* (义, righteous) accordingly. *Yi* refers to what is considered as right, just and moral attitudes and behaviors of both parties in different types of relationships. Right and moral behaviors must be performed; therefore, *yi* also means obligations.

The most important five normatively defined relationships are the relationships between *junchen* (君臣, ruler and minister), *fuzi* (父子, father and son, parents and offspring), *fuqi* (夫妻, husband and wife), *xiongdi* (兄弟, elder-brother and younger-brother, siblings) and *pengyou* (朋友, friends). Each of these relationships – except friends – is defined by hierarchical orders and distinctive obligations. By hierarchical order it is meant that the former parties (ruler, father, husband, elder-brother) in the relationships enjoy a higher status compared to the latter (minister, son, wife and younger-brother). Paternalism is a result of this hierarchical order. In the traditional culture, the father, as the patriarch, has dictator power over almost all important family affairs and the wife and children must obey and follow. Power is often embodied in *guiju* (规矩, explicit rules) set by the ancestors or patriarchs, as those who disobey the rules are supposed to be punished.

The obligations of each role in the relationships are also defined. For instance, the Confucian classic, *The Book of Rites*, says,

“What are ‘the things which men consider right?’ Kindness on the part of the father, and filial duty on that of the son; gentleness on the part of the elder brother, and obedience on that of the younger; righteousness on the part of the husband, and submission on that of the wife; kindness on the part of elders, and deference on that of juniors; with benevolence on the part of the ruler, and loyalty on that of the minister – these ten are the things which men consider to be right. Truthfulness in speech and the cultivation of harmony constitute what are called ‘the things advantageous to men.’ (何谓人义? 父慈、子孝、兄良、弟弟、夫义、妇听、长惠、幼顺、君仁、臣忠十者, 谓之人义。讲信修睦, 谓之人利。)”⁸

The *yi* between friends is *xin* (信, trustworthiness and fidelity), as stated in the book of Mengzi (孟子).

The relationships rooted in the family – the relationships between parents and children, husband and wife and among siblings – and their corresponding *yi* (obligations) are the most fundamental and central parts of *lunli*. In this sense, *lunli* actually serves as an organizational system inside the family, which emphasizes harmonious order and obligations. For this system to function, it is very important for everyone to know her/his place as father or son, husband or wife, and to honor the obligations. For instance, the parents-offspring relationships are governed by *ci* and *xiao*. *Ci* (慈, kindness) means that parents have the obligation to nurture and educate their children with kindness. *Xiao* (孝, filial piety, i. e. respect, obedience and care to one’s parents, elders and ancestors) is the obligation of the children – irrespective of their age – and the principle to guide their behaviors.

In practice, this system has been expanded to larger communities such as the kin, the whole village and even the whole country. For ancient Chinese philosophers, the concept of family can be infinitely expanded to encompass a nation or country, even the whole world. The whole nation can be viewed like a family (*tianxia yijia*, 天下一家). Although the *lunli* originates from family, it can also be applied flexibly to the governing and organizing of the whole country. Hence, contrary to the Western society which is mainly organized and kept in order by law, the traditional Chinese society is functioning based on *lunli* (*lunli benwei*, 伦理本位, *lunli*-centered).

In a normatively defined relationship, both parties have clear obligations to the other party as well as strong expectations that the other party will honor his/her own obligations. In these relationships defined by *lunli*, the need of the self is seemingly ignored as the emphasis is on obligations instead of rights. The satisfaction of the need of the self is dependent on others fulfilling their obligations. This implies that, on the one hand, in the traditional Chinese culture, there is no individualism in the Western sense as the Confucian self only exists in relations

⁸ Translated by James Legge.

to others. Namely, it is of vital importance for the Chinese to construct and maintain their social networks and to master the art of networking. On the other hand, the Confucian self understands relationships assuming her/him as the starting point. She/he has much freedom to choose and decide the relationships which are not ascribed to her/him, e. g. friends.

The Confucian indoctrinations did not explicitly point out how to deal with the relationships outside the family except stating being loyal to the ruler and trustworthy to friends. In practice, people follow these principles in normatively defined relationships – *yi* – with much freedom to “a lesser degree to one’s interactions with relatives outside one’s immediate branch of the family, and even less yet to friends and colleagues” (Chung and Hamilton, 2001). As such, familism is generalized to non-family social organization.

According to Yang (2006), “the emergence and functioning of generalized familism in various kinds of nonfamilial organizations is called pan-familism”. Pan-familism has been found to exist in industrial and business organizations, with the Chinese paternalistic leadership style as an outstanding example of pan-familistic organizational phenomena.

4.1.2 Sentimental: *Qing* (Feelings) and *Xin* (Trust)

As discussed above, *yi* (义, obligations) is a core fabric of *lunli* and thus a core aspect of interpersonal relationships. Liang (1949) pointed out that *yi* is based on *qing* (情, sentiment, personal feelings). *Qing* in the interpersonal relationship context has two important aspects.

The first aspect refers to attachment, affection or sentiment towards the other person, which is naturally developed in the interaction process between the two persons in a relationship. In this meaning, *qing* is interchangeable with the concept, *ganqing*, which will be discussed in more details in the following section.

The second aspect of *qing* is *xin* (信, trust). Affection normally generates a feeling of trust, yet trust must not necessarily base on affection. Rational evaluation of past interactions and situational contexts can also generate trust. Therefore, Herrmann-Pillath (2009) distinguished affect-based trust (resulting from shared emotional experiences) from cognition-based trust (based on evidence and reason). Both *qing* and *xin* are usually the outcomes as well as basis of interactions.

The first bundle of relationships a person has root in his family, i. e. family relationships. Each family, small or large, is a small institution that assumes some functions such as nurturing the offspring, organizing economic production and meeting certain needs. To ensure the functioning of family, the Western culture may count on love (a type of *qing*), while the Chinese culture relies on *lunli*, i. e.

order and obligations. In the Confucian logic, as long as one's behaviors towards family members are based on *lunli*, i. e. knowing her/his place and fulfilling her/his obligations, family keeps functioning in a stable and harmonious state. Personal feelings should be restricted so that the fulfillment of obligations won't be disrupted by personal preferences. However, human beings are emotional and sentimental and human behaviors are almost inevitably influenced by this nature.

4.1.3 Instrumental: Jiao (Exchange)

Yi and *qing* explain the processes in the mind that govern or sway the relational behaviors but say little about the actual motives, patterns and outcomes of these behaviors. These issues, such as the questions why and how people build and maintain their relationships, then can be addressed by the instrumental dimension of social relations.

The instrumental dimension focuses on *jiao* (交, exchange), i. e. the interactions and exchanges of thoughts, ideas, feelings, favors, gifts, information and other resources etc., between the two parties of a tie, which are useful or meaningful to the parties. This dimension is most related to the concept of social capital. As suggested by social capital theory, relationships give access to useful resources. Scholars have found countless proofs that social relationships enable access to critical resources in almost every aspect of life. Resources are transferred to the other party of a relationship in a bidirectional manner through social exchange, e. g. communication (exchange of ideas, information and feelings), gifts giving, and favor exchange.

Interactions and exchanges are the basis as well as the consequence – sometimes also the purpose – of relationships. When considered as basis, relationships tend to become closer or stronger when interactions and exchanges accumulate.

There can be diverse motivations behind and interpretations of interactions and exchanges. The benefits or resources one gains can be explained as the by-products of her/his relational behaviors, which occur in the natural process of interpersonal interactions impacted by *qing* and *yi*. Alternatively, especially readily accepted by economists, resources access can be argued to be the instrumental aim of the self-interest maximizing individual, i. e. exchange is primarily means or instrument to get resources instead of maintaining the relationship itself.

Moreover, different types of ties are differently instrumental. The strong family ties are indeed instrumental in the sense that family often provides the most important emotional, economic and social supports to its members. Normally, family ties are not deliberately built nor maintained by an individual with

instrumental goals in mind but rather a natural given as the result of natural or even unconscious behaviors. In the Chinese culture, it seems that even the two persons of a family tie are in a social exchange relation. A child, for instance, is supposed to try her best to *baoda* (报答, requite, repay) her parents for the unrepayable *yangyu zhien* (养育之恩, the kindness of the parents for raising and nurturing the child), which is the key argument of the doctrine of filial piety.

Other strong ties, friendship ties, tend to be more expressive (more in pursuit of emotional support) in the Western culture while more instrumental in the Chinese culture. The instrumental dimension of social relations is actually most prominent in *guanxi* ties, as to be discussed in the following section.

4.2 The Concept of Guanxi

4.2.1 Defining Guanxi

The Chinese term for social relationship is *guanxi* (or *kuan-hsi*), which could have multiple levels of meanings. In a broader sense, *guanxi* refers to all types and practices of social relationships. Two parties are regarded as having a *guanxi* as long as they are related or connected to each other by any means. *Guanxi* can refer to both the relationship and the person one has a relationship with. For instance, “B is A’s *guanxi*” and “A has a *guanxi* with B” express the same meaning.

More often, *guanxi* ties are referred to in a narrower sense as a special type of relations differentiated from family ties and friendship ties, which are generally weaker ties that share some particularistic characteristics such as being more instrumental in nature.

Guanxi plays a critical role in almost every aspect of Chinese social-economic life. Redding and Wong (1986) posited that the modern Chinese societies remain very much *guanxi*-oriented. Gold et al. (2002) also pointed out that “Conventional wisdom among Chinese and foreigners holds that in the People’s Republic of China (PRC), *guanxi* is absolutely essential to successfully complete any task in virtually all spheres of social life”. *Guanxi* “purportedly performs a critical lubricating function” not only in China but also in other peripheral Chinese societies and Chinese diasporas.

In fact, *guanxi* has been infamous with negative connotation such as a corruption, nepotism, and rule of man instead of rule of law etc. More positive judgments of *guanxi* are based on its underpinning humanity and its role of substituting underdeveloped or consistent regulations or guidelines for social conduct.

Early studies on Chinese social relations by Western researchers found that the complex and dynamic nature of guanxi and the pervasiveness of guanxi practice could not be fully captured by the concept of social relationship studied in the Western literature. Therefore, they adopted this indigenous Chinese term which then “gained its status as a legitimate socio-cultural construct in Western mainstream literatures of cultural anthropology, sociology, social psychology, political science, and business and management” (Chen & Chen, 2004).

As a particularistic type of social relationship, guanxi ties also possesses the three dimensions, yet the specific content of each dimension differs from other types of social relationships such as family ties and friends. That is to say, there are also the *yi* and *qing* dimension in the instrumental-implying guanxi ties.

4.2.2 How to Build Guanxi: Renqing

As guanxi ties usually play a vital role in bringing resources that are critical in achieving important ends, in the guanxi-based Chinese society, people view guanxi as resources and cultivate it “energetically, subtly, and imaginatively” (Luo, 1997).

As Gold et al. pointed out, the resource-bringing nature of guanxi makes it resemble Pierre Bourdieu’s concept of social capital. Guanxi is an important type of social capital in which the actors purposively invest with the expectation of gaining instrumental returns. “Clearly, in China, guanxi as social capital is accumulated with the intention of converting it into economic, political, or symbolic capital”.

Namely, guanxi is instrumental. The dyadic guanxi ties are “based implicitly (rather than explicitly) on mutual interest and benefit. Once *guanxi* is recognized between two people, each can ask a favor of the other with the expectation that the debt incurred will be repaid sometime in the future” (Yang 1994). Regarding the instrumental dimension, there are a few points to be made.

Firstly, guanxi must be consciously or intentionally built and maintained through investments of gifts, favor, and other guanxi practices. Jacobs (1982) coined the term “guanxi base”, which is referred to as the common starting point for the creation of a guanxi. A guanxi base depends on “two or more persons having a commonality of shared identification. That is, each of the persons having a guanxi base shares an aspect of personal identification that is important to them as individuals, such as identification with family, hometown, school or place of work. Such identification may be ascribed, e. g. native place of lineage, or it may involve shared experience.”

When a person wants to *la* (拉, pull) a guanxi, that is to build up a guanxi tie with another person, to find a guanxi base could be a good starting point. Al-

ternatively, the person could act as an intermediary to make a bridge for them. Guanxi bases may be naturally occurring or created, yet guanxi must be “consciously produced, cultivated, and maintained over time” (Gold et al.).

Secondly, *renqing* and favor exchanges are an important guanxi practice, which is ruled by the social norm of reciprocity, more specifically, long-term reciprocity.

In the broader sense, *renqing* (人情) means the sentiments, feelings and emotions underlying human relationships and interactions. *Renqing* can be materialized as Chinese are prone to express their *qing* (情, i. e. sentiment, e. g. love, affection, respect, trust, etc.) towards others through e. g. giving them faces, gifts or doing favors for them. Therefore, the derived meaning of *renqing* is the carrier of *qing* – the exchanged favors, gifts and face etc. – in the interactions between two guanxi parties. Favor, in this sense, is a type of *renqing*. “Favors done for others are often considered what may be termed ‘social investments’, for which handsome returns are expected” (Yang 1957). A further point is that guanxi “requires the imbalance of reciprocal exchange of *renqing*, and that balances only count in the long run.” (Herrmann-Pillath, 2009)

The Chinese *renqing* exchange has three types: a favor in need or urgent aid, purposive *renqing* investment (i. e. *song renqing*, 送人情, send *renqing* gifts to get certain task done) and *lishang wanglai* (礼尚往来, gift exchange), which is linked to the concept of face.

“In Chinese society, when one has either happy occasions or difficulties, all one’s acquaintances are supposed to offer a gift or render some substantial assistance. In such cases, it is said that they send their *renqing*. Henceforth, the recipient will owe a *renqing* to the donors.” (Hwang, 1987)

Qian (欠, owing) *renqing* to somebody means that there is a favor or emotional debt that needs to be repaid. As long as guanxi is still extant, this is always debt. *Hubu xiangqian* (互不相欠, owing each other nothing) means the end of guanxi. In this sense, *renqing* exchange is a form of social exchange, the goal of which is to maintain or develop guanxi or to use guanxi to achieve personal goals.

Thirdly, *renqing* is closely related to the concept of face, the Chinese term of which is *mianzi* (面子) or *lian* (脸). *Mianzi* concerns one’s social reputation while *lian* is one’s moral face. *Renqing* exchange is normally quite private; however, when it concerns the social image, i. e. *mianzi*, it becomes a public issue for the guanxi parties. “*Renqing* is the external expression in terms of socially recognized and approved mutual obligations [...] *Renqing* refers to social expectations of proper behavior in social networks, which turn into public phenomena by the flow of gifts which is, in principle, observable for many participants” (Herrmann-Pillath 2009). Therefore, he posits that guanxi is not simply a dyadic structure; instead, it can be a triadic one, as the observer plays an im-

portant role. Shame and face constitute the regulatory mechanism of long-term nature of reciprocity.

Fourthly, *renqing* is different from *ganqing* (感情), which means sentiment, or an affective component of human relations.

Ganqing concerns the sentimental dimension of *guanxi* and is a sub-concept of *qing*. “*Ganqing* is personal, while *renqing* is social” (King, 1991). “Kan-ch’ing [*ganqing*] differs from friendship in that it presumes a much more specific common interest, much less warmth and more formality of contact, and includes a recognized degree of exploitation” (Jacobs, 1982). According to Herrmann-Pillath (2009) “*ganqing* refers to the emotional quality of what is otherwise perceived as an instrumental relation”. *Guanxi* thus is a mixture of emotional and instrumental ingredients, which distinguish the Chinese conceptualization of social relations from the Western one, where “there is a tendency to keep emotional and instrumental relations separate, even assuming a potentially mutual negative effect on either of the two”.

Ganqing as the emotional basis of *guanxi* is also the foundation of trust and “needs confirmation by the fulfillment of the instrumental relation” (ibid.). “Dependability or reliability is essential to the maintenance of close *guanxi*. Nothing transforms a close *guanxi* into a distant one faster than unreliability.” (Jacobs, 1982)

Lastly, *guanxi* is egocentric and dyadic. “Chinese kuan-hsi building can be characterized as an ego-centered social engineering of relation building” (King, 1991). As a single individual can have various personal characteristics which can serve as a *guanxi* basis, “*guanxi* can only be specified with reference to a particular individual” as “the network of an individual cannot be just identified with a particular group which is defined according to a particular group identity” (Herrmann-Pillath, 2009).

4.3 Egocentric View and Personalized Social Capital

A Chinese usually has a self-centered viewpoint of their social world where another person exists only when she/he has a relationship with this person, i. e. she/he primarily sees herself/himself as the center of the social network she/he embeds in.

There are generally two views of social network: the egocentric view and the sociocentric (or group) view.

The egocentric network view focuses on an individual’s personal network, namely the ties an actor has. The sociocentric network view, in contrast, mainly quantifies the relationships among people in a group and studies the patterns of

interactions and how these patterns affect the members of the group and the group as a whole.

Fei (1992) pointed out that a Chinese's social world tends to be organized based on a differentiated classification of relationships with corresponding sentiment and obligations. According to Fei, one's social relations are usually categorized into discrete circles around her/him according to her/his perception of the relationships as close (*qin*, 亲) or distant (*shu*, 疏). "Like the ripples formed from a stone thrown into a lake, each circle spreading out from the center becomes more distant and at the same time more insignificant". Whether another person is close or distant to the Confucian self is strictly distinguished because she/he has to know what degree of obligations and expectations should be assumed and behave accordingly. Fei coined the term "*chaxu geju*" (差序格局, the differential mode of association) for this differentiated relationship structure.

Despite his insightful observation of the relational structure in Chinese culture, Fei ignored the resource part of one's personal network. Each person may occupy a specific social position thus the persons in the egocentric network has unequal social status, which implies accessibility to different resources.

Personal network is the source of social capital. Each person possesses a stock of resources consisting financial capital, human capital as well as her/his social capital etc. which can be invested in a social relationship and converted into other persons' social capital through social exchange. Thus, social structural and positional differences are reflected in the quality and amount of one's personal resource stock.

The differential mode of social network reveals that an evaluation system of relationship is necessary for the ego to understand her/his social world and to manage it with orientated actions. This system has been learned and practiced by the Chinese since they were born and throughout their whole life. When looking in depth into its foundation, it is a complex system blended with instinct and intelligence of socialized human being, as well as culture, traditions, values and social norms etc.

4.4 Social Capital of the Firm

The firm, as an organization, is normally seen as a network of actors instead of an individual actor in the social capital literature. Considering the fact that corporation, as the major form of the firm, is regarded by law to have the status of personhood, i. e. a juridical person the firm can be regarded as an independent actor who has various relationships to its stakeholders and consequently its own social capital. In line with the definition of social capital, the social capital of the

firm is thus embedded in its relationships with its stakeholders, which could facilitate the actions of the firm towards certain ends such as firm survival and profitability.

A stakeholder refers to, in a broader view, “any group or individual who can affect or is affected by the achievement of the firm’s objectives” (Freeman, 2010). The stakeholders of the firm thus include owners, employees, customers, suppliers, governments, competitors and media etc.

A narrower definition was offered by Clarkson (1994) who defined stakeholders as voluntary or involuntary risk-bearers – “voluntary stakeholders bear some form of risk as a result of having invested some form of capital, human or financial, something of value, in a firm. Involuntary stakeholders are placed at risk as a result of a firm’s activities”.

According to the resource-based view of the firm and the narrower definition of stakeholder, the resources – financial capital, human resources, knowledge and social capital etc. – the firm deploys are all investments made by respective stakeholders (investors, managers, employees and business partners etc.) in exchange of something valuable to the resource-investors. In other words, a stakeholder has an exchange relationship with the firm. For instance, initial investment of financial capital and human capital (including ideas, time and energy etc.) of the founder-entrepreneur is the starting point of the business, which is then used to purchase means of production and to recruit personnel. New exchange relationships are built up in this process.

Some of the exchanges between the firm and the stakeholders pertain to the economic exchange principle, being definite, formal, immediate and rational, while the rest might resemble social exchange between two individuals. When the organization of the firm is based on formal institutions, the firm and stakeholder tend to resort to economic exchange. When it is more relationship-based, the transactions would be more likely to be shaped by social exchange.

Each stakeholder-firm relationship has its unique attributes, though the same type of stakeholders may have more or less similar relationships to the firm. The employee-firm relationship, for example, is usually guided by formal contracts which states clear time span and contents of exchanges such as the tasks and responsibilities of the employee and the wages or salaries they should be paid. However, in this relationship there is almost always a degree of risk and trust, thus an undefined, informal part.

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Part IV.
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Chapter 5.

Introduction of Cases

5.1 The List of Cases

The basic information of the 63 family businesses examined in this study is presented in Table 1.

Table 1 List of Cases

List A Firm	Founding year	Interviewee (F = founder; SG = Second generation)	Age	Location *	Core Business	Employees **	Interview Date
A1	1992	Mr. Chen (F)	51	CQ	Landscaping	50	06.05.2015
A2	2002	Mr. Xiong (F)	51	CQ	Auto repairing service	10	06.08.2015
A3	2013	Mr. Nie (SG)	35	CQ	Toothbrush manufacturing	100	06.09.2015
A4	1985	Mr. Cai (F)	49	CQ	Transportation	600	06.10.2015
A5	1992	Mr. You (SG)	23	CQ	Property development	60	06.10.2015
A6	1992	Ms. Mi (SG)	28	CQ	Construction, property development	80	06.12.2015
A7	1995	Mr. Liu (F)	49	CQ	Freight transportation	20	06.12.2015
A8	2014	Mr. Yang (SG)	28	CQ	Trade	10	06.14.2015
A9	1995	Mr. Liu (F); Mrs. Liu Jr. (SG); Ms. Liu L Jr. (SG)	64 38 27	CQ	Textile manufacturing	25	06.15.2015
A10	1995	Mr. Wan (F)	48	CQ	Coral trade	50	06.17.2015
A11	2002	Mr. Wang (F)	48	CQ	Medicine trade	500	06.17.2015
A12	1996	Mr. Sun (F)	50	CQ	Property development	100	06.19.2015
A13	2005	Mr. Zhang (F)	60	CQ	Microcredit	20	06.20.2015
A14	2000	Mr. Wu (F)	55	CQ	Construction equipment Leasing	5	06.23.2015
A15	1996	Mr. Li (F)	49	CQ	Property development	300	06.25.2015

Table 1 List of Cases (Continued)

A16	1990	Mrs. Liu(F)	56	CQ	Textile manufacturing	1,000	06.26.2015
A17	1989	Mr. Yin (SG)	37	CQ	Agricultural processing	1,200	06.27.2015
A18	2002	Mr. Yuan (F)	58	CQ	Automotive components manufacturing	700	06.29.2015
A19	1993	Mr. Cheng (F); Mr. Cheng Jr. (SG)	53 27	CQ	Construction, property development	500	06.29.2015
A20	1975	Mr. Huang (F)	62	CQ	Construction, trade	500	07.03.2015
A21	1998	Mr. Ran (F)	53	CQ	Property development, agriculture	60	07.06.2015
A22	1980	Mr. Tan (SG); Mr. Tan Senior(F)	35 61	CQ	Property development, construction, landscaping	260	07.08.2015
A23	2008	Mr. Zhu (F); Mrs. Zhou (F); Mr. Zhu Jr. (SG); Ms. Zhu Jr. (SG)	55 52 30 25	CQ	Farm	30	07.10.2015
A24	2000	Mr. Zhao (F)	39	CQ	Trade	30	07.10.2015
A25	1988	Mr. Hu (SG) Mrs. Liu (SG)	36	CQ	Textile Manufacturing	100	07.12.2015
A26	1999	Mr. Zhang (F)	53	CQ	Transportation	200	07.13.2015
A27	1980	Mr. Gao (F)	61	CQ	Property development	80	07.14.2015
A28	1992	Mrs. Wang (F)	53	CQ	Automobile service/trade	260	07.16.2015
A29	1992	Mr. Mou (F)	51	CQ	Construction	560	07.17.2015
A30	2000	Mr. Cui (F); Ms. Cui Jr. (SG)	49 22	CQ	Printing	50	07.20.2015
A31	1997	Mr. Lu (F)	53	CQ	Agriculture development	200	07.20.2015

Table 1 List of Cases (Continued)

A32	1985	Mr. Xin (F)	59	CQ	Construction, property development	200	07.23.2015
A33	1998	Mrs. Xu (SG) Mr. Zhang (SG)	29 29	CQ	Automotive components manufacturing	100	07.29.2015
List B	Firm	Interviewee (F = founder; SG = Second generation)	Turnover (ca.)	Location	Core Business	Employees (ca.)	Interview Date
B1	1982	Mr. Li (SG); Mr. Li Senior (F)	280 m €	GD	Construction, property development	200	10.13.2015
B2	1994	Mr. Gu (F)	700 m €	GD	Construction	1,000	10.14.2015
B3	1997	Mr. Chen (F) Mr. Chen Jr. (elder brother); Mr. Chen Jr. (younger brother)	45 m €	GD	Cable and adapter manu- facturing	n.a.	10.14.2015
B4	n.a.	Mrs. Zhang (SG)	430 m €	GD	Electronics, cable	700	10.15.2015
B5	1991	Mr. Chen (F)	110 m €	ZJ	Pharmaceutical	n.a.	10.16.2015
B6	1975	Mrs. Tu (SG), Mr. Li (SG)	11.7bn yuan	ZJ	Silk	1,900	10.17.2015
B7	1991	Mr. Wang	16.4bn yuan	SH	Aviation transport, commercial retail, and financial service	10,000	10.18.2015
B8	1994	Mr. Lu (F)	140 m €	SH	Floor manufacturing	2,000	10.19.2015
B9	1990	Mr. Gao (F)	1.3bn €	ZJ	Electrical appliances man- ufacturing	8,000	10.19.2015

Table 1 List of Cases (Continued)

B10	1994	Mr. Zhuang Jr. (SG); Mr. Zhuang	166 m €	JS	Automotive components manufacturing	1,600	10.20.2015
B11	1966	Mr. Zhu (SG)	160 m yuan	JS	Circuit boards manu- facturing	300	10.20.2015
B12	1988	Ms. Deng (SG)	100 m yuan	JS	Automobile components manufacturing	250	10.21.2015
List C Firm	Founding year	Founder	Turnover (2014 or 2015, ca.)	Location	Core Business	Employees (ca.)	
C1	1982	Mrs. He Yongzhi, Cynet Group	1.6bn yuan	CQ	Catering	18,000	
C2	1997	Mr. Yang Guoqing Holdings	140bn yuan	GD	Property development	64,869	
C3	1984	Mr. Su Dawu	2bn yuan	HB	Farming and Stock Breed- ing, Agricultural Processing	3,500	
C4	1996	Mr. Mao Lixiang	7bn yuan	ZJ	Kitchen appliance manu- facturing	12,000	
C5	1987	Mr. Cao Dewang	11.5bn yuan	FJ	Automotive glass manu- facturing	21,000	
C6	1987	Mr. Li Haicang	/	SX	Iron and Steel	liquidated	
C7	1992	Mr. Yin Mingshan	30bn yuan	CQ	Automobile manufactur- ing	12,966	
C8	1980	Mr. Deng	2bn yuan	ZJ	Shoes manufacturing	4,000	
C9	1968	Mr. He Xiangjian	138bn yuan	GD	Household appliances manufacturing	100,000	

Table 1 List of Cases (Continued)

C10	Mission Hills Group	1992	Mr. David Chu	n.a.	HK, GD	Golf and leisure resort	14,000
C11	New Hope Group	1982	Mr. Liu Yonghao	90bn yuan	SC	Agribusiness	80,000
C12	Nine Dragons Paper Group	1995	Mrs. Cheung Yan	29.9bn yuan	HK, GD	Linerboard, paper manufacturing	17,800
C13	Sanquan Food	1992	Mr. Chen Zemin	4.2bn yuan	HN	Fast-frozen food producer	20,000
C14	Sany Group	1989	Mr. Liang Yezhong	23.3bn yuan	HuN	Construction machinery manufacturer	16,119
C15	Sassin International Electric	1993	Mr. Chen Zhixian	n.a.	SH	Industrial electric manufacturer	n.a.
C16	Wahaha Group	1987	Mr. Zong Qinghou	72.8bn yuan	ZJ	Beverage producer	30,000
C17	Wanda Group	1988	Mr. Wang Jianlin	290bn yuan	SC	Commercial properties	130,000
C18	Wanxiang Group	1969	Mr. Lu Guanqiu	118bn yuan	ZJ	Automotive components manufacturing	30,000

Note: * CQ = Chongqing, FJ = Fujian, GD = Guangdong, HB = Hebei, HN = Henan, HuN = Hunan, HK = Hong Kong, JS = Jiangsu, SC = Sichuan, SH = Shanghai, ZJ = Zhejiang, SX = Shanxi.

** Some of the numbers of employees are rough estimation instead of accurate numbers.

The list consists of three parts (List A, List B, and List C), each of which includes family businesses examined based on different sources of data.

List A is composed of 33 family businesses investigated through first-hand data collected from semi-structured interviews in a field research trip to Chongqing made in June and July 2015.

The field trip composes an essential part of this research on Chinese family business succession. The field trip was aimed at interviewing founders and successors or potential successors (both as successor hereafter) of 30 family businesses in Chongqing, China, so as to find out how the key actors in each family business make succession related decisions and the rationale behind these decisions, as well as how the relationship dynamics, ideas, interests and external forces shape their behaviors. At last, 43 founders and second-generation family members from 33 family businesses located in Chongqing (List A in Table 1) were interviewed.

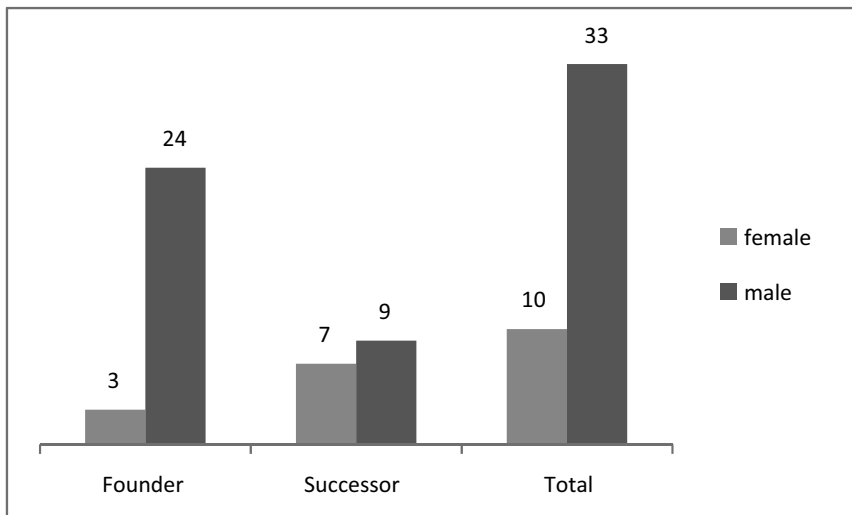


Figure 1: The Composition of Interviewees of List A. Source: the author.

As Figure 1 shows, the total number of first generation founders interviewed is 27 with their ages ranging from 39 to 65 and 3 of them are female. The 16 second generation family members are between 22 and 37 years old, of whom 7 are female. Moreover, as Figure 2 and Figure 3 demonstrate, the majority of the family firms is small to medium sized and a large portion of the firms operate in industries such as construction, property development, manufacturing and trade.

In the presentation of the findings, the company names are replaced by code names (from A1 to A33, in Table 1) and the interviewees' full names are not

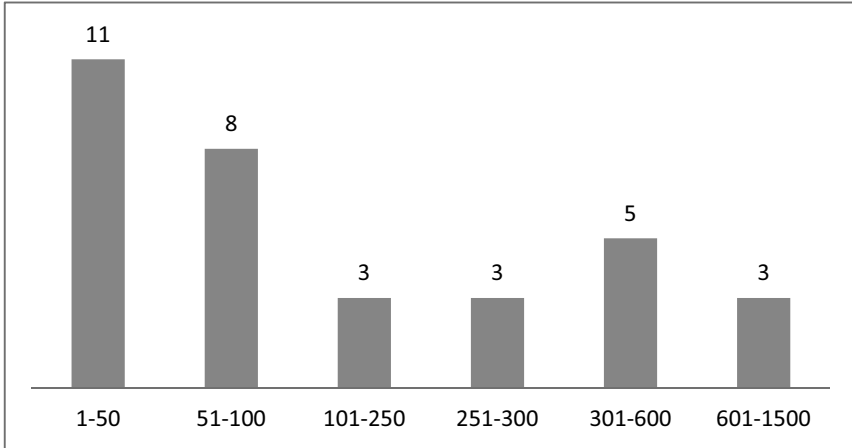


Figure 2: Firm Size by Numbers of Employees. Source: the author.

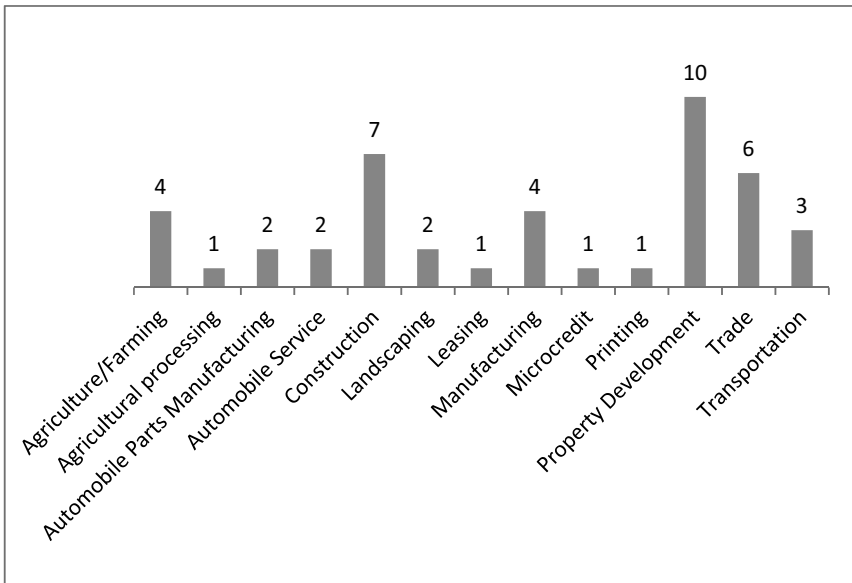


Figure 3: Breakdown of Family Businesses by Industry. Source: the author.

provided in order to ensure confidentiality. This principle applies to List B as well: the company names are replaced by code names from B1 to B12.

List B consists of 12 family businesses located in Guangdong, Zhejiang and Jiangsu provinces and Shanghai. Data was collected during another field trip with a visiting group from the Witten Institute for Family Business (WIFU). The information about these family firms and the perspectives of the founders or the

second generation were collected from the presentations of the company representatives (founders or successors) and information gained in the question-and-answer sessions or group interviews and discussions.

The majority of the firms in List A and B are small to medium sized. For a more comprehensive understanding of the family business succession in China, the knowledge about how the largest family businesses deal with succession is indispensable. These largest family businesses are listed in the third part, List C.

The data of the cases in List C is composed of cases studied based on purely secondary data. Therefore, besides the size as a criterion, the selection of cases in List C is based on the availability of information. The listed 18 family businesses are mostly large sized and well-known firms in China, which have kept drawing the attention of the media. Thus, there is plenty of information available. Fragmented evidences were collected from different sources – which include biographies of the entrepreneurs, interview records, journal articles, reports and other online information – and then compiled and analyzed. Considering that the information is already publicly available, the real names of the companies and entrepreneurs are given in the List C.

There are a few points to be mentioned about the whole sample of cases.

Firstly, the majority (43 out of 63) of family businesses in the whole list is more than 20 years old and most of them are still run by the founder-entrepreneurs or in the process of intergenerational transition.

Secondly, of the 63 business families, 27 have only one child in their second generation (See Figure 4, p. 84). A notable discrepancy is that the majority of the business families in Chongqing (List A) has only one child, while the proportion of one child families in other provinces seems to be much lower. For instance, there are 8 family businesses (from both List B and List C) located in Guangdong province, all of which have more than one child in the second generation of the founding families.

A reason might be that some of the founders from Chongqing selected in the sample are comparatively younger (under 55), thus their first children were born after the introduction of the one child policy. Another possible reason might be that in some regions such as these dominated by *chaoshan* culture (潮汕, mainly in Guangdong) and *minnan* culture (闽南, mainly in Fujian)⁹, the traditional family culture which favors large family with multiple children (especially sons) prevails, while in other regions, such as Chongqing, the effect of traditional familism tends to be weaker.

Thirdly, the majority (89 %) of the founders of the 63 family firms are male, and only 7 firms have female founders. In the second generation, there is a slight

9 Some of the business families in the sample originate from minnan, Fujian province, though the operation is in Guangdong.

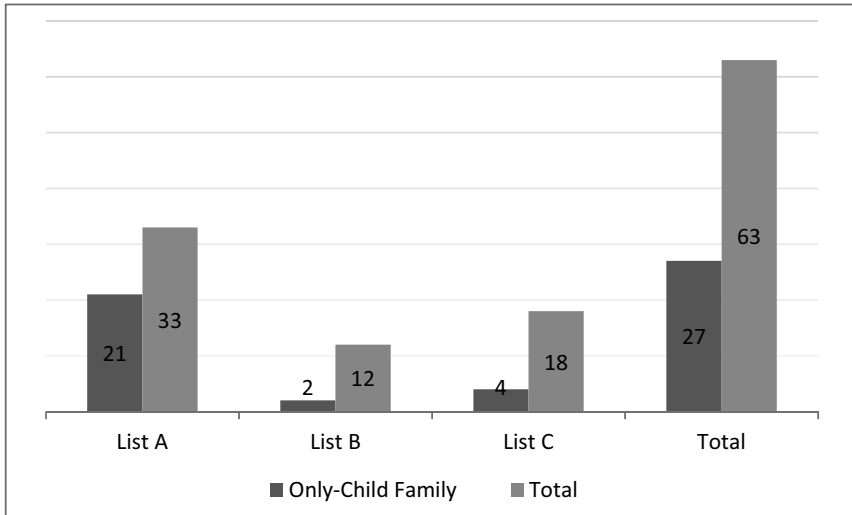


Figure 4: The Number of Only-child Business Families. Source: the author.

change of the gender ratio of the successors. Of the 63 firms, 12 (19 %) have female successors, which may due to the one child policy. However, as the sample only has a small size, this finding cannot be generalized.

5.2 Three Portraits of Chinese Entrepreneurs

5.2.1 Building a Business Empire: Mr. Zong Qinghou

Mr. Zong Qinghou is the founder of Wahaha Group, the beverage giant in China, which had a turnover of 72.8 billion yuan in 2014 and over 30,000 employees.

Zong Qinghou was born in 1945 in a well-educated family. After graduated from junior high school in 1961, Zong was deprived of the chance to receive higher education due to his family background and started to work in order to help his mother support the family. He has always possessed the spirit of an entrepreneur. After he shuffled between a lot of part-time and temporary jobs such as popcorn seller and milkman, at the age of 18, Zong started to work in the state-owned salt farm in 1963 and was transferred to a tea farm a year later, where he worked for 14 years due to Mao's policy of bringing intellectuals and urban youth to the countryside. The job in the farms was extremely strenuous but he bore up. In 1978, at the age of 33, Zong came back to the city Hangzhou from the rural area and worked as a salesman in a factory which was owned by a primary school. In May 1987, he grasped the chance and became the manager of the new

sales department, which can be understood as an independently operated subsidiary of the factory. He partnered up with another two female teachers and distributed stationery, ice, soft drink and electricity meters. With the profit made by the sales department, he founded the Baoling Nutritional Food Factory in the same year, which was an OEM for an oral liquid brand called Baoling. Until May 1988, the factory had made a profit of 220,000 and employed 130 workers.

Inspired by a news saying that one third of all children in China suffered malnutrition, at the age of 42, Zong decided to develop a nutritional product for children. The R&D was done within three months and the production started in October 1988. Under Zong's ingenious marketing strategy, the newly developed Wahaha Nutritional Oral Liquid for Children made a great success and the brand Wahaha sprung into fame. In 1989, the factory was renamed Hangzhou Wahaha Nutritional Food Factory and became the Wahaha Group in 1991, which has under Zong's leadership grown into the largest beverage company in China.

From 1991 to present, the Wahaha Group was gradually privatized. Zong has fully controlled the business and served as the Chairman and General Manager of the Wahaha Group for 25 years. Wahaha Group is only a part of a huge business empire that Zong controls through a complex system of pyramid and cross-holding structures, which, according to Forbes China Rich List, made him the richest man in China in 2010 and 2012.

Zong Qinghou is famous for his outstanding management skills, an autocratic leadership style, innovativeness and workaholicism.

"In the business life, I think hard-working is the most important quality," said Zong, "and the second most important quality is innovativeness." He established a nationwide distribution system in early 1994 which has encompassed more than 8000 primary distributors and around 40,000 secondary and tertiary distributors, which has been the key to Wahaha's success.

The top management of Wahaha Group was comprised of only Mr. Zong Qinghou, the founder of the brand Wahaha, even after the company has become one of the most reputed Chinese beverage giants. His daughter, Zong Fuli, said disapprovingly in an interview that, "Wahaha will be nothing without my father". A commentator also wrote, "Zong Qinghou is the brain, the pivot and the heart of Wahaha. Others are just gears and screws. The development of Wahaha has relied on the power of one man."¹⁰ The dropping revenue in the past two years made Mr. Zong realize the limitations of his leadership style, "My weakness is too hands-on, so that the staffs depend on me too much. Now I am trying to let my subordinates take responsibilities."

Mr. Zong's only daughter, Ms. Zong Fuli, born in 1982, joined the business in 2005 after graduated from college in the US. She is now the Chairman and CEO of

10 http://www.iceo.com.cn/renwu2013/2013/0505/266673_3.shtml.

the Hongsheng Group, the subsidiary group of Wahaha, which owns 36 subsidiaries with 4,400 employees.

5.2.2 A “Xiahaier”: Mr. Lu of the B8 Company

Mr. Lu was born in 1966 in a Wenzhou business family; his former generations had been running business for more than a century. Mr. Lu’s father was opposed to his son’s choice to be an entrepreneur because he knew well the difficulties of doing business. He insisted that Lu should go to college and find a stable and decent job. Lu followed his father’s expectation and became a public servant. However, the entrepreneurial spirit urged Lu to quit the job in 1994, as he smelt the great potential of the growing demand for floors. He used 300,000 yuan borrowed from his father as the startup capital and started his floor business. If Lu’s business failed, he was supposed to go back to the job in the office, whereas Lu proved his talent as an entrepreneur.

He started as a wooden floor distributor and two years later, in 1996, he built up his own wooden floor factory in Shanghai. In 1998, the government imposed a logging ban in natural forests, which cut off the domestic source of the raw material of his products. He had to purchase wood from Brazilian suppliers via Taiwanese intermediaries. After a long time of searching, he finally discovered the telephone number of a Brazilian supplier in 1999 and for a whole month, he tried to get in touch with the Brazilian supplier despite that he didn’t speak any Portuguese until he finally received positive response. Then the idea came to his mind: why not buy a forest in Brazil? In 2000, Lu flew to Brazil, conquered all the obstacles and finally bought 1,000 square kilometers of forest from a tribe. The Brazil story is just an example of his entrepreneurship.

He said in an interview that, “We [entrepreneurs from Wenzhou, Zhejiang] want to do something out of the ordinary and we have the guts to take the risks. We feel happy and have a sense of achievement in the process of building and creating. So we are ready to take the initiative.”¹¹

The bold, innovative entrepreneur has led his firm, the B8 Company, to grow into a major market player in the Chinese wooden floor industry, employing more than 2000 workers with a turnover of around 1 billion yuan in 2015. Lu expects his elder son, who was sent to the US at the age of 14 to study, to be his successor. Although the son is still studying in the US, the father and son have frequent communications. When B8 Company was undergoing a crisis, the son wrote a letter expressing his care and support for his father and giving a few suggestions. Lu was greatly touched and also saw the son’s potential for suc-

¹¹ <http://bj.house.sina.com.cn/news/2014-02-25/15452622023.shtml>.

ceeding his business. The 12 years old younger son was born and raised in Brazil, thus has less contact to the family and the business.

Abandoning the typical Chinese equal inheritance principle, Lu plans to pass the ownership and control of the firm to the elder son. However, the final decision depends on the result of his evaluation of the son's competences in the next five years. When the elder son takes over, he is expected to take care of "the happiness" of his younger brother.

Due to a few failed investment strategies, the firm is now in a sub-optimal condition. The successor has set the goal to make the firm the market leader. Lu has great confidence on him, "My son has many qualities that I don't have. He can correct my mistakes."

5.2.3 A Small Business Owner: Mr. Liu and the Daughter

Mr. Liu founded his Weaving Factory (A9) in 1996 in Chongqing. Born in poor families in rural area, Mr. Liu and his wife were both famers. Mr. Liu started to make iron pails before the implementing of the household responsibility system in the early 1980s. "At that time, you had to do everything to make your family survive. Working in the collective farm could hardly feed the family. My two brothers and I decided to learn some craft when others didn't have the idea or the opportunity."

The pails had been the only source of income of the family. With years of savings, Mr. Liu decided to open a small mill to produce cotton gloves in 1990. They hired a few women workers from the village to work on the major phase of gloves production in their house, while they themselves worked on the remaining part of the production process, and Mr. Liu also had to peddle the products in the region. A few years later, Mr. Liu decided to invest in the upstream of the business, to build a weaving factory that produces cloths. He had to borrow from his relatives, friends and acquaintances to finance the new startup. "They trusted me because they know me very well. I have kept a good reputation."

He sees the business primarily as the source of income and employment for the family. "I started the business with a very straightforward goal: to make some money so that the family lives better. If I didn't do business, I would have stayed as a poor farmer, struggling to raise the family." There are currently 25 workers working in the mill, some of them are relatives of the family.

Mr. Liu had been the only manager until his elder daughter, Yan, began to assist him. Yan recalled that, "at that time it was very hard to get admission to college and I didn't make it. So after finishing high school, I came back home to help my parents. If my parents weren't running a business, I would have to find a job or a man – to be a fulltime housewife. To find a good job means being far away

from parents. They didn't like that; besides, they needed a hand for the business. I felt that it was my obligation to stay with them."

She was asked to help manage the business after she gave birth to her own daughter. "I am in charge of accounting, money transactions and personnel management since 2000. I became the legal representative a few years later. But that doesn't mean I become the real boss. And I don't want to be the boss. My father has always been the person to make market related decisions such as deciding which type of and how many products to produce, how much the price should be etc., but he listens to my opinions." Yan has been happy with the division of work between her and her father. "I think it doesn't matter who makes the decisions. Generally, the business is informally organized but it has worked well so far. I am not an entrepreneur like my father. He is always the center of the business and I hope my work is to reduce his workload as much as I can."

The three generations of the family lives under the same roof. The family house is connected to the mill building and their living room is also the business office. Therefore, it is actually impossible to separate the family life from the business life. "I am one third housewife, one third manager and one third worker." said Yan. Yan's younger sister is currently studying abroad, being supported by the family. With a good education background, she is expected to find a good job after graduation. "There is no need for other family members to get involved in managing the business because it is small."

The business has been a stable source of income for the family, but it hasn't experienced much expansion due to various reasons. The founder wanted to expand the business about 10 years ago, but his wife and daughter were strongly against this idea. "I had always known how hard it is to do business when you don't have any *guanxi* to those people who control the resources." said Mr. Liu, "and there was always high risk as the market had been so fluctuant. My daughter thought I was too old to take such risks." laughed Mr. Liu. "The profit has been thin as the business is small. However, it has provided stable and comparatively good income for us and our workers." said Yan.

The business has also provided employment to some relatives and in turn helped them improve their living conditions. In the past few years, running the business became harder due to the economy downturn. The traditional industries were hit harder. "I don't know how long we can keep running the business. But we will try our best. The business is already an inseparable part of the family." said Yan.

Chapter 6. Succession or Non-succession?

The family business succession literature often takes the family's intention for succession and business continuity for granted, assuming it as a defining characteristic of family business to be succeeded by the next generation family members. Non-succession, i.e. when family ends the business or sells the business to family outsiders, thus has been often regarded as a failure, a situation to be avoided by the family business. An example is the popularity of the estimation made by Beckhard and Dyer (1983) which states that two thirds of the family businesses can't make it to the second generation – a quotation many papers of succession like to start with.

In fact, only when we regard retaining family control over the business itself as the ultimate goal of the family, non-succession is the disappointing failure. Let's consider the situation when a founder sells his majority shares to family outsiders instead of giving these shares to his children because his children are unwilling to take over. Although the family loses control and the business becomes a non-family business, the founder gets a fat payment that could still be managed to sustain his family's lifestyle or to support the next generation's new business ventures. Meanwhile, the business continues and might even perform much better than its old days being controlled by the family. Non-succession becomes a situation of win-win for both the family and the business. Passing the ownership and control of the business to the next generation, therefore, might not be the only preferable choice.

In other words, non-succession of a family business might not be an unwanted, helpless failure but just an outcome of a judicious choice out of an estimation of the conditions of the family and the business, as well as the broader economic, social and political environment. This choice, however, is largely neglected by the literature. Only a few researches discussed the rationale behind and factors influencing the choice between succession and non-succession. For instance, Barnes and Hershon (1976) pointed out that "there is something more deeply rooted in transfers of power than impersonal business interests. The human tradition of passing on heritage, possessions, and name from one gen-

eration to the next leads both parents and children to seek continuity in the family business.”

Although it seems that most founders tend to have an inclination for succession, it might be a difficult question for some founders to answer. In fact, the founder, as well as the second generation, might be constantly asking himself this question and he will probably get different answers at different time points, and we might only call his decision as final when he signs the contracts of selling his equities or officially transfers his ownership and power to his family successor.

6.1 The Founder's Intention for Succession

The founder of a family business will eventually have to decide what the preferable future of the business is after he retires or becomes unable to control the business any further, although he might not have full control over the actual outcome. Generally, he is likely to choose and act upon one of the three scenarios: the first being liquidating the business, the second being selling, i. e. transferring the controlling ownership to family-outsiders; and the last being transferring the control to the next generation family member(s). Each has different consequences for the family and the business.

From the angle of the business, when the founding family cuts or excessively diminishes its relationship (influence, control) with the firm via selling the equity, giving out control (in the case of family trust, family may become a pure beneficiary without any control over the strategy and operation of the firm), the business may continue but it's no longer a family business, at least not the original one. In this case, it is non-succession.

How the founder finally reaches the decision could involve a complex set of factors and dynamics of her/his interactions with the next generation and other family and business stakeholders. Similarly, the second generation has to decide whether they will take over the business. Then the question becomes what factors motivate or discourage the founder and the next generation to favor succession.

6.1.1 Economic Motives and Familistic Logic: Family Business as Jiaye

Why would the largest resource-provider of the firm, i. e. the family controller, maintain its relationship with the firm? Keeping controlling a business, like most if not all other things the family decides to do, could result in benefits as well as costs for the family members involved. The most palpable benefit of controlling a business is the economic return, i. e. the right to net cash flow. As the key mission of the for-profit business organization is profitability, obviously, a firm which is

believed to lack the potential to be as profitable as expected can hardly be sustained by its resource-providers.

Gaining financial return is a key motive of entrepreneurship. The stories of the entrepreneurs in this study reveal that many of the Chinese founders became entrepreneurs primarily out of financial concerns of themselves and their families – to escape poverty, to make ends meet, or to live a better life. They audaciously seized the opportunities, used their wisdom, “ate the bitterness” and quickly achieved their initial goals. When the next generation takes over the business, it obviously won't bring any economic benefit for the founder. Why would he want the children to keep control? This must be explained in the context of the family.

From the angle of the family, transferring valuable resources to children is a key part of the parent-child relationship. It is human nature for parents to care for the wellbeing of their children, minors or adults. An important way of fostering the children's wellbeing is to give them valuable resources. A business could be a great legacy as the ownership of the business is seen as a valuable asset. In the Chinese culture where people are highly concerned about the future of their families and the wellbeing of their descendants, it is almost an obligation as well as a pride for them to leave their children a legacy, a *jiaye* for succession. In fact, the founder's motive to do business is largely influenced by her/his family, who play a central role in driving, motivating, and supporting their adventures in the business world.

Following the familistic logic, a key objective of the business is to serve the family's needs. In this sense, the business is rather instrumental and is primarily viewed as a private property of the family, i.e. the *jiaye*. Since it is a property, based on the common property principle, it also belongs to the children. Therefore, the founder may regard it as a norm to transfer the ownership, along with the control, to her/his descendants to secure the economic and non-economic advantages when the business is supposed to bring continued, more or less secured income and wealth for the later generation. Founders with this mentality care more about the lives of their children than the fate of the business because essentially the business is not different from a family property, say, a house.

In this sense, who runs the business is essentially irrelevant as long as the manager is competent and the family can secure its economic benefit, e.g. as the shareholder or trust beneficiary. However, in the Chinese context, who runs the firm often does matter as the non-family business manager who has managerial control over the business could easily harm the interests of family shareholders due to low investor protection. Therefore, the families prefer to run the business themselves.

On the other hand, succession is actually based on a premise that the business has the potential to be profitable in the future. When the family firm is troubled

by some major problems that are hard to be solved and is expected to be not profitable enough, succession is unlikely to happen.

6.1.2 Socioemotional Wealth

Unlike institutional investors, the family is rarely driven by pure economic motives. The founder may have an intrinsic motivation to pursue business continuity, as the business bears the memories and emotions such as personal pride of the founder and constitutes a key aspect of the founder's self-concept and identity. The business' economic utility to the family might be a major concern but not always the only important reason for succession.

The continuity of the business is a dream shared by most founders, no matter being controlled by their descendants or otherwise.

For instance, *bainian laodian* (百年老店) is a Chinese word describing a store, a brand or a business that has been operating for at least one hundred years. Traditionally, a *bainian laodian* was passed on from generation to generation based on the mode of *zicheng fuye* (子承父业, son succeeds father), thus was continuously operated by the descendants, or in some cases disciples and followers of the founder, who were supposed to inherit the skills, art and secrets of the founder, so that the key merits of the products would be preserved.

As an emblem for business achievement, reputation and pride, making the business a *bainian laodian* might be the highest goal and a key value of traditional Chinese business families. It is still a dream of many Chinese entrepreneurs. Succession, therefore, has been a central concern. Explicitly stating this dream as a goal of the business to other stakeholders could make it a shared dream, a vision, a value and a part of the culture of the organization.

When the offspring of the founder internalize these values, goals and visions and grow their own attachment to the business, their ability to exercise authority and control over the business becomes imperative and an important source of emotional satisfaction. As Mr. Cheng (A19) said,

“You created the business. You spend most of your time and effort taking care of it. So you grow attachment to the enterprise. It is like your other son. You want it to grow and thrive, and you want it to be in good hands after you leave.”

When the business reaches certain scale, along with the accumulation of the family's wealth, maintaining control over certain business – comparing to a more diversified investment portfolio – might not be an optimal strategy in the economic sense. Despite this, emotionally, the founder wants her/his child to take care of “the other child”. The business symbolizes the founder's achievements

and she/he hopes the children to identify with her/him – to share her/his values and experiences through the traditional practice of *zicheng fuye*.

“Running the business is not about money anymore. Money is just the number on your bank account. We have earned enough money for my children to live a comfortable life without running the business, even without working at all. It’s about succession of spirit, career and aspiration and it’s about responsibility.” said Mr. Yuan (A18).

In fact, for an entrepreneur, the business he/she created is rarely solely linked to profit maximization and the creation of wealth. Family owners are likely to see potential gains or losses from the perspective of socioemotional wealth, i. e. the nonfinancial benefits of controlling the business, which is their primary frame of reference in the management of the firm. Succession thus involves the preservation of socioemotional wealth.

Some founders realized that the business is neither an instrument whose existence and destiny are completely controlled by the family, nor a private property of the family even when the family fully owns it. For instance, Mr. Wang (A11) said,

“I want to make the firm go public. For that it should have a strong culture and good management that could ensure the sustainable development of the firm. The enterprise is like your child. You want it to grow up, to have success and to live a long life. It should continue without you. When it does, that’s your success. A person’s success should not be judged by his wealth. I think there is no need to get hold of a large bulk of the shares for the sake of your offspring. When the firm is ready to go public, I think I am going to keep only 1 % of the shares. After all, the enterprise doesn’t belong to you, or your family. It belongs to the society. You don’t just run the business for yourself or solely for your family. The business must continue and develop because you also have responsibilities to your employees and to the society.”

Similar arguments were also made by Mrs. Wang (A28), Mr. Yuan (A18), Mr. Ran (A21), Mr. Zhang (A26), and Mr. Lu (B8) etc. For instance, Mr. Zhang (A26) stated,

“Doing business is not about how much wealth you have created. It’s about how much you have done for the society. My offspring’s wealth and life must be built by themselves. For me, accumulating wealth is not of much uses, because it can’t be taken into the grave. Making the enterprise bigger, however, is much more meaningful to the society.”

This concern for the prosperity of the business may result in a “business first” logic that rejects the incompetent family members as successors. In this case, when the children of the founder are regarded as not competent enough, the founder might decide to yield the control to family outsiders.

On the other hand, the founder’s attachment to the business or feelings of responsibility to employees and other stakeholders such as local community and local government might be stressed and succeeded by the family successor but

not a non-family one. In this sense, the family successor probably is a better hand for the business, as the family's preference for preserving the socioemotional wealth associated with the business makes the successor a patient, long-term investor and a dedicated manager.

6.1.3 Succession of Knowledge and Social Capital

The knowledge and social capital accumulated by the founder normally can be and are indeed often transferred, to a lesser or greater extent, to the family successor as part of the parent-child interactions, which could help the successor achieve success in managing the business. Many Chinese founders involve intensively in mentoring, training and preparing their successors through transferring their knowledge and social capital to the next generation.

Much of the firm-specific knowledge and *guanxi* constitute the "familiness" of the family business, which is the key part of the firm's competitive advantage, thus are of critical importance to the business. The family capital could be lost in the case of non-family succession as the founders lack the incentives to transfer these resources to family outsiders, such as professional managers. Although some founders claimed that they were also devoted to cultivating non-family talents and professional management teams, they often held back key knowledge and *guanxi*.

6.1.4 Challenges of Running a Business

Universally, doing business involves uncertainties and risks. However, many founders believe that doing business is especially hard in China. The economic downturn in the last few years might have contributed to such impression. Due to reasons such as shifted market needs towards middle to high-end products, increased competition brought by globalization and rising labor costs, financing costs and regulatory costs (the costs to conform to regulations and laws which were non-existent or non-enforceable in the past), many family businesses are facing survival crisis. The majority of the family businesses in my sample operate in traditional industries such as manufacture, construction, property development, trading and catering. The trend of industrial structure transformation and upgrading in the Chinese economy is driving traditional industries to upgrade themselves through e. g. eliminating the low-efficient, low-value-added, and high energy-consuming enterprises. In this situation, transformation is also imperative for many family businesses.

Besides, in China, the institutional environment has been unfavorable, though improving, for private business activities. Especially high uncertainties and risks may rise due to underdeveloped market system, weak institutional infrastructure, underdeveloped financial market, strong and frequently changing government intervention, which are common in emerging economies. In the SOEs dominated Chinese economy, private enterprises, especially the small to medium sized ones, are vulnerable due to many constraints and disadvantages such as unfair competition, volatile policies, limited access to finance and excessive taxation. These factors increase the difficulty of running a private business in China.

Another challenge to be mentioned is the complexity of *guanxi* in doing business. Mr. Mou's (A29) words represent this view.

“*Guanxi* is a productive force. I haven't paid much attention to maintain *guanxi* in the last few years; therefore my enterprise couldn't develop very well. Nowadays, maintaining *guanxi* is especially hard. People are shrewd, especially the government officials. They all think they are more capable than you. You are merely a person who has more money. It's really tiring to maintain *guanxi*. How nice it would be if we entrepreneurs could just focus on the business! But we have to *dadian* [打点, i. e. provide benefit, e. g. a gift or money, to someone in exchange of favor, special treatment, convenience, support, or admission etc.] many people to get things done. You have to frequently invite them to dinner and drink a lot with them. It's really exhausting. However, *guanxi* network is indispensable.”

It should be noted that the importance of the entrepreneur's personal *guanxi* with government officials is decreasing due to the improvement of formal institutions and the recent anti-corruption campaign, in which the instrumental *guanxi* activities have been greatly restrained. However, few Chinese entrepreneurs would agree that the importance of *guanxi*, with government official or others, would ever diminish. Yet managing *guanxi* is always costly as it consumes large amount of time and energy, needless to say high material costs.

These challenges could have a significant impact on founder's attitude towards succession. Chinese are believed to be long-term oriented; however, the founders of family businesses rarely make explicit succession plans. Most scholars would explain this from the founder's reluctance to face their own fatality or fear of losing power or identity. While these reasons might also be present, a neglected but critical reason in China might be that Chinese entrepreneurs, who have suffered from the high uncertainties of the socioeconomic and political environment, lack confidence on long-term development thus might embrace a short-term, opportunistic orientation in their business activities and have a weakened intention towards succession. Therefore they prefer to take things as they will be in the future.

Moreover, on the one hand, these challenges might discourage the offspring from taking over their parents' businesses, thus leave the business without a family successor. On the other hand, they might make the founders to consider succession as a highly challenging task that requires particularly high competence of their successors. Lacking confidence in their children's abilities could lead the founders to choose non-succession or alternative succession solutions. Some founders may even reject the idea of letting their children succeed their career irrespective of their abilities in order to save their children from the onerous burden of running a business.

"The Chinese private businesses face many difficulties: underdeveloped legal system and financial market institutions, impeded channel of investing, lax supervision by government authorities, and against-private-business policies. It's really hard to be an entrepreneur. Many of us entrepreneurs don't want our children to follow our track in doing business."

said Mr. Ran (A21), who plans to nurture his 18 years-old son to be a scientist or a scholar.

Some other founders tend to have a paradoxical attitude towards succession. For instance, Mr. Mou (A29) said,

"Doing business is too arduous in China, for both the body and the mind. You have to face a lot of disadvantages of being private enterprise, deal with the complicated guanxi network, and take all the pressure. It's not a job for everyone. I don't want my children to eat the bitterness. But on the other hand, we don't want the business we worked so hard for can't be continued."

6.2 The Second Generation's Choice

When making decision about succession or non-succession, founders also take into consideration the attributes and attitudes of the successor. The prospective benefits and costs determine whether the business is worth succeeding. The realization of the benefits, however, requires a competent and committed successor, who might be absent in many family businesses. For instance, due to the OCP, many founders don't have a backup successor candidate. Some of them have to face the situation that their only-children are unwilling to take over the business or lack the necessary capabilities and qualities required, as they believe, to run a business. For some, competence problem could be solved by training and founder's assistance as long as the successor is willing to take the crone. Others may lack the motivation or find their hands tied to prepare their children for succession. When there is no qualified successor available, the founder would

have to abandon the idea of succession. Therefore, the second generation's choice is also critical.

6.2.1 The New Generation: The Post-80s

The second generation of the entrepreneurs, who founded their business in 1980s to 1990s, were mostly born after 1980 and the majority of them are *balinghou* (八零后), the post-80s, who were born between 1980 and 1989.

Although each generation is unique in its own way, the post-80s are widely known in China for their uniquely shaped characteristics. They were born after the one child policy was introduced and grew up in a rapidly changing China thanks to the reform. As the majority of the post-80s are singletons, they tend to be less trusting, less trustworthy, more risk-averse, less competitive, more pessimistic, and less conscientious little emperors. There are no siblings to compete for the family resources but also no one to share their family responsibilities.

Most of the post-80s second generation in the sample received higher education at home or abroad. They seem to have been carved by both traditional values and Western modern values, which might present a startling contrast to their parents who tend to share more traditional Chinese values.

Liu (2008a) found that young adults in China tended to take an individualized, self-authoring approach to life planning and goals, and “had their own concept of “the good life,” which they see as the middle-class life-style, modeled on perceptions of success in Western developed societies”.

The founders also made their observations.

“The first-generation entrepreneurs have many virtues such as *chiku*, hardworking and combatant spirit. Our children, the 80s, are much less so, because they grew up in affluence. And they are much more self-conscious. There are three types of people who would fight for their goals really hard: the first are those with aspiration; the second are people with pressure and the last type of people are forced by the need to make ends meet. My son, I feel, still lacks a clear goal to fight for, because he doesn't belong to the three types. He doesn't have a plan about how far he would take the business to. And I won't force him to fight for the future of the business. Because according to my own experiences, I feel that making business is very hard, with a lot of pressure and risks. So I told him, 'you must decide by yourself. I've built the foundation. You can utilize it to realize your ambition to make the business big. Or if you want to leave things as they are. Or maybe you want to study or live abroad. It's all your choice.' You can't force your child into succession if he is not interested.”

said Mr. Xin, the founder of the Firm A32, which has 200 employees and 2 billion yuan assets with construction and property development as its core business.

Nevertheless, the next generation has its own strengths. For instance, they are mostly well educated. A large percent of the second generation of the founding families have studied abroad, thus have gained a more internationalized knowledge structure and vision. With more up to date knowledge and opener minds, they adapt faster than their parents to the rapidly changing, more and more globalized world in the information and digital era. As Mr. Xin further commented, “They have better education and more knowledge about the modern world characterized by Internet, information and technology. Besides, they are more innovative and adaptive than the older generation.”

6.2.2 Career Choice

The most obvious and direct motive for the children to succeed the business is pecuniary interest. For example, Ms. Mi (A6) said, “Money is the primary reason why I want to take over the business as soon as possible. I don’t want to live on a salary.”

In most cases, succession requires the successor to achieve and keep a very short relational distance to the family business, that is, to invest a large portion of her/his personal resources in the family business, which include time, energy, knowledge, social capital etc. that are required to manage the business in a way that it remains profitable. This relationship with the family business might prevent her/him from pursuing an alternative career or lifestyle. It can be seen as an opportunity cost on the part of the successor.

When the successor’s interest is voluntarily aligned with the family business, the opportunity cost of succession is low. Otherwise, the cost could be an important impact factor on the next generation’s decision on whether or not to succeed. This cost, however, could be easily ignored by the founder. In fact, the next generation’s career choice is in many cases influenced by the founder. The founder’s attitude towards the children’s career and life choice varies, largely depending on her/his personal values and preferences and the nature of the parent-child relationship.

In Western cultures, one’s life choices including career choice tend to be very personal, conforming to the spirit of individualism. Western parents are inclined to let the children find their own way to their future. When the children become adult, parents no longer have the right to interfere with their choices. Chinese parents, on the contrary, are more likely to interfere, even control, their children’s lives in many ways for the children’s own good as they believe. Obedient children would hardly reject or doubt their parents’ arrangements. Therefore when a founder believes succeeding the business is a good choice for his only son, he might try to push it disregarding the son’s own wish.

The founder favoring succession normally believes that the children would be better off succeeding the family business than pursuing an alternative career. And the children, on the other hand, tend to ignore “other possibilities” when the large part of their lives have been planned and arranged by their parents.

Nevertheless, sometimes the successor's choice might be a result of a careful calculation of the situation she/he faces.

“Succeeding the family business is definitely better choice compared to starting my own business or being employed. My father had built up a smooth path, so that I can walk on it without being tumbled. However, everyone has his own dream and aspiration. This path might not be the same one I've dreamed of, but it is the best path for me.” (Mr. Hu, A25)

6.2.3 Obligation

The children of family business founders generally have the material basis to choose the life that they want to live even if they don't succeed the business. Many founders worked really hard, full time without much enjoyment, not only to realize their self-values, but also to build a *jiaye*, a heritage for their descendants to live a happy life. The children are supposed to appreciate their parents' love and sacrifice, thus in return they should protect the *jiaye*, and even better carrying the spirit forward. This is an essential part of the filial piety. Therefore, children often feel obligatory and compulsory to succeed the business – the fruit of the parent's life-time of painstaking work. In fact, Chinese children may feel obligatory or have a genuine desire to fulfill all the wishes that their parents placed upon them even when they are in conflict with their own wishes.

For instance, the successor of the New Hope Group, Ms. Liu Chang said in an interview, “I've been an obedient child since I was little. I obey the suggestions from my parents reflexively.” Her parents made many arrangements for her and decided what and where she should study and work. Liu Chang was sent by her parents to New York when she was 14. After she came back, she studied MBA and then worked shortly in an advertisement firm before she came back to the family business, as her parents planned for her.

Talking about her decision of succession, she said,

“My mother said to me, ‘You haven't got much time with your father because he was always busy with the business and you went abroad since very young. [...] Now you want to move out and make your own business. You do the math, how much time do we, our family, still have to be together? How about this: you give it a try to go back to work in the firm. You treat the firm as a home. You think of the time together with you father in the firm as you are being filial to him at home. Try to see the relationships from another angle. At least, our family could have a little bit more time together.’ The last sentence

was what finally persuaded me to make the decision to go back to the firm. To me, it is a solution that combines love, family and personal abilities. That's why I chose this way. I prefer to use my ability and the knowledge I have learned to help my parents. I don't think I am the only person who can be the successor, but I am definitely the most loyal one, who genuinely want to develop the business and do well from the heart. I hope to do my best to watch for the enterprise.”¹²

Mr. Tan (A22) actually planned to study and settle in Germany after graduation from university and he went to a German language school for half a year. However, he finally decided to stay with his family and take his obligation to his parents.

“My mother cried a few days before my departure date. She feared that his only son won't come back again. I suddenly realized that what filial piety really meant. My parents did a hard work raising me up and nurturing me, I can't just leave them being sad afar”.

He also wanted to start his own business before he made up his mind to take over the family business.

“I finally realized that it was irrational to start my own business because I would anyway take over the family business someday.”

6.2.4 Under the Founder's Shadow

Some of the second generation, who like to pursue an independent life may want to achieve their own successes instead of depending on the foundations laid by their parents. Others may find it hard to transcend the achievement of their parents inside the business. For instance, the elder son of Mr. Sun (A12) joined the property development business after graduated from college. Half year later, he resigned because he didn't want to live under the founder's shadow. According to Mr. Sun, the son had been quite independent, who valued autonomy.

“My son told me that ‘If I succeed the *jiaye*, in other people's eyes, I am just your son. I will never truly develop inside the family business, because I will always be a little grass under the big tree. Only creating my own enterprise will give me a true sense of achievement and self-fulfillment.’ I was moved by his speech, so I agreed to let him leave and support his own business venture.”

In some cases, the strict and demanding father overwhelms the second generation with pressure, while they also have to bear the feeling of shame caused by living under the shadow of their tough father. These feelings might eventually drive the next generation away from succeeding the family business.

¹² http://www.cb.com.cn/person/2014_0617/1066537.html.

6.2.5 The Variable of Firm Size

The majority of family businesses around the world are SMEs. The comparatively small size and its focus on traditional industry may render the family business unattractive to the second generation as well as non-family professional managers, which might eventually lead to the successor's choice for non-succession.

Take the small firms for example, they usually strive to meet the demand of a small, niche market. A small family firm is likely to operate in a traditional sector as a small member of a value chain, and a provider of low-end manufacture goods or services. The survival of the firm so far may largely attribute to the extremely high involvements and efforts of the hardworking founder and the family. A typical case is the weaving factory (A9) Mr. Liu founded.

Generally speaking, non-start-up small firms tend to be less successful in financial terms. Although many newly emerged types of successful firms from technology, investment and creative industries might also have a relatively small size, in most traditional sectors, small size normally indicates under-performance, limited profitability, lack of competitiveness, and hence low long-term survivability.

From a resource-based angle, the current set of relationships the firm possesses fails to deliver to the firm the key resources necessary for growth – e.g. capital, good management, quality employees, knowledge, good public relations and innovation etc.

To solve this problem, the manager has to improve the quality of these relationships or to build some new relationships that can give access to the needed resources, which necessitates the manager's ability to mobilize, organize and allocate resources effectively and efficiently. This somewhat intractable task may fall on the shoulder of the second generation, who, however, may refuse to take over the management due to the absence of incentives – e.g. lacking interest in the traditional industries – or the lack of ability to solve the problems crippling the development of the firm.

For instance, Mr. Zhu (A23), having previously engaged in businesses in different industries, started the farm business together with his wife Mrs. Zhou in 2008. Their 24 years old daughter is running the family's restaurant which mainly serves food produced by the farm. The daughter has done a good job running the restaurant, but she didn't want to succeed the farm because "it's too tiring. I don't think my brother would do it either." After studied finance at a university in Singapore, the son, Mr. Zhu Jr., came back in 2010 and started a new venture with his father's money. The startup failed soon and then he became a full-time independent stock investor. Despite being debt-ridden, Mr. Zhu had been supporting the son's near to luxurious financial needs without questioning him. Mr. Zhu Jr. has lived far from the family for most of the time and had never

been interested in his fathers' businesses including the farm business, which he regarded as old-fashioned and has no future.

"I don't think there is any potential in that business. It requires extremely long-term investment, but you could earn much more in the financial market. Besides, it has especially high policy risk." said Mr. Zhu Jr.

Moreover, SMEs are also less attractive to professional managers, which makes it non-viable for the families to succeed the businesses by employing a professional manager to run business while the family keeps the ownership. On the one hand, the market for professional manager in China is underdeveloped; on the other hand, as Mr. Lu (A31) argued, there might be an entrepreneurial ethos shared by many Chinese – they prefer entrepreneurship or self-employment to being employed by others:

"The able person would have preferred to start his own small business instead of managing a medium sized firm, let alone smaller ones."

In summary, the founder's and the next generation's wishes, the status quo of the family business and the benefits of keeping control are key factors impacting the founder's decision about whether to let the children inherit the control of the business. Most founders are inclined to decide for succession due to familism, emotional attachment in the business and confidence in business continuity etc. However, there are also factors, such as the challenges of running the business and their love for their children, which can attenuate the founders' succession intentions. The next generation may be willing and committed to take over the family business due to reasons such as firstly, she/he is confident on the growth potential of the business and her/his abilities; secondly, she/he takes succession as her/his obligation to the family; and she/he regards taking over the small business as a better career choice etc. She/he might also refuse to take over due to reasons such as the lack of interest in the industry and the pressure and discontent to live under the founder's shadow.

As the controlling owner and the head of the family, the founder could make an authoritarian decision to transfer the control to his children, even when a careful consideration and calculation would suggest otherwise. When he insists, succession could happen, yet the risk of failure may be high.

Chapter 7.

Succession of Ownership, Control and Management

If the family business intends for succession, there are much more complex dimensions that need to be considered. When a founder has the desire for succession – namely, he wants to pass the ownership and control to his offspring – he must then consider whether to separate ownership from control and how to divide ownership and control. As we already know, that the next generation family members could choose either to be active as top executive, board member or non-active in business management while retaining their ownership.

The family is the controller of the business. However, if we reject the idea to treat the family as a whole and see it as a group of individuals instead, we may find that control is sometimes shared by a small group of individuals, more likely we are able to find out an actual controller among the family members, who is the ultimate source of authority and the leader of the business family. This is especially prominent in the cases of most Chinese family businesses in the founder's era.

The founder who is the sole owner and manager of the firm is the best example of the most powerful actual controller. She/he is the agent of the firm who makes decisions about

- (1) the goals of the firm,
- (2) the acquisition of resources from the firm's stakeholders (e.g. employees, investors or creditors, suppliers etc.),
- (3) the use of these resources to achieve the goals (i. e. production, marketization etc.) and
- (4) the allocation of resources back to these stakeholders (e.g. salaries).

These decisions are largely shaped by her/his personal characteristics, ideas, preferences and abilities.

Under the founder's reign, the structure of the network stays more or less in a stabilized mode. This structure – let's call it the old structure – however, will inevitably go through some changes in the intergenerational transition process

because the task of succession is not only to replace the founder with a new controller, who can completely change the game, but also, ideally, a new system.

Firstly, the possible change of the ownership structure, e.g. from founder-ownership to sibling partnership, redefines the distribution of benefits, power and responsibilities. Secondly, as the next generation leader might have distinctive characteristics, values and beliefs compared to the founder generation, she/he may view the organization differently and prefer a different management system and style. As Hall and Tolbert (2005) pointed out, “new leadership can produce dramatic changes in the organization”. Thirdly, relationships must be redefined or rebuilt. Consequently other members of the organization have to deal with these changes – to walk away, to resist or to adapt.

After a transitional phase, a new structure arises. Therefore, to understand how the old structure transforms into the new one, it is crucial to identify the features of the old structure and investigate how these features could shape the new structure and in what way. The source and means of control can be an important clue to unravel the mysterious box of the succession process.

7.1 Family Ownership in the Founder’s Generation

The governance and management of the business is confined by its ownership structure, which varies between the two extremes – from sole ownership, i.e. a firm with only one owner, to highly dispersed ownership, e.g. widely-held, publicly traded large corporations.

A family firm, is characterized by family ownership, i.e. a large portion of its equity is concentrated in the family. On the one hand, the degree of ownership concentration in the family varies to each family firm. On the other hand, the structure of family ownership, i.e. how ownership is divided among family members, is also heterogeneous.

The ownership structure of privately held enterprises is often kept secret not only to the public but also to their employees. Therefore, quantitative information is hard to acquire, but it is possible to identify some general attributes of family ownership.

From the legal perspective, the Regulation on Individual Industrial and Commercial Households, Sole Proprietorship Enterprise Law, Partnership Business Law, and Company Law permit a Chinese enterprise to take the form of either individual business (*geti gongshanghu*, 个体工商户), sole proprietorship (*geren duzi qiye*, 个人独资企业), partnership (*hehuo*, 合伙), limited company (*youxian zeren gongsi*, 有限责任公司) or stock company (*gufen youxian gongsi*, 股份有限公司).

An individual business has a sole owner, an individual or a family household, which must be managed by the owner and has a small size – historically less than 8 employees according to the regulation. Most entrepreneurs started their businesses in early reform stage took this form because the Company Law which regulates limited company and stock company was inexistent before 1994. Currently, some small family businesses such as mom and pop stores, small restaurants or family workshops still take this form. A sole proprietorship is fully owned by one person who bears unlimited liability. The law doesn't restrict its size, but it is normally small to medium sized. The owner of a sole proprietorship may employ a manager to run the business. Partnership is based on natural persons and fully controlled by their owners with unlimited liability. Businesses taking this form are rarely controlled by a single family.

A limited company has 1 to 50 shareholders. A shareholder has an interest of the firm's equity and assumes limited liability based on their registered capital contribution. The majority of family businesses take this form. Stock company generally has a large scale. Its shares can be freely traded and owned by an unlimited number of shareholders. Only stock companies may be listed on stock markets. Therefore, when the owners of limited companies want their businesses to go public, they usually restructure the assets to establish a new stock company.

It is common that a family controls a few companies instead of only one. It usually integrates these closely related companies based on parent-subsidiary relation (the parent controls more than 50 % of the subsidiary's equity) or affiliation (affiliated companies are related to the parent company through shareholding, management, or controlling of resources etc.) into a business group. In line with the business registration regulations, a parent company can be named "group" (*jítuán*, 集团) when it controls a few – usually at least five – subsidiaries.

7.1.1 Ownership Structure

The ownership structure of the family-controlled firms in the Chinese context is diverse. Let's first take the family as a single entity. To achieve control usually requires the family to hold the majority i. e. more than 50 % of the total shares. In most private family firms in China, this figure tends to approximate 100 %.

The prevalent form is that the firm is fully owned by the family. In addition to those small ones which take the form of individual business or sole proprietorship, larger limited companies are also commonly owned by a single person or a family. Of the 45 family businesses interviewed, 28 founders claimed that they were the sole proprietors of their core businesses. For instance, incorporated in 2002 by the founder, Mr. Mou, the Firm A29 consists of more than ten sub-

sidiaries which operate in construction, real estate development, finance, hotel, agriculture and other business areas with 560 employees and total assets of 650 million yuan. Mr. Mou and his wife directly own the group and some subsidiaries, while other subsidiaries are fully owned by the parent company. There are also examples of family firms with non-family minority owners who can be trusted family friends, founding members or employees.

In China, ownership structure of a family firm in the founder's generation can be attributed to its founding origin – the business was either founded by the family owner(s) from scratch or transformed from SOEs or TVEs through privatization.

The first type of family firms which were built up by the founders is out of “private” concerns, with family members as their main contributors of capital and labor. Thus they are owned and controlled by the family from the beginning. Many of these firms founded between 1970s and 1990s were financed by their founder-entrepreneurs' personal or familial savings or borrowings. During the initial stage, the investors market was still in the bud; therefore these entrepreneurial firms had difficulties in finding investments. Until the amendment of the Constitution in 1988, which cleared the ideological barrier, private business activities were regarded as illegal, which implies highly risky undertaking and unsecure investment.

The entrepreneurs kept reinvesting the earnings made and financed the firms by debt. More often than not, this pattern continued in the developing stage. On the one hand, the finance market and the legal framework for investor protection – i. e. the enacting and enforcement of laws which protect investors from expropriation by the managers and controlling shareholders of firms – had been underdeveloped. Low investor protection, for instance, discouraged external investors to become non-controlling shareholders. Only those who had built up highly trusting relationships were likely to invest. Therefore, bringing in nonfamily shareholders was still not viable to the vast majority of the family firms at that time. On the other hand, the desire to retain absolute control over the business also kept the family from bringing in new players to the game. Although this might invite and ensure more voices to be heard and more angles to be approached, it could also make the consensus reaching more costly and inefficient. The strategic decision of ownership structure implies the careful calculation of these trade-offs. In reality, most Chinese founders had preferred debt to equity as funding methods, thus maintained concentrated ownership within the family, where the owner had full control.

A consequence of highly concentrated ownership might be that many family businesses remain relatively small due to their limited access to finance. Some family businesses, however, are able to overcome this constraint. Thanks to improving investor protection, venture capital and private equity funds have

grown rapidly in China in the last decade, which sustained some of those family firms' expansion via capital injection. Meanwhile, the stock market has also converted many family firms into publicly traded firms.

The second type of family business is the result of the privatization of SOEs or collectively owned, e.g. township and village enterprises (TVEs) and red hat firms, let us call these the privatized family firms. The restructuring of ownership of each enterprise depends on its specific conditions. Some firms' arrangements facilitated the acquisition of shares by the manager or his/her family through management buyout, which gradually rendered a highly concentrated family ownership. Sometimes the firm became fully owned by the controlling family.

For instance, the predecessor of A20 Group was a collective enterprise founded in 1975. Mr. Huang was a founding member and became the General Manager in 1992. In 1997 the collective enterprise was restructured and incorporated as a limited company and Mr. Huang became the Chairman and General Manager. At the time of reformation, each employee, around 200 in total, was given an amount of shares. Shortly after that, the company fell into a steep decline. In 2000, the operation of the business undergone severe difficulties and started to downsize. Mr. Huang then gradually purchased most of the shares from the remaining employees, as he stated, "I didn't want to control the majority of the shares in my family. I was forced to do so. When the company had difficulties, everybody wanted to refund his shares. I had no choice but to let my family take over those shares." Now Mr. Huang's family owns close to 100 % of the equity of the group.

Some firms, nevertheless, have kept minority nonfamily owners. A typical example is the FW Company (A17).

FW Company is the second largest producer and the largest exporter of pickle products in China with 1200 employees and a turnover of around 635 million yuan in 2014. The predecessor of FW Company was a state-owned enterprise. Began to work there in 1989, the founder, Mr. Deng, turned the loss-making enterprise into a profitable one and gradually built up the FW brand. In 1999, the enterprise was restructured and the new corporate FW Company was founded with Mr. Deng being the Chairman of the board and General Manager. A few former employees became shareholders of the new company. Currently, Mr. Deng owns 82.4 % of the shares, with other ten shareholders owning the remaining 17.6 %, most of whom are also senior employees who are still working in the firm.

Started in comparatively large size, the privatized family firms are more likely to develop into large groups and become publicly traded. For instance, Wanda Group, Midea Group and Wanxiang Group all started as TVEs and currently they

are all market leaders in respective industries with their core businesses publicly traded.

7.1.2 Family Ownership Structure and a Story of Fenjia

The concentration of ownership within the family guarantees the family's dominant position in the business. Treating family ownership as one block, however, actually ignores the fact that the family is essentially made up of a number of individuals, each of whom has a different stake at and play a distinctive role in the family business. Thus the structure of family ownership is heterogeneous, resulted from path dependency, family relationships and power relations inside the family. Generally speaking, the owners of a family business in the founder's generation can include the founder and her/his spouse, siblings, parents and children etc., in other words, family ownership can be held by an extended family or a nuclear family.

An extended-family ownership structure is often the result of sibling partnership in the founding phase. It is common that siblings, especially brothers, started a business together. In the start-up phase, the brothers might work together without negotiating ownership division, especially when the brothers hadn't gone through the process of *fenjia* (family division). Conflict of interests accrued from ambiguity of ownership when the business grew larger. The solution generally reflects the power relations among the brothers. Only a small fraction of the family businesses could maintain sibling partnership, i.e. each sibling holds a significant portion of equity and plays an important role in the management of the business, as it requires well-functioning cooperation and trusting relationships among the siblings. When the interests can't be aligned, the solution is *fenjia*.

Fenjia can be fatal to the business, but sometimes could also render rebirth. The fenjia story of the Liu Yonghao brothers is a good example of the latter:

Mr. Liu Yonghao and his three brothers started a feedstuff factory in 1982. The factory had been regarded as a common property until 1991, when the four brothers clarified the ownership structure, with each holding one-fourth interest of the factory. Earnings accumulated were also equally divided. Liu Yonghao and the eldest brother Liu Yongxing started some new businesses separately with the earnings, but all the firms belonged to the Hope Group, with the original factory being a member as well. The real *fenjia* happened in 1995 when the brothers decided to divide the Hope Group and formed four new groups, which have been financially independent to each other. Each brother took his responsibility to his own group. Liu Yonghao's New Hope Group has been developing the fastest and made great success. With annual sales of around 90 billion yuan, the New Hope

Group (NHG) has grown into a multi-national giant as the leading agribusiness operator in China with more than 600 subsidiaries and over 80,000 employees around the globe. Besides agribusiness, NHG also operates in three other major areas: chemical industry and resources, real estate and infrastructure, and finance and investment. Now Liu Yonghao, his daughter and wife own 100 % of the restructured New Hope Group, which owns many other subsidiaries and associated companies, as well as publicly traded firms through complex cross-holding and pyramid system. For instance, the Liu Yonghao family owns 53.39 % interest of the publicly traded New Hope Liuhe Co., Ltd through two fully owned companies: the NHG and the Southern Hope.

The story of the Liu Yonghao family is just an example of the unstable sibling partnership, which eventually transforms into nuclear-family ownership before the second generation gets involved in the business.

A different situation might be that some family firms have had a clear nuclear-family ownership structure since the beginning even when siblings are involved somehow in the same business. An interesting case is Mr. Liu (A9). His two brothers and a sister are also business owners in the same industry. The four factories are close to each other but the siblings keep running the businesses separately since the beginning because the Liu family was divided years before the brothers started the business. After *fenjia*, the siblings each built their new *jia*, but they have kept close relationships. The four siblings have often discussed business together and helped each other to solve problems, including lending without interest, technical support, and information and orders sharing etc. Nevertheless, financially they are totally separate. Each sibling is responsible for her/his own firm in decision making, operation and risk bearing.

When the siblings of the founder join the firm explicitly as employees, they are unlikely to be given any equity. As a result, ambitious siblings prefer to leave the firm and start their own businesses. They may get financial support from the founder, which on the one hand is a reward for their contributions; it can also be deemed as an act of assuming family or kin responsibility from the founder's side on the other hand.

Inside the nuclear family – the founder spouses and their children – there could be a separation of ownership and control among the family members. A few founders' wives are non-active shareholders, whose shareholder rights are fully delegated to the founders. Some founders of the family firms in the List A claimed that "I am the only owner of the firm", who apparently denied the spouses' status as owners. Legally, even when the founder's spouse is not authorized with ownership, the spouse might still be a legitimate shareholder. According to the Chinese marriage law, the spouse of the founder has rights to the half of the ownership (and earnings) held by the founder if the ownership (and earnings) is acquired after they get married, unless a pre-marital arrange-

ment stated otherwise. Nevertheless, most of these spouses usually do not actually control the equity or exercise shareholder rights.

This nuclear family ownership structure changes when the second generation family members are allocated ownership. It could turn into an extended family ownership structure when the children get married. As the founder is the head of the nuclear family as well as the extended family developed out of it, power and authority over the business still reside in him. When the family head, the founder, is still in place, the children are united together under the same *jia*, thus family harmony and the second-generation sibling partnership is likely to be maintained. After the founder passed away, the situation may change as the siblings each become the head of their own *jia*. The extended structure then might also follow the path of division and transform into new nuclear structures.

Before we go to the question of how family ownership is actually divided in the next generation, to fully understand the ownership arrangement in the new structure, the multi-company structure of family business needs to be briefly addressed.

7.1.3 The Family Business Group

Much of the family business succession literature has seemingly assumed that a family controls only a single business and the family's succession decisions thus all center on the transfer of management and ownership of this business. However, most families in this sample control multiple companies, which usually consist of a core business as the main source of revenue with a few subsidiaries, and some other companies which are parallel to the core business, being either developed or acquired later. The relationships of these companies controlled by the family can be highly complex.

7.1.3.1 Parallel Companies

When a few companies are controlled by the same owner while they are financially and organizationally independent to each other, they are considered to be parallel. For instance, Mr. Liu (A7), aged 49, currently owns three companies: the LD Transportation Co., Ltd founded in 1998, the RD Automobile Sales & Service Co., Ltd founded in 2008 and the Bio Agricultural Development Co., Ltd founded in 2014. Besides, he also invested in a restaurant of his only daughter. The three companies are all small and financially independent to each other, except that they have the same owner-manager. The newly started agricultural company hasn't made any profit, and its operation has been supported by Mr. Liu's personal earnings from the other two companies. These companies Mr. Liu controls

are parallel because they are unrelated to each other in terms of financial relationship, control structure and legal responsibilities. Controlling one of them won't affect the others, therefore they are easily separable.

7.1.3.2 Parent-subsidiaries

In the course of development, many families become diversified in their business areas. A large size family business is often a group, with a parent company or a holding company owning a few subsidiaries (more than 50 % of their equity) and associated companies. The group can be a complicated network of companies connected via family ties, management system (e.g. centralized controlling system or shared management personnel), supplier contracts, or, most importantly, ownership control by e.g. cross holding and pyramid structures.

For instance, Mr. Yuan's A18 Company was established in 2005, which controls 7 subsidiaries that operate in auto parts manufacture (core business), cultural investment, coal trade, market management and restaurant. Controlling the parent company gains automatically the control of its subsidiaries. The founder also directly owns 100 % of three other parallel companies: BS Technology Development Co., Ltd., JL Agricultural Development Co., Ltd. and ZY Auto parts manufacture Co., Ltd.

Sometimes, the group develops into a very large one, comprising a number of sub-groups, each of which controls a set of subsidiary companies. In the case of publicly traded family business, it is a common practice for the family to establish a new parent company or a few holding companies, whose ownership is fully controlled by the family before (or sometimes after) the IPO, to control a large block of its shares. The cases of the Wanda Group and Lifan Group both exemplify this logic.

Wanda Group was founded in 1988 in Dalian, Liaoning province by Mr. Wang Jianlin. Operating in four key areas – commercial properties, culture & tourism, E-commerce and department stores, Wanda Group has become the world's largest commercial property company and cinema chain operator. In 2014, the company had assets of 534.1 billion yuan and revenues of 242.48 billion yuan (Wanda Group, 2015¹³). According to the IPO Prospectus of Wanda Commercial Properties, Dalian Hexing Investment Co., Ltd. directly owns a 99.76 % interest in Dalian Wanda Group, while Mr. Wang Jianlin directly owns the remaining 0.24 %. Moreover, Wang Jianlin directly owns 98 % of the equity of Dalian Hexing, and his son Mr. Wang Sicong owns the remaining 2 %. This means that Wanda Group is 100 % owned by the Mr. Wang Jianlin and his only son via this holding company – Dalian Hexing. Meanwhile, Wang Jianlin also becomes the ultimate

13 Wanda Group official website: <http://www.wanda-group.com/corporate/>

controller of many subsidiaries and associated companies including two publicly traded companies: the Dalian Wanda Commercial Properties Co., Ltd. and the Wanda Cinema Line Co., Ltd.

7.2 The Transfer of Ownership

The family ownership will be passed on to the next generation in the succession process. Due to the one child policy, the next generation sometimes consists of only one child, thus the ownership succession is normally simple and straightforward: from parents to single daughter/son.

In the sample cases, nearly half of the business families have only-child in their second generation. Although due to the applied sample strategy this result should not be generalized, it's safe to say that single-child business family is indeed a very common phenomenon. These families don't have to face the division of family property or the business in the first succession, despite that they might have other problems to solve – such as the lack of willingness or competence of their single heir in taking over the business.

When the founder has more heirs, the division of the ownership among the children can become a complex and tricky issue. According to Gersick et al. (1997)'s model, family ownership typically tends to evolve from controlling owner to sibling partnership and then to cousin consortium. Do the multi-heir Chinese family firms follow the same path? This section examines how the Chinese founders divide ownership among the heirs and discusses the reasons and outcome of these arrangements.

7.2.1 The Equal Inheritance System

Family ownership of the business is generally regarded as a part of the family property; therefore, theoretically its succession is subscribed to the general principles of family property inheritance. The traditional Chinese inheritance is dominated by patrilineal equal principles. According to the equal inheritance system, family properties are divided more or less equally among sons during the *fenjia* and inheritance process, while daughters are excluded.

Ownership of the firm is usually associated with properties, assets and wealth. It is a value accepted in most societies that parents' properties and wealth are inherited by their children. In the traditional Chinese culture, this value is especially influential. Parents strive very hard for the goal of leaving their children a fortune and they are more than ready to support their adult children financially

in many ways, including giving them large amounts of money for starting a business.

Unlike Germany or the US, there is currently no inheritance and gift tax in China. Regulated by the Chinese inheritance law, the passing of properties and assets from one person to her/his spouse, children, parents, siblings and grandchildren won't be taxed.

Studies of overseas Chinese family business suggest that the traditional equal inheritance system is still a prominent feature of family business ownership succession. Wong (1985) proposed a four stage model to explain the growth and development of family businesses in Hong Kong. According to this model, family business firstly emerges, then it becomes centralized in the founder, which becomes segmented in the second generation through family division, and finally disintegrative when the third generation gets involved in the business. Comparing the approaches to succession in Japanese and overseas Chinese family businesses, Chau (1991) found that "the tradition of coparcenary is alive and well perpetuated" and it is potentially damaging to the family business. Chau's idea had been hardly challenged until recently. In his study of Chinese family firms in Hong Kong, Victor Zheng (2010) found that "the equal inheritance system per se has a certain constructive function that can reduce business instability and family conflict instead of provoking internal rivalry."

In mainland China, the situation is quite different as there has been a weakening of the traditional familism. The ideology of equal inheritance is still vivid in the mainland; however, the actual inheritance system – how family assets are actually divided among whom – has undergone some changes. Although the traditional idea of equal treatment of heirs is generally still wielding its power in shaping the succession process, the principles of the equal inheritance system are not necessarily conformed in ownership division.

7.2.2 Daughter Heirs

The traditional equal inheritance system declines daughters' rights to *jiaye* (family business and property). This principle has been abandoned by most founders, although daughters are sometimes given less shares compared to sons.

In most cases in Chongqing and Zhejiang, daughters are treated the same as the sons in terms of their rights to family property, despite that daughters are sometimes declined as management successors. As an example, Mr. Gao, the founder of Firm A27, repeatedly mentioned "gender equality" when talking about his ownership arrangements plan in the interview.

“Our principle is that our property will be equally divided between our daughter and son. There shouldn’t be any bias. Now people say sons and daughters are equal.” Mr. Gao’s idea was that the asset should be equally divided as both children didn’t contribute to the family business. “If any one of them has made great efforts to the wealth creation, she/he should be given a little more. When they both have no big contribution, then it should be equal. Only like this will it be fair.”

Discriminated treatment to sons and daughters, however, is present in some cases. For instance, Mr. Hu Senior, the founder of A25 Company passed the full ownership of the company to his son a few years ago. His two daughters, who were given a large amount of dowries when they got married, were not distributed any share of the firm. The successor position had always been reserved for the son. Patrilineal ideology seems to be present; however, not giving the daughters equity might be out of the concern to ensure the son’s absolute control. The daughters were actually not regarded as *wairen* (non-family) as they have received some financial support from the parents after they got married. Moreover, the daughters have shown no interest in the shares of company themselves, which may due to the fact that their husbands have been running their own businesses so they are not financially constrained.

Another contrasting case is the Firm B1 in Shenzhen, Guangdong province. The business is now running by the second generation, the three sons of the founder. The family is strongly imprinted by the traditional family culture – ancestral temple and family tabulates enshrined in the family house. The eldest child of the third generation, the granddaughter of the founder Mr. Li Senior, has been working in B1 after she finished her study abroad and gained a year’s working experience outside the family business. The CEO and son of the founder publicly said in a group meeting that daughters could work in the business but they would neither be chosen as successors nor given any equity. Hearing these words, the eldest daughter didn’t raise an objection. It seems that the no-daughter rule has been taken for granted in the Li family.

7.2.3 Division among Siblings

The first-generation founders rarely have more than 3 children. The majority of founders in my sample have one or two children. It is assumed as a more challenging task to divide the ownership if there are more than two heirs.

As discussed above, the founder often owns multiple firms instead of only one. In most cases, these firms, especially the parallel ones, are separable from each other. Therefore, the founders often choose to let each heir inherit one or more firms separately, as a way of *fenjia*.

For instance, Mr. Mou (A29) plans to divide the family business into two groups in the future so that his son and daughter could each inherit one. In another example, Mr. Mao Lixiang (Fotile Group) passed the full ownership and control of Feixiang Group to his daughter. The Fotile Group which was founded later was completely handed over to his son. As Fotile had grown into a much larger firm compared to Feixiang, the daughter was given 14 % of the equity of Fotile Group many years after the firm's establishment.

After inheritance, heirs may keep a close cooperation in business with each other, but each heir is independently responsible for the firm(s) being allocated to her/him. Sometimes, separating the firms can turn the siblings into competitors. Besides, dividing a large business into a few small businesses might lose the advantage of economies of scale.

When the founder regards the business as inseparable as there is only one company or the core business is much larger than the others, two strategies are often applied.

The first strategy is to give each heir a part of the ownership. For example, the Firm B1 was founded by Mr. Li Senior in 1989. The parent company, the B1 Holding Group Co., Ltd. now owns 14 subsidiaries and affiliated companies. Mr. Li Senior has completely transferred the ownership of B1 Holding to his three sons: the eldest son with 36 % of the shares, second eldest with 32 % and the youngest son with 32 %. The three sons are running the business together, with the youngest son being the CEO.

Mr. Chen Zemin is the founder of Zhengzhou Sanquan Foods, one of China's largest frozen dumplings suppliers which provides employment to ca. 20,000 people. Mr. Chen has a passion for food. He invented fast-frozen dumplings and sold the products in local market. In 1992, despite the opposition of his entire family, Mr. Chen, at the age of 50, quitted his job as a surgeon, rented a formerly small print shop and started China's first frozen-food business. In 2008, a year after the firm's IPO, Mr. Chen handed the baton to his two sons. The elder son Nan became the Chairman and the younger son Xi was appointed as the General Manager. The two sons were each given the same amount of shares. Currently, the founder's family holds more than 60 % of the total shares of the public firm, with the founder directly holding 10.48 %, the two sons holding respectively 9.91 % and 9.84 % and the founder's wife holding 8.55 %.

Another example is the Lifan Group. At the age of 53, Mr. Yin Mingshan established the Chongqing Lifan Company in 1992, which has developed into a large corporation with staffs of 12,966 and sales over 30 billion yuan in 2014. In 2010, the subsidiary, Lifan Industry (Group) Co., Ltd. was listed in Shanghai Stock Exchange. Currently, 49.25 % of the shares of the publicly traded company are held by the parent company, Chongqing Lifan Holdings Co., Ltd.

The holding company is fully owned by Mr. Yin Mingshan (26.5 %) and his family – his wife, his son and his daughter each with 24.5 %.

The three families' ownership arrangements so far remind us of the equal inheritance system. However, Lifan and Sanquan's future plans for the parents' remaining shares are not yet clear. Mr. Chen Zemin has handed over the management baton to his sons. Mr. Yin Mingshan, on the contrary, is still the dominant shareholder and has the absolute authority in firm affairs. He has built a top management team which consists of three professional managers, who he claimed are his three successors. How Mr. Yin Mingshan and his wife distribute their 51 % shares in the future is a critical issue as it will affect the ultimate ownership structure.

Unlike other properties, dividing business ownership equally among heirs could affect the functioning of the business as decision making rights are also dispersed. Unless a system is especially designed to define the delegation of the control among the heirs, decision rights are automatically assigned to all heirs. When none of the siblings has the controlling (i. e. majority) ownership, there is a high chance for the breed of "internal war for control" due to the conflicts among siblings and thereof tear the firm and the family apart. However, even when the family is aware of this potential peril, they can hardly reject the idea to more or less equally divide the ownership of the business among heirs, because fairness is a key for family harmony.

Alternatively, as the second strategy, some of the heirs are encouraged to create their new businesses with the support from the business family. The family's earnings made through the family business are invested in the startups.

The second generation often joins the business after they finished their formal education. The age difference between siblings determines that one sibling – normally the eldest – joins the family business earlier than others. Naturally she/he is more likely to take over the business. Founders thus may consider alternatives for other heirs.

After graduated from college, Mr. Yang (A8) didn't join the family business, an auto parts factory, as his elder brother did 5 years earlier. He was instructed to start his own business by his father because the elder brother had done a good job managing the firm. Using the money provided by his father, Yang started a trade company.

In summary, generally the concentrated family ownership in the first generation is inclined to be segmented in the second generation in multi-heir family firms in the mainland, which roughly confirms the observations of overseas Chinese family businesses. A major difference might lie in the change of daughters' status from being excluded from the heir list to being entitled more or less the same inheritance rights as the sons, which might attribute to the introduction of the one child policy.

The change of ownership structure, i.e. the transfer of ownership from the founder to the heirs, can have significant impact on the control structure, and in turn the management structure, of the family firm.

7.3 The Management of Chinese Family Firms

The structure of ownership is the foundation of the firm's management structure – which includes a governance structure when control is to some degree separated from ownership – as it determines how the power to make decisions regarding the organization of the business is distributed.

The management structure of the family firm is more intricate compared to the ownership structure, because management is to a large part intangible. Management structure evolves and shifts its form as it goes through the organizational life cycle. Generally, there is a trend towards an increasing degree of professionalization, which transforms the old management structure into a new one.

As management structure is mainly determined by the person who manages the firm, its transformation thus relies on the person's decisions and actions. The founder, as the controlling owner and manager, plays a central role in carving the management structure of the family firm. Under his rule, the management system and organizational culture are accustomed to his personal style and linger about in a relatively stable state. However, the need for organizational adaptation may become imperative and urgent to cope with the growing complexity brought about by the development of the firm. Additionally, sometimes the organization reformation is originated by some open-minded founding entrepreneurs intentionally due to more recognition of self-limitation or purposeful preparation for heirs' succession. Therefore, the transformation can be initiated and led by the founder, either passively or actively.

Yet the founder might be fettered by entrenched ideas and relations that keep the firm away from moving forward. Alternatively, the successor can be the real change-bringer. Succession therefore can but not necessarily be a changing force to the management structure.

In short, the successor stepping into the leading management position will have to adapt to the old structure or make the structure adapt to him. In either case, the successor is inevitably influenced by the legacy of the founder's management.

This section discusses a few typical features of the management structure of Chinese family business in the founder's generation: founder centrality, *renqing* governance and family management.

7.3.1 The Final Say: Founder Centrality

In Chinese family firms, as the ownership is concentrated in the founders, control is usually completely held by the founders before the next generation actually takes over. Generally, the firm relies heavily on the founder's ideas, knowledge, expertise, capabilities, and personal *guanxi* for functioning and development.

In most family firms, authority and decision making are highly centralized in the founder – she/he has absolute authority over firm affairs and the final say to all firm decisions. As the agent and controller of the firm, the founder largely influences the behaviors of the family business by shaping the behaviors of the other stakeholders, who, especially the employees, adapt themselves to the leader's management style.

When the firm is still small, the founder-manager is the hub of organizational process, where decisions are made and commands are given by the founder.

In the founding stage, the Chinese entrepreneur is often both the manager with unquestionable authority and the employee who is extremely hard-working and skillful. These hands-on founders know all the details of the production and build close personal relationships with the employees. When the firm grows, new stakeholders join the game – more employees, investors, suppliers, and clients, etc. It could reach a point that the requirements for the business' well-functioning transcend the founder's managerial capabilities. The managerial capacity deficit may arise in the operational level but could also lie in the strategic level. Operational constraints can be solved by delegating operational responsibilities and power to lower level management. The strategic level limitation, on the other hand, requires the owner-manager to adopt decentralized, more rational decision-making mechanisms backed by professional management team. The founder might employ managers to take on operational tasks, while she/he reserves the decision making about all matters that she/he regards as important.

Mr. Li is the Chairman of the Firm A15, which is a medium sized real estate developer with around 100 employs and an annual turnover of 300 million yuan last year. A few years ago he gave out the General Manager title to a non-family professional. The current General Manager is in charge of sales and routines, and the Vice General Manager is responsible for dealing with the paperwork and construction supervision. Mr. Li, meanwhile, looks into and makes decisions about “things that are important”. “Being an entrepreneur, you have to deal with everybody, every kind of people.” Like many other Chinese founders, he has an open office, where he can be approached by any employee if an issue occurs. During the interview in his office, an employee came and showed him the draft design of a print advertisement. He gave a few comments and ordered a revise. This little incident implies that “things important” include not only these of strategic importance but also very specific details. In fact, he is still the hub of

centralized decision making and the top management team is mainly responsible for execution and suggestions.

In small to medium sized firms, where the management structure is relatively simple, centralized management power in the founder is a common practice, whereas many founders of very large firms also exhibit this authoritarian type of characteristic.

Mr. Wang Jianlin has been running Wanda Group in a highly autocratic manner. He said,

“A leader being forceful facilitates decision making. When he is smart enough and avoids making mistakes, the enterprise will develop very fast. On the other hand, obstinacy breeds mistakes. I am trying hard to find a balance point. Enterprise after all depends on the entrepreneur. I don't agree on democratic decision making in the business.”¹⁴

The merits and drawbacks of the concentrated control have been discussed in full length in the literature. A single voice can be a double edged sword, on the one hand enables the firm to react swiftly to the changing market conditions and seize the fleeting opportunities; on the other hand reckless decision making can bring fatal consequences to the business. The good or bad of authoritarianism mainly depends on the abilities of the manager to appropriately assess the situation, decisively make up the call and efficiently implement the tasks. Not surprisingly, many of the successful family businesses are led by charismatic and visionary founder-managers in an authoritarian way.

The centrality of the founder may render the organization overly dependent on him/her so that the building-up of management team and alternative decision making mechanism is neglected. A typical example is Mr. Zong Qinghou's centrality in the management of Wahaha.

Due to the absence of supporting management systems, family firms with extreme founder centrality can easily fall into decline after the successors take over, as the successors may not be as insightful, forceful, decisive and charismatic as the founding leaders. For instance, after the autocrat founder of Haixin Steel was murdered, his son took over the business in a rush without any preparation. Being alone in the top management, he made a series of fatal mistakes such as switching from the core business to finance in an impetuous way, which eventually led to the firm's bankruptcy.

14 <http://www.talentsmag.com/article.aspx/5100/2>

7.3.2 Renqing Governance

The overwhelmingly powerful founder at the center of the family firm is portrayed in the last section. How does she/he actually manage the business? Strongly affected by the traditional *guanxi* ethos, she/he is inclined to resort to *renqing* governance to deal with her/his relationship to the firm's employees.

Renqing governance means that in the business organization, it is the personal, informal and *guanxi* oriented *renqing* rules instead of the more formal, contractual and impersonal governance mechanism that governs the behaviors of both the manager and the employees. The foundation of *renqing* governance is deeply rooted in the norm of reciprocity and traditional Confucian *lunli*.

Renqing governance has a few attributes. Firstly, the manager manages via personal *guanxi* building with employees instead of relying on impersonal and contractual relationships.

The manager applies the mechanism of *renqing* to organize people and solve problems. The boundary between the personal and the business is often blurred. The manager and the employees often bring their sentiments and exchange history to the workplace so that they mix the business life with private life. In this type of governance, the manager tends to rely on mutual trust and tacit understanding synergy, while believing that formal rules may be connoted as distrust.

Moreover, the employees might be treated in a manner which is in accordance with the same principles of family relationships (pan-familism). The founder of the Firm B5 is a typical paternalistic leader who is authoritarian and benevolent. He values his authority so much that he can't tolerate any disobedience, while at the same time he treats the employees well as his own children. When the employees got sick, he diagnosed and prescribed for them himself.

The founder might see herself/himself as the *jiazhang* (family head) of the family-like organization, instead of merely a manager. For instance, Mrs. Wang (A28) has tried to promote a family-like atmosphere in the company by caring for the employees and supporting them at her best.

"You are like the *jiazhang* of a big family. Besides being generous on employee's welfare, you have to trust them, help them when they have problems in their lives and credit them in their work." said Mrs. Wang.

She is the only interviewee who makes home visits to know her employees better and to pay attention to their private life, which might manifest the special sensitivity of a female manager.

To promote a family-like atmosphere in the firm is an important means of *renqing* governance.

"Instead of 'boss', I prefer to be called 'changzhang' (head of the factory), because it sounds intimate and like the head of the family. I am willing to be a good *jiazhang*

(family head).” said Mr. Zhuang, “Our staffs come from all over the country. I think no matter where they come from, they are a family in the firm. I respect everyone.”

With the responsibilities of *jiazhang* in his mind, Mr. Zhuang provides his employees very attractive welfare programs which also care for the employees’ families. This caring culture has kept the staff turnover rate around 2 % in the last ten years.

Secondly, the manager-employee relationship is asymmetric, as the manager being the superior and the employee being the subordinate. The two roles are clearly defined by the traditional *lunli*. The manager expects the respect, obedience, trustworthiness and loyalty from the employees, while he is expected by the employees to be benevolent and moral. For instance, Mr. Yin (son-in-law of the founder of A17) commented on the management style of the A17 founder,

“The older generation believes that there is a difference of authority and position between the elder and the younger. They have the traditional Chinese values of ‘*jun jun, chen chen, fu fu, zi zi*’ [i. e. the ruler should rule, the minister should minister, the father should behave like a father and the son should behave like a son]. They value *lunli* and emphasize discipline.”

There is high conformity by the subordinates, who depend on the leader’s command or guidance as the ground for actions, especially those influenced by the Confucian ethics.

According to Hofstede’s cultural dimension research, China has a high score with 80 in Power Distance – compared to 35 of Germany and 40 of the US as illustrated in Figure 5 – which indicates that in Chinese business organizations, employees are more likely to accept and expect the boss to be the powerful and centralized authority. There tends to be “considerable dependence of subordinates on bosses. Subordinates respond by either preferring such dependence (in the form of an autocratic or paternalistic boss) or rejecting it entirely. Large power-distance countries thus show a pattern of polarization between dependence and counterdependence. In these cases the emotional distance between subordinates and their bosses is large: subordinates are unlikely to approach and contradict their bosses directly” (Hofstede, Hofstede, & Minkov, 2010).

Overly dependent on *renqing* governance might have unwanted consequences for the family firms. The first consequence can be that formal rules and institutions are not established. The lack of formal institutions, such as clear formal procedures, written rules for guiding and regulating the behaviors of employees might render the organization inefficient. For instance, Mr. Hu, the second generation leader of A25 Company, said,

“My father’s generation believes that it is very difficult to use *zhidu guanren* (resort to institutions to manage people). Chinese are a person-based nation and *renqing* is

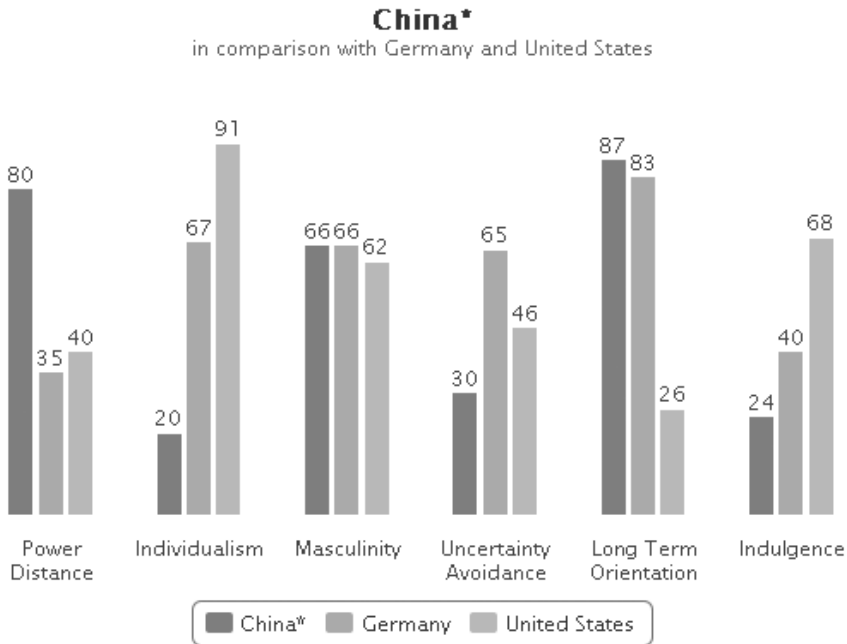


Figure 5: The Cultural Dimensions. Source: The Hofstede Center (Hofstede, 2015).

superior than institutions. That's why they are suspicious to institutions and stick to rule by man approach.”

The second consequence might be nepotism, when *renqing* is given priority to efficiency and formal organizational rules. The treatments of employees such as delegating of authority and responsibility are based on trust and reciprocity, and trust is based upon differential mode of association. Thus the employees with shorter relational distances to the manager are very likely to be placed in higher levels in the organizational hierarchy. As family members and family-like friends are usually the most trusted, they are often entrusted with important positions.

Due to the inextricable entanglement of family relationships in the workplace, the founder may feel some problems are hard to solve without hurting *renqing*.

“I don't want my relatives to work in my company, because they are hard to manage. If a family member work in your firm, you can't just let him be an ordinary worker. You have to put him in the management. Because of the *renqing* tradition, if a family employee makes a mistake, you can't accuse him. That will make him lose face thus hurt his feelings. I don't want to offend my relatives.” said Mr. Wan (A10).

Zhiduhua (i.e. institutionalization) is a frequently mentioned topic in the interviews. It is put in contrast with the *renqing* management. The aim of in-

stitutionalization is to achieve employee conformity through rules and institutionalized authority instead of personal authority resulted by status or charisma. “When authority is transferred from a supervisor to core principles or values, subordinates are no longer obedient to ‘man’ but to ‘law’. [...] Impersonal authority built on principles or values should be less likely to arouse employee resistance than personal authority in contemporary China” (Farh, Cheng, Chou, & Chu, 2006).

For instance, Mr. Tan (A22) said,

“I rely on the team to manage, but my father relied all on his own. He was hands-on to everything, even some minor issues. Consequently, he was very tired at managing. On the construction site, the employees were trying to loaf on the job behind his back. They just needed to be wary of his moves, and nothing else. He managed the employees following the ‘rule by man’ and *renqing* governance, while I adopt *zhidu guanren* approach. I have set very strict rules of the check-up system. I think I manage better than my father. On the one hand, the profits generated are higher; on the other hand, I am not tired by managing.”

7.3.3 Family Management and Family Employees

Family management refers to the situation when the key management positions are taken by the family members such as siblings and offspring of the founder-manager of the firm. In the stereotypical imagination of the traditional family firms, the upper echelons of the management are all family members as the Chinese family firms hardly place any trust upon outsiders.

The strength of the family pulling together in the same direction might also contribute to a rapidly growing phase in the initial stages. But gradually the family members may become constraints for development. The family clique hardly place any trust on non-family employees, which may eventually drive out highly competent employees. They occur as roadblocks to necessary organizational changes as their priority has become how to secure their vested interests. As a result, the business gets troubled by the bottleneck for further development, or intra-family conflicts which eventually consume the family business.

This image might not represent the current reality of the majority of the family businesses, but many family businesses do have gone through a phase when important management positions were mostly held by the owning family. Generally, people tend to have the impression that many of those family managers are “less professional” than the non-family professional managers except for the founder who might be a charismatic, visionary and even legendary leader with superb management skills.

Why are family members employed in the first place? The first batch of Chinese entrepreneurs began to create their own businesses after the inception of the economic reform in 1978. They raised the capital from their families, kin, and *shuren* – who were also important source of labor – and started the adventure. Family employees often played an important role in the founding stage.

As another example, some family members of Mrs. Wang, the founder of Firm A28, have been working in the business since the founding stage. She attributes a large part of her success to the family employees. She said in the interview,

“Family members are very important in the early stage of enterprise development. For our service industry, customer satisfaction is of vital importance, which requires good services. Other employees may learn it through training, but family members will naturally use their hearts to serve the customers. Family members, my sisters and my husband for instance, could touch the hearts of the clients without training, because they want the best for me and the best for the business. Maybe they do not have very strong abilities, but they definitely have the most loyal and motivated hearts.”

From the perspective of Mr. Zhang (A26), employing family members is the obligation of the family firm.

“The development of family business can’t do without family members. For instance, when I had financial problems, my siblings, parents and friends lent their money to me. They might not have much, but they contributed as much as they could to support the development of my enterprise. That’s the power of the family. When my firm grows larger, I do everything I can to support them. For instance, I offer jobs to them. If they are not capable enough, I train them. Family firm needs the support of the family especially in the initial developing stages, and it should help and take care of the family when it has grown larger.”

When delegation of authority and responsibility is imperative, many founders have favored family members. Mrs. Wang (A28), for instance, appointed her husband as the General Manager and her sisters and a sister-in-law as department managers. The return she gave to the family members’ commitment, however, was not sacrificing the business.

“I kept emphasizing to them that ‘I won’t treat you as family in the firm. You won’t be treated differently from other employees. Our family relationship exists outside the firm.’ However, this clear separation could only exist in imagination. You can’t ignore and escape the impact of human feelings. Human is human after all. So things can be delicate. Anyway, I will never put an incapable person in the important managerial position only because he or she is my family.” said Mrs. Wang.

From the founders’ perspective, employing family members is often not out of nepotism but a practical, rational choice that is win-win to both the family and the business.

“You have to take care of your *jiaren* when you have the capability. It is impossible and unnecessary to completely exclude your family and relatives from the firm. But how to deal with them is an art.” said another founder, Mr. Yuan (A18).

Some founders kept emphasizing that the family members’ abilities were their primary criteria for appointing management roles. And many of them have managed to promote the “business first” logic in their firms. However, the founders’ meritocracy can sometimes be crippled by *renqing* rules.

When Mr. Mao founded the Fotile Company together with his son, they adopted a rule that no kin members would be accepted to work in the management because the son deemed the family members as a problem that could impede the development of the firm. At the age of 58, Mr. Mao Lixiang had to go down on his knees in front of his 80 years old mother when he declined his younger brother’s request to work in his company as a department manager. The old mother cried and blamed him as unfilial son who turned his back on his own brothers when he got rich. Mr. Mao said, “I am filial and mother’s tears made me distressed.” He felt aggrieved to be misunderstood but promised to her mother to take care of his brother outside the business. “I offended a lot of relatives and friends by declining their requests as suppliers or employees of Fotile.” In the mind of Mr. Mao’s mother, family bond and thus the need of the family members were much more important than the business. A lot of entrepreneurs choose to compromise and surrender to *renqing* when they face the conflict of *renqing* and business, because they want to eschew the consequence of offending the *guanxi* parties.

Family management is essentially not a style or way of management, but in popular Chinese discourses, family management is often put in contrast to modern management and professional management, which are supposed to be superior forms of management. Thus family management has become a term with negative implications, often associated with poisonous nepotism, chaotic organization, inefficiency and non-competitiveness. As a result, a lot of scholars and commentators have suggested that family business must de-familize (*qu jiazuhua*, 去家族化) and exhort the family members to step down and let professionals take over. “Family management is a phase of development of the business life cycle, which must be replaced by the modern management as soon as possible” (Chen, 2014).

Objections are also present. Some scholars argue that family employees are bounded by the family ties thus loyal, trustworthy and committed. Moreover, theoretically and indeed in practice, family members can also be professional and skillful, equipped with modern management methods. This means that the problem of some family businesses is not family management per se but rather the action of letting the incompetent ascend to power.

In summary, the centralization of power on the founder, *renqing* governance and family management are common characteristics of Chinese family business management, which is often regarded as the traditional way of management. When the firm grows larger, the management structure usually becomes more complex and there is a trend towards de-familization and professionalization.

In the founder's era, ownership and managerial control are combined and held by the founder. Controlling ownership, with very few exceptions, will be passed on to the heir of the founder. In most cases, the heir also takes over the managerial control of the firm when the incumbent steps down. In other cases, managerial control is delegated to non-family professional managers as the result of professionalization. In fact, in intra-family management succession process, the professionalization of management could also play a role. Therefore, before I continue to depict how the business families choose the management successors who are supposed to assume managerial control, I firstly discuss how professionalization could influence the family business succession process.

7.4 Professionalization: Management and Governance

“The traditional family business is doomed. Its living space is disappearing. It must be transformed into a modern enterprise relying on modern institutions, modern management and talents.” These words of Mr. Lu (A31) represent the viewpoints of many scholars, commentators as well as entrepreneurs.

In this discourse, the traditional family business refers to the firms which are managed by an autocratic founder and her/his family members who resort to *renqing* governance and neglect the establishment or enforcement of formal institutions and standards. Of the large population of Chinese family businesses, the small sized firms are more likely to be managed in the traditional way.

When the business grows larger, the complexity of management also increases, which may gradually overload the founder or family managers. More managerial resources, sophisticated management and organizational systems are needed. In other words, family firms will eventually confront the need for professionalization when they develop along their organizational life cycle.

When the traditional family firm adapts and professionalizes, it could evolve into the modern family business, which refers to family ownership combining professional management with modernized formal institutions including corporate governance systems.

The transition from a traditional family business to a modern one thus is essentially the transformation of management structure instead of fundamental changes of the ownership structure. Advocates of this transition thus advise the

family members to step down from the executive positions and let the professionals and “institutions” play their parts.

Whether this transition is possible depends on the specific context of the business and the family. The choice, however, is in the family’s, or more accurately, the founder’s hand.

Intergenerational succession could catalyze the professionalization process as the next generation may be a changing force and challenger to the traditional management structure. On the other hand, professionalization can facilitate succession by creating a supporting management system – such as a professional management team – which helps the successor deal with the challenges of taking over the leadership. Moreover, professionalization could also be an alternative for intra-family management succession, as the professionals will take over the management control.

7.4.1 Two Dimensions of Professionalization

Professionalization in the family business literature generally has two dimensions. The openness dimension refers to a family firms’ actions of hiring full-time professional managers, who are often referred to as professionals from outside the familial network.

Professional managers may be employed in different layers of the organizational hierarchy. When the professional managers are employed in the top level management, including the CEO and the board, it is regarded as a high level of professionalization in the openness dimension. Family firms which embrace nonfamily professional executives are thought to be open and progressive, as the import of quality managerial resources can benefit the development of the firm.

The top level professional managers are often promoted from inside the firm. Less frequently is a top executive directly hired from outside the firm, the *kongjiangbing* (空降兵, paratroopers) as the Chinese observers like to call them, which is generally regarded as a radical move of the founder towards professionalization.

The difference between a family manager and a professional manager can be actually ambiguous. Generally professional manager is thought to hold a professional attitude and expertise on management, who received a higher education on management and has outstanding working experiences. What may be more important is that their actions are guided by professionalism and they rely on team for decision making. In this regard, family managers are unnecessarily “unprofessional”.

For instance, Mr. Li, the son-in-law of the founder of Firm B6, who is the CEO of the firm, said “I am primarily a professional manager, and then a family

member. I am accountable to the board instead of being only responsible for the family.” Similarly, the younger brother of the founder of Firm B10, Mr. Zhuang J, is the General Manager. He started from the bottom and was gradually promoted to the General Manager. As the firm is owned by the founder and his son, Mr. Zhuang J doesn’t own any share. He regards himself as a professional manager. “In my notion, it doesn’t matter whether it is my brother I work for or where I work, I just do what I need to do. I am nothing different from other employees, only I am in the General Manager position.” he said. The two family members’ expertise has been proved by their good performance in their positions. When the family members share the attitude of professionalism and possess the expertise, they fit perfectly into the criteria of professional managers.

Therefore, to increase the openness of the management system is per se not about de-familization, which involves the elimination of family members from management, but about adopting meritocracy, i.e. appointment based on competency. Under meritocratic principles, one’s identity as a family member or non-family plays no role when she/he is selected for a management position.

When top management position is given to non-family professionals, the family owners might be exposed to the agency problem. A non-family professional manager (as the agent) doesn’t bear the consequences of his decisions the same as the family owners (principal), therefore the agent might behave in opportunistic ways at the expense of the owners due to the inherent conflict of interest between the principal and the agent. To eliminate the negative impacts of agency on the owners, monitoring mechanisms such as an effective board of directors are indispensable to govern and oversee the management and defend the interest of shareholders.

This need necessitates the building up of formal institutions including governance systems and management control systems from the owners’ perspective. The professional manager, at the same time, also has the incentive to adopt a modern, formalized management system in the organization, to facilitate the organizational process on the one hand and to ensure her/his discretion and performance on the other hand. This consensus results in the other dimension of professionalization – the institutional dimension.

The institutional dimension relates to the change of the organizational institutions. Formal institutions and mechanisms such as governance system, rational decision making procedures, formal control system, and clear definition of authorities and responsibilities are adopted to regulate organizational behaviors. Professionalism and meritocracy which are based on formal institutions are promoted.

This dimension of professionalization can be initiated by the family controller, following a “rule by law” philosophy. For these formal institutions to be enforced, family members will not be given any preferential treatment. *Renqing*

rules are largely replaced by formal institutions, whereas professionalism and meritocracy are promoted in the workplace. Due to the meritocracy principles, many important positions will be taken by non-family professionals. This means that the two dimensions – openness and institution – are actually inextricable.

7.4.2 Rationale for Professionalization

Professionalization of management has been an important theme of the succession process repeatedly mentioned by the interviewees, which reflects that the need for professionalization has become urgent to many family firms. On the one hand, the limited capacity of the old management structure in both operational and strategic levels may have hampered the further growth of the firm; on the other hand, the rapidly changing market conditions and the more and more intensified competitions may have been threatening the survival of the traditional family firm which is usually characterized as lagging behind in adaptation and innovation. Moreover, the changes of values brought about by modernization might have undermined the foundation of the traditional way of management. For instance, Mr. Xin (A32) said,

“In our Chinese culture and due to the fact that we are now in an underdeveloped market economy, people can’t escape *renqing* and *guanxi*. On the other hand, we have lost much of the traditional Confucian values due to the influx of Western ideologies. The values business activities had relied on in the past have been lost. Without them, doing business in the traditional way becomes harder and harder.”

Most family firms become to a degree professionalized when they grow, which may either be initiated by the founder or the successor, who wants to improve management to adapt to the ever changing market environment and to remain competitive.

The decision of “to professionalize the business or not” is primarily based on the controller’s subjective evaluation and judgment of the particular situation business faces. There are many factors that could potentially affect the decisions of the Chinese founder or the successor on whether to professionalize or not.

Firstly, the benefits of professionalization are its potential in bringing in new managerial resources, setting up more sophisticated management and organizational systems, as well as generating new ideas and knowledge to maintain and enhance the competitiveness of the firm. As an example, Mr. Yuan (A18) started the auto parts manufacturing business in 2005, which has developed into a group, consisting of more than ten companies and operating in machine manufacture, energy, finance, catering and other business areas with totally 600 employees. In the founding stage, the business was managed in a typically traditional way –

many of his family members and friends worked in the firm. Mr. Yuan had paid attention to the employment of formal mechanisms to manage the employees when the firm grew larger. Subsequently he started professionalization through building up professional management team and enacting more sophisticated formal institutions. In 2013, he made 8 family members and senior employees stepping down from important management positions. Meanwhile, he brought in a paratrooper CEO. “My CEO’s management expertise greatly surpasses mine.” Moreover, he built up a management committee which comprised the CEO and 7 other committee members. The committee is responsible for the management of the group. In the past 8 years, the business has grown very fast, as Mr. Yuan said proudly,

“I am a legend in Wanzhou (a district in Chongqing) because I started from scratch without any *guanxi* yet turned a small business into a large group with 700 million assets within less than 10 years. My secret is professionalization.”

Secondly, some founders take professionalization as a strategy for succession. Professional management team could be a handy assistance to the heir-successor in decision making and operation, and the establishment of formal institutions could reduce the difficulty in managing.

Moreover, some founders face the problem that their only-child is not interested in managing the family business. The solution could be to completely delegate management power to the professional management team and at the same time build up the governance system. The heirs will only be shareholders and directors. As such, their children will be freed from the burden of management and the firm will be saved from falling into the wrong hands. Meanwhile, sophisticated corporate governance system and well-designed institutions could ensure that the family’s interest as owners won’t be sabotaged by the professional managers.

For instance, Mr. Wang Jianlin (Wanda Group) has built up a professional management team, which might take over the management of the business after he retires. Mr. Wang Jianlin said in an interview, “My son is still young. He is just 24. Whether he can succeed me depends on his capabilities. I will wait for another 5 to 8 years. By then if he can get himself recognized and accepted by the people, he will take over the baton. If not, then I will let the professional management team lead the company. My son will be just one of the shareholders, who can enjoy the benefit of holding ownership.”¹⁵ The professional management team will be monitored and governed by an effective, powerful board. Currently, the heir, Mr. Wang Sicong, who will inherit the ownership, is a board member.

15 <http://www.talentmag.com/article.aspx/5100/2>

There are also impediments which discourage professionalization. Firstly, the agency costs can be too high. In emerging markets, there tends to be low investor protection due to underdeveloped and weak legal and judicial institutions. In an environment of low property right protection and weak law enforcement, monitoring costs can be extremely high. As pointed out by Peng & Jiang (2010), “when formal legal and regulatory institutions are dysfunctional, founding families must run their firms directly. In the absence of effective investor protection, bestowing management rights to non-family, professional managers may invite abuse and theft – in other words, rampant agency problems.” Small firms must be managed by the owner(s) because it is too costly to employ a sophisticatedly institutionalized governance system to monitor the agent. Public firms are better able to solve this problem.

Secondly, competent professional managers are a scarce resource that the majority of family firms may fail to attract. As Mr. Yuan (A18) said,

“Anyone who can assume the role will choose to be his own boss instead of working merely as a manager in a small firm. Most Chinese prefer to be his own boss earning 1 yuan instead of being an employee paid with 100 yuan.”

Large firms are more capable of attracting competent professionals, because they can offer more attractive compensation packages. Consequently, a high degree of professionalization is infeasible or not an optimal choice to many family firms, especially these in small to medium sizes.

Even if the competent managers are available in the market, there have been concerns for the trustworthiness of the professional managers. Some entrepreneurs are skeptical about professional managers because they believe that the Chinese professional managers commonly lack professional ethics. This concern has been expressed by some scholars as well. For instance, Zhang (2001) asserted, “In China, there is no lack of innovative, adventurous entrepreneurs. What needs to be worried is the paucity of ethical professional managers”. The expectation of a high ethical manager might originate from the Confucian doctrine. The Confucian way of solving agency problem is not based on sophisticatedly institutionalized governance and incentivizing systems as the corporate governance literature suggests, instead, it relies more on personal trust building. Therefore, the owner delegates managerial control only when the agent is proved highly trustworthy. Building a high trust with a non-family, nevertheless, needs a long history of exchange and bilateral investments.

Thirdly, in some cases, professionalization is not possible because, on the one hand, the prevalence of *renqing* culture in the organization makes professionalization hard to be promoted; on the other hand, resistance may be present as the other organizational stakeholders, such as the other family executives, have vested interests in keeping their current positions intact in the organization.

In summary, small firms have a higher possibility to pertain to traditional management than large ones. The decision on professionalization can be affected by many factors, in either positive or negative way.

7.4.3 Corporate Governance

A family firm's professionalization may be aimed at two divergent succession-related ends, which results in the family business being either a family-owned and managed or a family-owned and governed but professionally managed business after it is passed on to the second generation.

The first is to build up a supporting professional management team and institutions for the next generation, who retains managerial control. As most founders see control as inseparable from ownership, they generally assume that the heirs must succeed the management in order to protect their interest as owners.

Professionalization may provide the family an alternative succession option: to separate ownership and management. The second aim thus is to establish a professional management team which will take over the management yet without compromising the family's interest as shareholder. In the latter case, a corporate governance system is indispensable.

When professionalization involves a certain degree of separation of ownership and management, it often brings about the introduction or improvement of the corporate governance system in the family business.

Simply put, corporate governance "deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer & Vishny, 1997). To be specific, the primary aim of the governance mechanism concerns the assurance of the owners' interests when managerial control is delegated from owners to a non-owner manager (situation 1) or from minority (or non-controlling) owners to a controlling shareholder (situation 2). The focus is laid on situation 1 here because it's more relevant to the succession problem.

Ownership of a business indicates that the investor has provided financial resources, i. e. capital, to the business, which is expected to generate profits as a return for the investment. Generally, the organization of the firm resources – assets, materials and the personnel – requires a manager who makes decisions and controls the process (i. e. managerial control) which is necessary for the final delivery of the products or services to the market. This role has been traditionally assumed by the owner. When an owner employs a manager to help him run the business either because he doesn't want to do it himself or the business is too large for him to do it alone, managerial control is fully or partly delegated to the

manager. The decision making power, or discretion, of the employed manager depends on how much power the owner is willing to relinquish.

The agency theory suggests that the powerful manager may behave in opportunistic ways at the cost of the owner's interest; therefore a governance system including monitoring and incentivizing mechanisms is needed to ensure that the manager behaves in a way that is acceptable to the owner.

Under a typical governance system, the management of the business is divided into two tiers: the board of directors as the upper tier, which is often referred to as the governance body representing the interest of the shareholders, and the management as the lower tier which is headed by CEO or compatible positions such as General Manager (GM for short) – a title often used in the Chinese companies.

According to the Chinese Company Law, a limited company should have a board with 3 to 13 directors, or alternatively an executive director instead of the board when the company is small in size or with a small number of shareholders. It is obligatory for stock company to set up a board of directors with 5 to 19 members and also a supervisory board. When the stock company is publicly traded, at least one third of board members should be independent directors.

Due to the requirements for IPO in the stock market, the publicly traded firms tend to have a comparatively well-designed corporate governance system, with a professionalized board of directors and management. In this case, the roles of the heirs can be a combination of one or more of the following: shareholder, director and executive. Most likely, the heirs are both shareholder and director. The Chairman of the board is normally regarded as the leader of the firm, who assumes a dominant role in the board, thus is differentiated from other directors. For instance, Ms. Liu Chang (New Hope Group), as the heir, holds 36.93 % interest of the New Hope Group, which owns 53.39 % interest of the public firm New Hope Liuhe. She is also the Chairman of New Hope Liuhe. Mr. He Jianfeng (Midea Group) is a non-Chairman director and shareholder, who is not involved in the management.

In private family firms, an effective board is often absent. As discussed earlier, in the founder's early era, there is usually high concentration of ownership and management authority. When the equity is fully owned by the family and decision making is concentrated on the founder, a board is essentially not necessary. A privately held Chinese family firm might set up a "paper board" only to deal with the paperwork of the regulation or to make the firm look modernized, formal and large. Due to founder centrality, this kind of board is actually one-man board which consists of only one active director, namely the founder and some non-active family directors.

When the family firm has non-family owners, other active directors may be present. However, the board's function might still be different from which is

assumed by the typical two-tier management structure. For instance, the FW Company (A17) has set up a board with 5 directors who are all shareholders, and three of them are non-family. The board of FW actually combines both the governance and the management functions as each board member is in charge of a department. Mr. Deng, as the founder and the largest shareholder (82.4 %), is the Chairman and the General Manager (GM), who has been dominating the board. Mr. Yin, who is the son-in-law of Mr. Deng and a board member being in charge of marketing, said,

“Most decisions are made by the board. However, when we have disagreements, it is the Chairman who has the final say. He also has the power of veto.”

From the Chinese Company Law and the typical governance system perspectives, the Chairman of the Board is essentially not privileged to other directors as she/he also has only one vote in the board's decision making. The highest decision making is supposed to be taken by the board instead of any one person. In practice, however, it is an unwritten rule applicable to most Chinese family firms that the chairman alone is the ultimate decision maker. That is to say, an effective board is absent. Colloquially, Chinese often refer to succession as the succeeding of the chairman position instead of the CEO position.

In fact, it is common in China that the founder-chairman also takes the position of the GM or CEO (i. e. CEO duality), especially in private firms. For instance, Mr. Gao (A27), Mr. Xin (A32), Mr. Ran (A21), Mr. Tan (A22), and Mr. Zhang (A26) are all Chairman-GM. CEO duality is a typical form of founder centrality, which can be a double edged sword, as it could establish strong, unambiguous leadership on the one hand, and promote CEO entrenchment by reducing board monitoring effectiveness on the other hand. Through professionalization, some founders have relinquished the GM position and day-to-day operation to the professional managers, so that she/he can focus on her/his chairman role in strategic decision making. Examples are Mr. Yuan (A18) and Mrs. Wang (A28) etc.

Following an agency theory approach, corporate governance researchers suggest that the roles of the board and the management (represented by the CEO) should be separated and have a clear division of authority and responsibilities. For instance, the board should be responsible for governing the management by setting up objectives, policies, strategies and exercising oversight. The management executes the board's decisions while having the authority to make day-to-day operational decisions of the business. In the practices of Chinese founder-led family business, however, even when the chairman and the CEO positions are taken separately, their authority and responsibilities tend to be ambiguous. In fact, the authority division in Chinese family business sometimes can be confusing to an outsider. In most cases, the CEO/GM is subject to the chairman's will

on all firm affairs. Therefore the chairman in the Chinese private firm context is commonly the center of the authority, the ultimate decision maker who is responsible for strategic matters but also very likely to interfere in many aspects of day-to-day management. The manager's authority thus depends largely on the chairman's personalized decision about the degree and content of delegation.

In short, an effective governance body – the board – is essentially absent in the majority of the first generation private family businesses. Under this circumstance, the second generation will have to run the business themselves as long as the family wishes to retain the ownership after the founder retires.

Some founders, however, have been exploring their own forms of corporate governance systems. A good example is the founder of the Dawu Group, Mr. Sun Dawu, who has enacted a family business constitution, which installs a governance system of both the business and the family consisting a board of directors, a board of executives and a board of supervisors.

In summary, the building-up of corporate governance system is an important component of a high degree of professionalization. With an effective board, the importance and centrality of the family controller (the founder or the successor) in the management of the firm decreases. As such, the family's role can shift from the manager to the supervisor.

A well-functioning corporate governance system is regarded as the symbol of the modern corporation. In this sense, many Chinese family firms are in the middle of the transition from the traditional family business to the modern one.

7.4.4 Two Cases on Professionalization

7.4.4.1 The Case of Firm A28

Mrs. Wang started the small auto repair business in 1996 when she was laid off from a state owned enterprise at the age of 33. "I had to survive and make ends meet, so I had to do something." After going through a lot of hardships, Mrs. Wang has achieved great success, owning and running four companies providing auto repair, sale, and inspection services, with 250 employees and a yearly turnover of around 500 million yuan. Officially her husband owns 20 % of the equity (she owns the rest 80 %) and also works in the firm; however, the ultimate authority belongs to Mrs. Wang, the leader of the firm.

Her husband and sisters had been her first employees and they then became the backbone of the management. As the enterprise kept growing, Mrs. Wang realized that the limited managerial abilities of her relatives and their deficiency in innovation and creativity gradually become a constraint. In this situation, adjustment became an urgent need. In the past few years, she persuaded her

husband to give out the General Manager position of the auto sale company and her elder sisters and sister-in-law to step down from the key management positions. The family members and senior staffs who have made great contribution to the firm will be given shares of the firm after it goes public to show her gratitude and respect. As the result of her endeavor, the old management team is being replaced by young, motivated professional managers mostly born after 1985. Her goal is to make the enterprise a “*bainian laodian*”, and she believes that business longevity could only be achieved through business model innovation including business diversification, and more importantly professionalization.

“I think the future of our family business depends on the institutionalization, formalization and professionalization of the enterprise, which will impel the self-adaptation of business model and business operation. Only in this way will the succession of the business really happen, and the enterprise will last longer.”

She has a plan for the firm to go public in the next three to five years. Adding fresh blood from young people to the management team was one of her first steps. This team is supposed to help install formal institutions and mechanisms to the firm system. She has placed great hope on the professional management team which she is building as the solution to the question of succession.

She is still searching for a leader for the team, a CEO, who can take the overall control. “I am over 50, and I can’t work with all my might for long. I think in the future, the business doesn’t have to be run by a person from my family. Running an enterprise is not fun. It’s a responsibility. You have so many employees to feed. It’s a social responsibility.” said Mrs. Wang, “so I won’t push my children to succeed. Actually I have been encouraging them to do what they are interested in.” Her 25 years old daughter has been working outside the family business as an official. “I couldn’t spend a lot of time with my daughter when she was young because I was too busy, so she didn’t perform very well academically and she knows little about the business. I think she should firstly have her own family and child before she comes to build a career, whether in my firm or not. Or maybe she doesn’t want a career but a comfort job, standing behind and supporting her husband. It’s her choice. I will support her no matter what she chooses. Being a woman, it’s great to have a career, but also great to have a harmonious family. Anyway, in the context of China, it’s much harder for females to develop a career. So I will let her decide and support her.”

Besides the daughter, Mrs. Wang has a step-son working in the firm who started from the bottom and now belongs to the management team. “If he had the ability, he could of course run the business in the future.” Meritocracy is the principle of her choice of successor, which is also a principle she has been trying to stick to in dealing with the relationship with family employees. “I first consider

the abilities of a person instead of whether he is family or not. But I would be more than happy to choose a family member if she/he is capable.”

She plans to reserve some shares for her children after the business goes public. “This is how the meaning of the family will be at least partly conserved in the business.” She claims her daughter and step-son will be treated equally and given the same amount of shares. How to ensure the shareholders’ interest, especially that of the family owners, is a question she is still exploring. But the key, according to Mrs. Wang, lies in institution building and professionalization.

7.4.4.2 The Case of Midea Group

The company

At the age of 26, Mr. He Xiangjian, founder of Midea Group, with a total of 5,000 yuan, led a group of 23 local residents of the town of Beijiao in Guangdong province and established a bottle lid production workshop in 1968. In 1980 the company started to produce electric fans, marking its entry into household appliance manufacturing. It diversified its product portfolio subsequently and was listed on the Shenzhen Stock Exchange in 1993. The local government was its largest shareholder until the ownership restructuring through management buyout in 2001. Currently, the founder holds 35.08 % of the total shares through Midea Investment Holding (BVI) Limited. The company has grown into a leading consumer appliances and heating, ventilation and air-conditioning systems manufacturer, a rising giant with a global turnover of USD 23 billion in 2014 and over 100,000 employees in China and throughout the world (Midea website, 2016¹⁶).

Succession

Approaching his 70 year birthday, the founder stepped down from the Chairman position in Aug. 2012 and his successor Mr. Fang Hongbo, who joined Midea in 1992, became the Chairman and President of the company. Fang Hongbo had become the second key figure in Midea group, as he proved not only his commitment and competence but also his loyalty and trustworthiness in 20 years of close work with the founder. His choice of internal professional manager instead of family member as his successor might largely attribute to his “business first” orientation. “Since the 80s, I have maintained that Midea should have a corporate culture of openness. Therefore Midea has never had a paternalistic

16 http://www.midea.com/global/about_midea/overview/

atmosphere. My dream is to make Midea a modern company.”¹⁷ said He Xiangjian in an interview.

The founder’s belief resulted in a professional top management team with high managerial discretion, an evolving, sophisticatedly designed management system that clarifies duties, delegates powers and incentivizes employees properly as well as a healthy firm culture that enabled the rapid development of the company.

According to the media, Mr. He actually hoped that his son, He Jianfeng, could succeed him – despite the existence of the other two daughters. However, the son, instead, started his own business outside Midea Group in 1994 and had never joined the company until he was appointed as board member along with the appointment of the new Chairman. His rejection to be successor might be resulted by a fear that he couldn’t exceed his father’s accomplishment. Moreover, he might have believed his presence was not necessary due to the well-functioning professional management. Additionally he seemed more interested in making a success in financial market instead of manufacture.

From the perspective of management, Midea Group doesn’t share the features of a traditional family business, which might be the key reason for its atypically large size. For instance, He Jianfeng is the only family member in the board and management. However, in terms of control, the He family keeps their control of the company by their shareholding. He Jianfeng’s position in the board manifests the family’s influence on the strategic decisions of the company.

7.5 Successor or Heir? The Founder’s Differential Mode of Successor Preference

In the family business succession literature, the successor is normally referred to as the next leader of the family business and often as the next CEO. In the Chinese context, it would miss the point to consider the next CEO of the family business as the successor. In this book a successor is defined as the person who assumes managerial control after the founder retires, and an heir as a second generation family member who inherits the ownership. The two roles can overlap as the successor is commonly, yet not definitely, selected from the heirs.

The selection of management successor is a critical yet complex decision to make. In non-family business, the issue of succession is usually solely about transition of leadership, thus the criteria of successor selection are normally based on managerial competence. The literature tells us that family businesses

17 http://jjckb.xinhuanet.com/opinion/2013-05/09/content_443774.htm

appear quite differently because of their preference for family members as the leadership successors. In other words, the relational factor greatly shapes the succession decision making dynamics.

Furthermore, the arrangement of ownership and governance structure could add a lot of complexity to the successor choice. Above, two possible approaches to family business ownership succession have been described, which generally follow an equal inheritance principle. The first approach is *fenjia*, i. e. dividing the parallel firms and/or business group into a few independent parts (with each part consisting of one or more firms) and let each heir inherit a chunk. In this case, the control of each business is automatically given to its new owner. The second approach is distributing the business ownership instead of dividing the business, which may result in sibling partnership. This happens when the business is regarded as undividable.

The second generation family members may be born to be legitimate heirs, but not necessarily successors. The founder's preference for certain successor candidate could in turn affect the arrangement of ownership, when the founder wants to ensure the successor's control of the business. Moreover, the introduction of corporate governance and professional management team could also make non-family professionals possible candidates for successors. The question is then who are chosen as the successors and what are the grounds for such decision?

Many founders hold the belief that a business should have only one leader who gives the final verdict when disputes appear, therefore they will have only one successor. In the case of sibling partnership, there is also a leader, who holds the ultimate control.

7.5.1 Son Succeeds Father: The Case of Firm A25

The A25 Company is currently run by the second generation of the founding family, Mr. Hu. He is the only son of the founder and has two elder sisters. His father, Mr. Hu Senior, had a clear preference for son to be successor for his textile manufacture business.

Mr. Hu Senior was sent down to Xinjiang in 1969 at the age of 17. When he came back, he worked shortly as a farmer and then started his small trading business. With 7 years of savings, he opened a textile factory in 1988. All of his siblings and some relatives worked in the business, with his siblings being in charge of production, sales and accounting. Most of these family members left and started their own businesses later, with only a few stayed. The business was incorporated as a limited company in 2000 and entered the stable stage before Mr. Hu took over the leadership.

Mr. Hu started to work in the company after high school and got to know the business quite well. However, two years after getting married, he left the business and opened a restaurant with his wife in 2005 at the age of 26. "I wanted to build my own business and prove myself." Mr. Hu Senior was against this decision but couldn't stop him. "He always wanted me to run the business, to succeed his career. Not my sisters, only me, because I am the son and he believes that the son is born to succeed his father." said Mr. Hu. They finally closed the restaurant after two years, despite that it was successful, because they found that they did not have time to take care of their young son. The wife became fulltime housewife and Mr. Hu went back to the family firm. After two years of playing the second fiddle to his father, until Mr. Hu proved to have the ability to run the business independently and have inherited the relationships to major clients and other guanxi parties, Mr. Hu Senior retired, leaving full ownership and control of the firm to his son.

As an interesting contrast, the family firm of Mr. Hu's wife (Mrs. Liu) had a different fate. Mrs. Liu's father also owned a firm in the same industry. The two firms had a close business relationship which largely fostered the marriage of Mr. Hu and Mrs. Liu. "I felt that deep in the heart of my father, my gender was a huge disappointment. He loves me but he wishes that I were a man, so that I could succeed him." said Mrs. Liu, "As the only-child, I have learnt a lot about business from my father during my up-growing and I am confident about my abilities. My father and I both knew that I could have success in business, outperforming many men, but I would have to work twice hard as men and give up the time with my own child. He didn't want me to bear so much burden and stress instead of having a comfortable life." As the company located in another city and it is impossible for Mr. Hu to manage both, her father sold the company.

The traditional idea of *zicheng fuye* (子承父业, son succeeds father) is deeply rooted in the traditional father-son relationship. It is a common practice, a widely held value, and a norm that the father and the son, as well as other related insider parties are expected to conform to and outsiders also take it for granted.

In terms of value or norm, *zicheng fuye* could have at least three meanings: the first being that the son should succeed the father's profession and career e. g. as businessman, including the father's professional knowledge; the second being that the son should inherit the father's properties and retain and expand them; the last, which derives from these two meanings, being that the son should carry on the business the father created or succeeded from former generations. In terms of practice, the three aspects are often combined.

In the traditional discourse, succeeding one's father – especially succeeding the *jiaye*, i. e. family properties including family business – is seen as a form of filial piety for both the father and the son. *Jiaye* (family business and property) is seen as the basis for continuing the family bloodline and prosperity of the family,

which is a central filial piety obligation of descendants to their ancestors. The father who leaves the son a *jiaye* thus is thought to have honored his ancestors. Meanwhile, the succession of *jiaye* is also the father's expectation of the son, who should further pass the *jiaye* to later generations. Therefore, the filial son should succeed the father and maintain and develop the *jiaye*. The impact of this norm on the founder is that he normally considers his sons as the primary candidates of the successor. That is to say, on the one hand, the founder may deliberately cultivate the sons', especially the eldest son's, interest in the family business and their abilities to manage it while ignoring their daughters; on the other hand, if a son is willing to assume the successor role, the founder cannot easily reject this demand with reference to his incompetence because it could possibly damage the father-son relationship. To the sons, the norm means that it would be hard for them to refuse the successor role if their fathers place hope upon them.

Today it is still a value I find deeply rooted in the mind of many Chinese business families, although its actual power in determining the decisions of the actors – mainly the founder and the offspring – varies due to different contexts of family and family business. With this notion, the founder is likely to devote more time, effort and resources to the son(s) than daughter(s).

Mr. Hu's story is a typical case of *zicheng fuye*. This belief is not only shared by the family of Mr. Hu and his wife, but also by many other founders of Chinese family businesses. To them, the son is the primary successor candidate. According to these principles, daughters and *wairen* (non-family) are likely to be excluded and rejected as legitimate successors despite of their abilities.

Although *zicheng fuye* can be viewed as a taken-for-granted tradition or a hangover of the Chinese familistic culture, in practice, people tend to justify the preference to sons over daughters with more concrete reasons. For instance, men have traditionally been thought to be more capable in doing business than women because men are more likely to possess traits such as achievement orientation, activeness, emotional stability, independence, rationality and forcefulness which are believed to be important for business success.

"My son will be the successor." said Mr. Gao (A27). At the age of 17, Mr. Gao started to work in a collective construction firm. In the rural area, it was common at that time for parents to send their young sons to learn certain professional skills such as that of stonemason, carpenter, bricklayer and tailor etc. Mr. Gao's choice was construction. He started from the bottom and gradually became a manager. After many years he established a construction firm, and then a real estate development firm, which now has about 80 employees. Of his two children, the daughter works in the firm in charge of accounting and finance and the younger son graduated recently from college with a construction related degree and started working in the firm with great interest. His rationale is that,

“Men are better entrepreneurs than women who tend to be weaker in bearing hardship, responsibilities and pressure, especially the post-80s. Besides, women have to put a lot of effort in dealing with their family responsibilities including taking care of the children and managing the household. Successful women entrepreneurs are rare to find. Therefore I will let my son take the management leadership. My daughter could assist him.”

He plans to let both children inherit more or less the same amount of equity.

“The equity can be divided equally but the managerial control must stay in one person. I will make sure that the siblings won’t contend with each other for the controlling power as they both have the same equity. There can be only one ultimate decision maker.”

Mr. Gao’s negative perception of daughter successor fits to the broad societal attitudes toward women as entrepreneurs and managers and cultural expectations of their gendered roles in society and family, which might be the stubbornest barriers to daughter succession. Daughters are more likely to be designated to the assistant roles, e.g. in finance department.

Another example is Mr. Deng Xiukang, the founder of Kangnai Group, which is a large shoes manufacturer founded in 1980, with 4000 employees. Deng Xiukang persuaded his elder daughter, Deng Laili, to give up her job offer and join the family business after she graduated from college in 1998. She was sent to the workshop, starting as a bottom worker who learnt to make shoes with her own hands. She had been very familiar with the factory as her father had asked her to do some small work there since junior high school. Gradually Laili was promoted to the management and finally vice president within four years. Her brother Laiyi, who is three years younger than her, joined the business after graduated from the UK with a degree in footwear design. Despite that Laili had performed well, she voluntarily suggested to let her brother take over the CEO position. Although Laili will be given a minority of the equity, she plans to make her own career outside the family firm. The founder commented her conduct as very considerate and “understand the family interest”.

“It would be hard for me to tell her that the position was reserved for her brother. She said it herself, that makes a difference. The son is younger and will be energetic when Laili is 50. She will go on the downhill path.” said Mr. Deng Xiukang, “Two sons or two daughters will both be a problem. They will fight. I am lucky to have a daughter and a son.”

Despite its potential in solving the “daughter or son” question, the idea of *zicheng fuye* doesn’t give a clue to the “which son” question. In practice, when there is more than one son to work in the same business, the successor role is normally given to the eldest son. On the one hand, although traditional properties were divided more or less equally among sons, primogeniture was applied in the

inheritance of throne and titles. Therefore, letting the eldest son take over control is still accepted as norm by many. On the other hand, the eldest son is often the first to work in the family business, thus has the first mover advantage compared to his younger brothers. Therefore, we are likely to see that the siblings hold approximate amounts of shares, while the most senior position is taken by the eldest son.

For instance, Mr. Chen Zemin's (Sanquan Foods) two sons were given the same amount of shares of the publicly traded firm, while the elder son Chen Nan became the Chairman and the younger son Chen Xi was appointed as the General Manager. Nan quitted his job in a state owned firm and joined Sanquan to help his father in 1995 when he was 26. He started as a frontline worker and was gradually promoted to the General Manager, and finally Chairman. Xi joined the business in 2001 after finished his study abroad. He didn't start from the bottom like his brother but was directly appointed as Vice General Manager and served as board member ever since. As a publicly traded company, Sanquan has a well-functioning corporate governance system, which paved the way for the second generation's management succession. The brothers thus have a clear division of power and responsibilities. Nan said that he was only responsible for steering the strategic direction of the company and deciding major employment contracts and reviewing investment decisions. Operational decision making is delegated to the top management team headed by Xi. The brothers have been cooperating well, at least for now.

Another example is the Firm B3, which was founded by Mr. Chen in 1986 and produces cables and adapters. Mr. Chen has two sons and a daughter. The eldest son joined the business after graduated from college with a degree in business administration. He worked in the R&D department and then marketing department for 8 years and was promoted to the General Manager in 2011. The youngest son studied human resource and business administration in the UK. After he came back, he began to help his brother manage the firm. His position now is an assisting role to the General Manager.

7.5.2 Daughter Successors

Although daughters are generally less preferred as successors than sons, they sometimes become the only choice or better choice. Therefore, many only-daughters and first-born daughters have succeeded or are expected to take over their family businesses. Ms. Mi (A6) is one of them.

Ms. Mi's father has deliberately nurtured and put a lot of emphasis on training her abilities to run the family business despite that she has a brother who is 3 years younger.

“My brother hasn’t been very interested in running a business since he was young. I, on the contrary, am always interested as I have seen how my father developed the business from a scratch. He was my role model. I want to be an entrepreneur like him, no, even better than him, and I believe I somehow impressed him and made him think that I was more suitable for the successor position. Besides, he is not a narrow-minded person who has this stupid son-preference or prejudice about female managers.”

Another example is Ms. Liu Chang. Liu Yonghao (New Hope Group) has a daughter and a son. The son is still very young, therefore the daughter Liu Chang is trained as the successor. She became the Chairman of the publicly traded New Hope Liuhe Co., Ltd at the age of 33.

Some only daughters of the founders of the largest family businesses in China, such as Ms. Zong Fuli (Wahaha), have become the new leaders of their family firms.

These daughters’ stories are redefining the traditional notion of *zicheng fuye*. Female entrepreneurs have also become important players in the business world. There are also many cases of “daughter succeeding the mother”. For instance, the only daughter of Mrs. Liu of the A16 Group joined her mother’s company after graduated in the US 8 years ago. Currently, Mrs. Liu has passed the Chairman/GM position to her and let the daughter take full charge, while she is being the advisor.

The Case of Firm B12

Firm B12 is an automobile component manufacturer founded in 1988 by Ms. Deng’s parents, which currently has 250 employees and a turnover of around 100 million yuan from both domestic and international markets in 2014. The founders used to work in a township enterprise. Later, because of an accident, they had to make big money to pay for the injured worker. To afford the large payment, they decided to start their own business. The *guanxi* and know-how they acquired during the time in the township enterprise were great facilitators. Ms. Deng’s mother was the manager, who is now in charge of quality, while the father remains in charge of the technical part. The spousal partners have made the firm a strategic supplier of VW, Magna and GE.

As the only daughter, Ms. Deng began to work in the firm after received MBA degree at Witten/Herdecke University in Germany about 7 years ago. Her ground for coming back to the family business was that, “the company is like another child of my parents. It would be such a pity if no one would take care of it in the future.”

In fact, Ms. Deng’s mother had been intentionally cultivating her interest in the business and imparting the related business and management knowledge since she was 6 years old. Thus she had kept a close relationship to the family

business before she joined. She is very open and talkative, similar to her mother. Now she is in charge of the day-to-day management of the firm.

The employees are the key resources to the firm. Ms. Deng's parents have kept very good, family-like relationships with the employees. Many employees have worked for a long time in the firm and some of them are founding members. The chief engineer, who is 75 years old, still works in the firm because he likes the job very much. To the spousal founders and the successor, he is like a family member, a grandpa for Ms. Deng who is very much respected and loved. One of Ms. Deng's cousins is also working in the technical department in the firm.

7.5.3 In-laws

In-law-successors are not as legitimate as son- or daughter-successors. For instance, traditionally, son-in-law is regarded as *wairen* (non-family member), who has no rights to the family's properties. There is a derogatory buzzword called "the phoenix man" which is often referred to as the synonym for a man who becomes rich and powerful through marrying the daughter of a rich and powerful family and consequently succeeding a powerful position and/or a *jiaye*. According to anecdotes, the phoenix man has a high propensity to betray the family after he is in power. This buzzword reflects a widely shared contemptuous attitude and distrust towards son-in-law successors. However, due to their love and care for their daughters, they might choose the sons-in-law to share the management burden. Most founders who choose a son-in-law as successor generally will transfer their ownership to their daughters, so that the daughter can be the shareholder who keeps control over the family wealth and has a say in both the firm and the family.

The Case of Firm A17

Mr. Deng, the founder and the largest shareholder (82.4 %) of Firm A17, is currently both the Chairman and CEO. Mr. Yin, the husband of Mr. Deng's only daughter, was a small business owner and joined FW Company in 2004 after he married the daughter. He started as a salesman and then became the purchase department manager. After 10 years, he became a board member, owning 2.18 % of the equity. Most decisions are made by the board consisting of five directors. However, "when there is disagreement among the directors, it is the Chairman who has the final say." Although each director has a different set of responsibilities, it is not clearly defined. Mr. Yin felt that his power in the firm was very limited and he didn't feel that the founder would intentionally train him as the successor. The founder hasn't made clear his plan for succession, therefore Mr. Yin was reluctant to talk about succession during the interview. As for the

founder's resistance to relinquish control, Mr. Yin expressed his full understanding and respect. "The founder doesn't have to retire, actually. He has great passion on his work and has devoted all his time and energy to it. He works 362 days a year and he barely has a life. The job is his career, his life. You can't deprive a person of the work he loves so much." His experience makes me wonder, would it be different if Mr. Yin is the founder's son instead of son-in-law?

Daughter-in-law successor, however, is often praised, which might be explained by the traditional ideology that the daughter-in-law belongs to the husband's family instead of her natal one on the one hand. On the other hand, the daughter-in-law being selected in the presence of a son seems to imply her extraordinary capabilities.

Daughter-in-law's Destiny: The Case of Mrs. Xu

Mrs. Xu's father-in-law (A33), Mr. Zhang, founded a motorcycle parts manufacture factory in 1998. Mrs. Xu and Mr. Zhang's only son were college mates who got married after graduation in 2009. Mrs. Xu stayed at home as housewife for a few years, taking care of her young daughter and son. Three years ago, Mr. Zhang got sick thus unable to manage the business any more. He then asked his son to take over the business. However, gradually he was convinced that his daughter-in-law was in fact a better manager.

"Father's illness was unexpected and we had to assume all the responsibilities all of a sudden. It was quite stressful, anyway we managed to adapt to our new roles quite soon." said Mrs. Xu. "In fact she has played a critical role in the taking-over" said her husband Mr. Zhang Jr., "because I am not quite a businessman type. She, on the other hand, is a natural leader. So I believe she should be the CEO. Of course we discuss things and make decisions together. Occasionally, we consult my father for advises." In the interview, Mrs. Xu exhibited an extroverted, charismatic, self-confident and strong character. "Managing 100 workers is not an easy job. More complicated is to clear up the skeleton of guanxi." The founder has now fully retired, leaving the business to the young couple. Alongside managing the business Mrs. Xu spends a lot of time nurturing her children.

7.5.4 Non-family Professionals

Choosing a non-family professional manager as successor indicates fully delegating the managerial control of the firm to a professional from outside the familial network, or more likely, to the professional management team. This arrangement is usually accompanied by an effective board by which the family's interests as the controlling owner are guarded. The family's control over the

business in this case is embodied in its rights to influence or even determine – via the board – the appointment, dismissal or replacement of the professional managers, as well as the firm's direction and strategic decision making.

Due to high information asymmetry and underdeveloped legal infrastructure, monitoring and incentivizing measures required for the alleviation of adverse effects of the agency problem can be infeasible or too costly for the small firms. The absence of an effective governance system in the majority of the small to medium sized family firms actually places a barrier to the selection of professional successor. Moreover, the dearth of competent professional managers in the market also requires the heirs to hold the managerial control directly. Therefore, professional successors are more likely to be found in large firms, especially publicly traded firms (with the case of Midea as a good example).

In private firms, the act of choosing a professional successor is likely to be based on the premise that the heirs are not willing to run the business themselves due to reasons such as they are uninterested in the business, or unconfident about their abilities to take the challenge. As long as there is a willing heir, who is not regarded as extremely incompetent or illegitimate, the founder is prone to select this heir as successor while employing a professional management team to assist her/him.

In publicly traded firms, because of the pressure from the public, especially the minority shareholders, the controlling family might be impelled to choose a more competent non-family professional. Additionally, as many families control their post-IPO firms via one or more holding companies or a parent company, the heirs might choose to manage these holding companies instead of the public firms. Despite this, transferring the leadership of a public family firm from the founder to the heir seems the mainstream practice. Examples are the New Hope Liuhe of New Hope Group, the Sanquan Foods, Fuyao Group and the Mission Hills Group etc.

In short, professional successors are rare cases, despite that professionals in top management are common.

Professional managers in top level management of family firms can be categorized into either paratroopers or ladder-climbers. A paratrooper is a top executive directly hired from outside the firm. Paratroopers are expected to excel internal managers, and their mission is to make a difference to the old management structure. However, it can be very difficult for a paratrooper successor to have success in family firms. For instance, the founder of Fuyao Group, Mr. Cao Dewang wanted to pass the leadership to a professional manager, however, both of his trials of employing paratroopers failed. As a result, he had to choose his eldest son as the successor.

A ladder-climber, which refers to the professional manager who is developed inside the firm, might have a better chance of being chosen as successor. She/he

starts from the lower level of the organization and is gradually promoted to the top. Her/his experience of climbing up the ladder of the organizational hierarchy gives her/him an in-depth understanding of the business and its organizational culture on the one hand, and proves her/his competences and trustworthiness to the founder and employees on the other hand. She/he is also likely to develop high commitment, attachment, and psychological ownership to the firm. An example of the ladder-climber chosen as successor is Mr. Fang Hongbo in Midea Group, who had worked in the firm for 20 years before he took on the leadership mantle.

Trust building is critical for the founder to choose a ladder-climber successor, which is often a very time-consuming process. Without normative relationship foundation, normally the founder must observe for a long time until she/he is convinced that the ladder-climber is competent and trustworthy. In this long period of interactions and exchanges, the ladder-climber must keep a high level of commitment to the firm as well as to the founder and consequently her/his relational distance with the founder gradually decreases as the model in previous chapter illustrates. However, the trust building process might be so time- and effort-consuming that many ladder-climbers eventually choose to leave their employers and start their own business after they accumulate enough experience, *guanxi* and capital.

As part of the old management structure, a ladder-climber successor may have a few constraints. Firstly, the development of the ladder-climber largely depends on the founder's willingness in fostering her/his leadership. With the founder being the dominate figure in the firm, the professional can hardly have the opportunity to demonstrate true leader qualities. Therefore, after the founder leaves, there might be a crisis of authority. Secondly, they tend to have fixed mindset and lack of innovativeness because they are entrenched to the old management structure. Thirdly, under the looming shadow of the founder, it is difficult for the ladder-climber successor to surpass the achievement of those of the founder's.

In summary, gender, birth-order, relational distance, competence and willingness are all potential factors which could play a part in the founder's decision on successor selection.

Scholars of family business have never proposed objections to the intention of the founders to pass their ownership to their offspring, but they have often questioned their idea to let their offspring keep managerial control. The rationale is clear: what if the next generation family is not competent for the top management role? Nepotism could plague the business.

In fact, son-succeeding-father has been the most practiced mainstream mode of management succession in Chinese family businesses. More and more daughters and sons-in-law are also becoming successors. But we don't know

whether this seemingly nepotistic choice is really out of pure nepotism consideration, or a carefully-processed, pragmatic calculation of the situation. This question can only be answered with consideration to the specific context in which the family business is situated.

7.6 Cases of Ownership and Management Arrangements

The ownership and management arrangements in the family business succession process are heterogeneous. The following four cases are aimed to delineate a fuller picture of how different Chinese business families deal with the inter-generational succession of ownership and management.

In the first case, Dawu Group has an unconventional succession scheme, a family business constitution, according to which, ownership will be passed on to later generations undivided while managerial control is given to two boards (a decision making board and an execution board) elected by the employees. In the second case, the Cao family of Fuyao Group has followed a primogeniture approach in choosing the successor, along with the professionalization of the management. The third case of the Firm B6 depicts a daughter-succeeding-mother process. The last case comprises three business families which have only one child in their next generation, which reveals how the one child policy has affected the family business succession process in China.

7.6.1 Family Business Constitution: Dawu Group

The predecessor of Hebei Dawu Group was founded in 1984 by Mr. Sun Dawu's wife, Mrs. Liu Huiru, who contracted a land and started the farm business with family savings and money raised from four other fellow villagers. Mrs. Liu Huiru was running the business because at that time, Mr. Sun Dawu worked in a bank, though the couple made the key decisions together. They decided to build a small feed mill to provide for their farm as well as local farmers. In 1989, after quitted his job from the bank, Sun Dawu joined the business and established the Dawu Company. As a visionary entrepreneur, Sun Dawu has led the group grown into a large business group which operates in farming and stock breeding, agricultural processing, education, tourism, health care and E-commerce, with 18 wholly owned subsidiaries and two joint-ventures. It currently has an asset of 2 billion yuan, an annual turnover of 2 billion yuan and around 3500 employees.

When the business was first founded in 1984, Sun's family and four other villagers each held 20 % interest of it. However, the next year, the four other shareholders withdrew their investments because of continued loss and the

business became sole proprietorship. Sun Dawu's two younger brothers began to work in the top management since 1992, but they didn't own any share. In order to meet the capital demand of the growing business, in 1997, Sun Dawu tried to raise fund from the employees by giving them shares. This idea was resisted by the employees, who preferred lending the money to him instead of taking the risks of being shareholders. Since then, this sole proprietorship has been maintained and worked fine. However, eventually, he had to face the question of how to pass the ownership to his two sons. Drawing lessons from other people's experiences, he saw the risk of dividing the ownership – disputes in business strategies, quarrels and discontents about ownership arrangements and so on and so forth – which could destroy the business and ruin the family relationships.

Out of this concern, Sun Dawu invented and started to implement the family and business governance scheme called “family business constitution” in 2004. The core idea behind this constitution is to separate ownership from management, i. e. keeping the ownership in the family and leaving the management to the competent company insiders. Ownership, strategic decision making and operation of the business are separated into three boards: the board of directors (abbr. The Board), the executive board and the board of supervisors (see Table 2).

What's unique to the system is that the members of the Board are elected by over 600 employee representatives every two years. And the Chairman and General Manager are elected from the members of the Board with a term of office for four years and the possibility of reelection. Unlike the board of directors in other family businesses where the Chairman is normally assumed by family members, in Dawu Group, the Chairman is not necessarily a family member. However, the president of the board of supervisors is reserved for a family member. This more or less democratic principle is aimed at picking out the most competent directors because it is believed that “the employees know better”.

This system not only ensures highly competent talents to enter into the managerial level through public election, but also keeps the ownership intact and inherited undivided in the family. The ownership becomes a common property for the whole family, i. e. ownership stays as a whole during intergenerational transition. The later generations of the family are entitled by birth to the ownership of the family business, yet each of them only has limited right to earnings (an allowance each month and payment for the costs of housing, education and health care etc. that could ensure a secured comfortable yet not luxurious living) and the right to be a supervisory board member. According to this rule, no single family member is actually given private property right, so that family members won't be able to sell or dispose of the equity. On the other hand, under the current version of the constitution, even when the family members act as a whole, they have no right to decide the disposition of company assets except the right to draw a certain portion (10 %) of the profit for family purpose.

Table 2: The Governance Structure of Dawu Group

	Board of Directors (The Board)	Executive Board	Board of supervisors
Function	strategic decision making	execution and operation	supervision
Members	15 board members including Chairman and Deputy Chairman	General Manager of the group and top managers of subsidiaries	President, owning family members, director of law department, financial director, president of the workers' union etc.
Duties/ Authority	e.g. (1) governing the business group by establishing board policies and objectives (2) approving annual production plans, budgets and investment plans etc. (3) setting up the incentivizing mechanism and compensation of the management	e.g. (1) day-to-day management (2) implementing policies and decisions made by the Board of Directors (3) General manager represents the group to deal with external affairs	e.g. (1) enacting the constitution (2) organizing the board member elections (3) inspecting financial status and business performance (4) overseeing the work of board members and managers with the power to impeach board members (5) president may attend board meetings (6) have the right to draw 10 % of profit made in the previous year

If the constitution is to be strictly conformed by family members in the next generations, it could ensure a stable investment relationship that could benefit the business in the long-term. However, Sun still seems to be hesitated to make these rules notarized, which will render the constitution legally effective. Currently, the offspring maintain the right to change or even abandon the constitution.

Sun's constitution sets the rules for managing the succession of ownership inside the family, while the succeeding of managerial control by family members is also encouraged as family value preservation.

Inside the family, future generation is exposed to some cultural and family values that are bound to the family business. For instance, Sun Dawu encourages his children to join the family business and perceives it as a great achievement when the children climb up to high positions. He has been actively promoting Confucian values in the family as well as in the firm, of which a key value is *xiao*. He believes that the supreme form of *xiao* is succeeding the aspiration and career of the parents and developing the family business to the next level. In the interaction between Sun Dawu and his two sons, these values were successfully

communicated to and internalized by the children, which have motivated them to work in the business and to become the next leaders. Meanwhile, the meritocratic system urges them to strengthen their capabilities with all their endeavors, as well as to compete with each other and with non-family competitors in a healthy environment.

On the other hand, the founding family's values are also embodied in the business. Through activities emphasizing the contribution and importance of the founder and the family to the business, as well as promoting such Confucian values as gratitude and loyalty, employees would naturally show respect to the family and give extra credits to the next generation's performance.

The design of the system is trying to promote the meritocracy logic. However, as a matter of fact, Sun Dawu's older son was elected as the Chairman of the board, his brother as Vice Chairman, his niece as General Manager and younger son as Vice General Manager in the last election. Judging from the results, it seems that the founding family members have still been given privilege in the firm, despite the fact of the establishment of the constitution.

Moreover, the compliance of family members to the constitution is largely voluntary due to their trust on, identification of the values of and emotional bond to the founder. In other words, the family still retains the right and possibility to take back the control of the firm's decision making and operation.

Nevertheless, Dawu's constitution has worked for 12 years during which the business has been growing continuously and rapidly. It displays how a family business could solve the succession issues through introducing a clearly defined governance structure that guides the behaviors inside and between the business system and the family system.

7.6.2 Primogeniture: Fuyao Group

Founded in Fuzhou, capital of Fujian province in China, in 1987, Fuyao Glass Industry Group Co., Ltd. (Fuyao Group) is a leading international manufacturer of automotive and industrial glass, a large transnational industry group based in China, which had reached sales of 11.5 billion yuan last year. It is listed on Shanghai Stock Exchange and the Stock Exchange of Hong Kong.

The founder

The founder of the Fuyao Group, Mr. Cao Dewang, born in 1946, is the second son of Mr. Cao Heren who was a successful businessman. The Cao family had been doing business for generations and accumulated significant wealth and reputation in the pre-PRC era. Due to a misfortune during the warfare, the Cao family lost all of its wealth when Mr. Cao Dewang was a little child. He thus grew

up in poverty and had to drop out of school at the age of 14. Since then he had fought for a better living doing some small businesses including selling cigarettes and fruits and repairing bikes for others etc. until he was 30 years old, when he got his first formal job in a glass factory collectively owned by the village. This work experience laid the foundation for his future business in the glass industry.

Controlling the business

Mr. Cao Dewang raised the capital from other eleven investors and set up the Fuyao Glass Company in 1987. Four years later, some shareholders wanted to refund their investments due to a pessimistic view on the company's future. Mr. Cao Dewang bought up the equity of these exited owners with usurious loans and became the largest shareholder. Although the company went public in 1993, Cao kept gaining control through three holding companies. 3 of the 6 board positions were taken by the Cao family – the founder, his sister and his eldest son.

“If the Cao family loses its control over the business, the business will be doomed. This won't do any good to the country.” said Mr. Cao Dewang in response to a journalist's doubt about his intention to keep family control, “I also consulted the government. They want us Cao family to control the company, to make it better.”¹⁸

Currently, the founder is the largest shareholder and controls around 28 % of the total stock. The current board is composed of 10 directors, 3 of whom are independent directors, and the Chairman and Vice Chairman Positions are taken by Cao Dewang and his successor, Cao Hui.

Succession

Mr. Cao has three children: the eldest son Cao Hui, the daughter Cao Yanping and the youngest son Cao Daiteng. The two younger children both have been in charge of the company's subsidiaries, who generally have kept a low-profile. Mr. Cao Hui is expected by the father to take over the leadership mantle.

Hui grew up with great respect even fear to his strict father. Mr. Cao Dewang's training strategy was to put him through ordeals. After graduated from high school, Hui was sent to the frontline workshop to do the job of a junior worker. He ate and lived with the workers for 6 years until he was sent to Hong Kong by his father to take charge of the sales work. He had to start over from zero experience again. After he successfully adapted to the new role and built his own team, he was again sent to a bigger challenge and this time to take over the subsidiary in the US. He again stood the test and even got a master's degree there. Having settled down and built his own family in the US, Hui refused to go back to China.

18 <http://finance.sina.com.cn/leadership/crz/20090414/20096100855.shtml>

Meanwhile, Mr. Cao Dewang had started his professional manager plan. In 2003, Mr. Cao Dewang quitted his GM position and appointed an old friend of his, a Japanese professional manager, as the new GM of the Fuyao Group, who was supposed to bring modern, advanced management to the firm. The Japanese GM, however, quitted his job after 18 months, as he failed to fit in the firm due to cultural difference and language barrier. In March 2005, Hui was appointed as the interim GM of Fuyao Group, despite that the GM function was actually taken by Mr. Cao Dewang. 8 months later, the position was given to another professional manager, Mr. Liu Xiaozhi, who had two doctor's degrees attained in Germany. Unfortunately, the professional GM resigned in less than a year, following the path of his predecessor. Hui was then summoned to take over the GM position.

Mr. Cao said, "At first I hesitated and couldn't decide. I planned to hire a professional manager to succeed me instead of Hui. I thought it was enough as long as my children have a decent job and live a life with dignity. I knew being a CEO was too hard".¹⁹ His two failed trials of employing professional managers made him to conclude that professional successor won't work because "the stakeholders wouldn't buy it". Consequently, he turned to his son and finally persuaded Hui to come back after being refused over and over again. In 2006, Hui became the General Manager of Fuyao and held the position until 2015, when he was designated as the Vice Chairman and the former CFO took over the General Manager position.

Mr. Cao Dewang said in an interview in 2011²⁰, "What I gave him was a team instead of a position, with Hui being the head. Hui just got luck. This team I cultivated is loyal to Fuyao, loyal to the career and will actively assist him. In terms of competence, Hui might not be the best among the team members. But because he is my child, he has to be the successor." According to Mr. Cao Dewang's plan, the real successor is actually the management team, and his son is just the spiritual leader of it. "I will keep being the Chairman for a while," said Mr. Cao Dewang, "because it takes a long time to cultivate a chairman. I'm an all-around. I can lead a large company. A chairman has to be an all-around, who can do the jobs of a CFO, an accounting director and a human resource director and so on. This kind of talent is still absent in Fuyao, now and in the near future."

In the succession arrangements known to the public, the daughter and the younger son of Mr. Cao Dewang have been largely neglected. Describing himself as "a devout Buddhist", the founder has become a renowned philanthropist in China, as "I was poor when I was young. So I have a deep understanding of poverty. Because of this, I try my best to help the poor when I get rich." He decided to devote the majority of his wealth to philanthropy instead of passing it

19 <http://finance.sina.com.cn/leadership/crz/20090414/20096100855.shtml>

20 <http://money.163.com/11/0424/21/72EFDFKL00254M3E.html>

to his children. In 2011, the founder set up China's largest philanthropic foundation, the Heren Foundation, with his personal donation of 300 million shares, equaling ca. 11.5 % of the total stock of the company. The ownership of these shares was transferred to the foundation; nevertheless, Mr. Cao Dewang still controls the voting rights of those shares. The three children currently don't own any share of the Fuyao Group.

7.6.3 Daughter Successor: Firm B6

The founder

Born in a sericulturist family, Mrs. Shen was appointed as the top manager of a loss-making township silk enterprise in 1975 at the age of 29 and made it profitable and expanded its scale within a short time. In 1999, the enterprise was restructured and privatized and Mrs. Shen's family became the controlling owner, with Mrs. Shen owning more than 58 % of the equity. Although Mrs. Shen had a deep passion for silk business, she applied a diversified-investment strategy in the 1990s, with investments made to biotechnology, medicines, real estate and even driving schools. This strategy saved the silk business from crisis caused by growing competition in the market. The fearless, selfless and charismatic founder made great success. Besides its core silk business, the group now operates in three other key areas – financial management, assets management and biotechnology, together with a turnover of more than 11.7 billion yuan in 2015 and over 2000 employees.

The successors

The two daughters and the two sons-in-law of Mrs. Shen all work in the family business group. The younger daughter, Mrs. Tu began to work in the family business after college. She started from the bottom as a salesperson, and then was gradually promoted to the General Manager. "Everyone knows I'm the daughter of the boss. But exactly because of this, I had to do better than others. I worked really hard, never got slack for a while for my work and duty."²¹ She was designated as executive Chairman of the business group in 2005 when she was 34, which signaled the shift of power from the founder to the successor. Her husband Mr. Li, a silk-culture expert, joined B6 in 2003 and became the CEO in 2004.

The existence of three minority non-family shareholders might have pushed the firm to set up a formal governance system. The current governance body of B6 includes a board of directors, which consists of the founder Mrs. Shen, Mrs. Tu and her husband Mr. Li, Mr. Wang (Mrs. Shen's another son-in-law), and another

21 <http://www.jiemian.com/article/434381.html>

non-family shareholder, and a supervisory board comprising the elder daughter of the founder and the other two nonfamily shareholders.

Mrs. Tu is in charge of strategic decision making while the CEO, Mr. Li, is responsible for tactic decision making and execution. Despite that the founding family represented by Mrs. Tu is generally dominating the governance and management, there is a certain degree of formality and professionalism. Strategic decisions are normally made by the board together, thus minority shareholders also have a say. As Mr. Li said, "Taking care of the interests of the shareholders is my responsibility. *Jia* (family) and business are two different dimensions. My primary role is the CEO. I have to be accountable to the company and the shareholders and strive hard to increase the firm value. When the interest of the business is in conflict with *jiating*, the business is given priority."²²

Familial culture

Mrs. Shen is obviously affected by traditional familistic values. "My mother is a very traditional Chinese woman. She is very filial to her elders and polite and generous to other people" said Mrs. Tu. "My mother is an entrepreneur with a happy family life. She attaches a lot of importance to harmonious family relationships. She values not only our small family, but also the big family of her siblings. In terms of management, she paid attention to the welfare of the families of the employees as well." Mrs. Shen also made the effort to create a family-like atmosphere in the company, asking the senior employees to treat newcomers as "your own siblings, to care for them and support them." Meanwhile, she also hoped her employees to treat their family members well. This family culture is further developed in Mrs. Tu's era. "In Firm B6, there is firstly the family culture, and then the firm culture, and finally the Western-Chinese mix management culture." *Jia wenhua*, i. e. family culture, has been interiorized among the people in the firm. Mrs. Tu also believes that only when the employees regard the firm as a *jia*, they will stay here and contribute to it from their heart.

Change and conflicts

Intergenerational transition, to the Firm B6, means change. Mrs. Tu and her husband have operated large surgery to the family business group. Their strategies include management professionalization, business specialization through withdrawing operations, brand-building and internationalization. There were sharp differences of opinions between the successor and the founder, especially on the problem of subtraction. Mrs. Tu led an important strategic transformation to specialize on the silk business after she took over, which meant selling the other businesses, to which her mother had devoted a lot of efforts and emotional

²² <http://www.wensli.com/?q=node/7048>

attachment. This resulted in a bitter quarrel between the mother and the daughter. Mr. Li has often played the “extinguisher” when quarrel between the mother and daughter occurs. In the end, the daughter’s strategy was implemented. Mrs. Tu cut off 8 companies of the group and her specialization-strategy proved to be successful. In the past decade, Mrs. Shen’s successors have made the B6 Company the leading brand of the silk industry in China.

7.6.4 Only-child: Firm A19, Firm B10 and Firm A31

The common feature of the following family businesses is that they all have only one heir to succeed the business. Firm A19 follows the traditional *zicheng fuye* approach and has started the power transfer process. Unlike A19 Group, which is managed in a more traditional way, Firm B10 is professionalized and modernized. Therefore, ownership and management might be separately succeeded. The founder of Firm A31 has an ambivalent attitude towards letting his only daughter succeed the management of the business; therefore he is still exploring alternatives.

7.6.4.1 Firm A19

Mr. Cheng began to work in the construction industry in 1985 at the age of 22. After finishing military service, he was arranged to work in a tannery. Quickly he decided to give up the position and learned construction engineering in a vocational college. After working in a collective construction firm for two years, he built his own independent construction team and became his own boss. At that time it was not allowed to open a private construction firm, therefore he operated the business under a red hat – being affiliated to collective firms – until 1993, when he finally established the A19 Construction Company. The firm, having grown into a business group operating in construction, real estate development, labor service and financial investment, currently employs about 500 technicians and managerial personnel and has 3 subsidiaries and 14 branches in different provinces.

Some of Mr. Cheng’s *jiazu* members work in the firm, but only his son is in top management. “We had a *jiazu* meeting, in which we reached the consensus that if someone wants to work in the firm, he will be treated exactly the same as non-*jiazu* member. Of course I will support my *jiazu* members privately when they need help because of our family bond, but not inside the firm. Ability is the only standard that determines the treatment in the firm, not family membership.” Mr. Cheng’s brothers have been running their own businesses and only a few relatives work in the firm.

Mr. Cheng's only son, Cheng Junior, has known that he would succeed his father since his childhood and he has embraced his fate readily. Cheng Junior was sent to a branch office in Qinghai province as the director to gain practical experience and training after graduated from college in 2011. After one and a half years, Cheng Junior was called back to the headquarter and took over his father's position as the corporate representative of the construction company. "Bidding for construction projects requires the presence of the corporate representative. I don't want to move about the country at my age. So I made him the corporate representative firstly and then pushed him to take over the responsibilities gradually." said Mr. Cheng. He also asked his wife, who was not involved in the business, to join the firm to help their son in financial issues. "She only manages the money. Administration and decision making are not her job." Mr. Cheng gradually gives Chen Junior more authority to make decisions and responsibilities to take, hoping to train his son in practice under his guidance and mentoring, and at the same time, to impart his knowledge and experiences to him.

Cheng Junior was recently given 30 % of the equity of the construction firm – the core business of the group, and he was appointed the Chairman of the one-man board of firm at the age of 26. "I plan to let him take over the control in three to five years. I have told the staff, 'my son is in charge', in a meeting as I hope he can learn by doing. The business won't be affected by the arrangement because he is assisted by the General Manager and Vice General Manager. Besides, he will consult me when the decision is big or difficult to make." Currently, Chen Junior has to report to him regarding major decisions, especially the approval of large amount of expenditure. The transfers of equity and Chairman position as well as moving into a brand new, modern office building were Mr. Cheng's strategy to motivate Chen Junior. "The new office is aimed at improving the image of the company and creating a better working environment. On the one hand, I want my son to feel proud of the family business he is taking over. On the other hand, the new look of the firm will help attract more talents. As such, new, modernized management system will be gradually installed."

"Guanxi is indispensable in doing business." In addition to the ownership and management, in the last few years, Mr. Cheng has been gradually transferring his guanxi to Chen Junior. "I have been teaching him how to deal with people and things and how to do business since he was a child. So he is doing a good job and my friends and the employees all have very good impressions." Chen Junior has been involving in guanxi initiating and maintaining activities such as the year-end clients-visiting for a few years. "Most of my guanxi now recognize my son as my successor. They generally give credit to him just as they have trusted me." said Mr. Cheng.

"Running a business is about self-fulfillment. It's a way to demonstrate your ability and achieve your self-worthiness. It also gives you freedom to do what

you want to do in your own way. However, what you can really accomplish with the business depends on your personal abilities and charisma.” Mr. Cheng is generally satisfied with the performance of his son, but he feels that it is still too early to give the son complete control. “I’ve told my son that I will leave the business fully in his hands in 3 years. The business by far is my achievement but also his foundation and starting point. Where he can lead the business to in the future depends fully on his own ambition and ability.” He plans to leave the firm in five years, but it won’t be a retirement. “I will invest in some projects that are manageable for an old man, such as ecotourism, agriculture or leisure projects. I can’t really retire. I will be unhappy or may get sick if I stop working.”

7.6.4.2 Firm B10

Firm B10 was founded in 1994 in Changzhou, Jiangsu province and is one of the leading small forging manufacturers of automotive parts and the biggest forging claw pole suppliers in the world, with the fixed assets of about 400 million yuan and staff over 1,500 including more than 300 specialized technical personnel of all types.

The founder Mr. Zhuang had worked in a SOE for 8 years before he finally decided to quit in 1983 as he wanted to have a career with passion. He then became the founder-manager of a township enterprise producing gears for tractors at the age of 23. “It was freshly established, so I had to do everything myself – from mixing the concrete for the foundation of the factory, to being salesman and manager.” The firm was successful and reached its acme in 1993. One year later, Mr. Zhuang began to build a few factories based on the resources of the old one with privately raised fund. “I was able to raise the money because the ten years of experiences of running the factory gave me good creditability.” He grasped the opportunity brought by the emerging motorcycle industry and shortly after, the firm became the market leader. He again felt that the motorcycle parts business would be going to suffer a decline, so he shifted his focus to automotive parts in 1997, which was a big challenge at that time due to extremely high technical threshold.

Mr. Zhuang’s visionary forward-thinking has made the firm grow rapidly into one of the leading global suppliers of specific automotive parts. His international recruiting strategy has attracted a few foreign talents to work in the firm. The first foreign employee, a French engineer, working in B10 Company for more than a decade as the vice president, has significantly contributed to the building-up of a professional management team, the modernization of the management system and the internationalization of the company. “In terms of management, our firm is compatible or even slightly superior to our European counterparts and we are constantly improving it.”

The younger brother of the founder, Mr. Zhuang J is the General Manager of the B10. He started from the bottom and was gradually promoted to the GM. Mr. Zhuang J doesn't own any share, as the firm is fully owned by the founder and his son. He regards himself as a professional manager. "In my notion, it doesn't matter whether it is my brother I work for or elsewhere I work, I just do what I need to do. I am no different from other employees, only I am in the General Manager position." he said.

The son of the founder, Zhuang Junior, worked in another firm in the same industry for two years after he came back from the UK with a MBA degree. This was part of the founder's training plan for his son. When he joined the family firm, Zhuang Junior firstly worked as a frontline worker and then in the marketing department, and later became the assistant to the General Manager. Mentored by his uncle and as the assistant, Zhuang Junior has been able to participate in major affairs and decision making process, which helps him gain an overall understanding of the business. Nevertheless, his uncle mentioned that the assistant position may hinder the successor's development of managerial capabilities as he is immune from independent thinking and decision making.

For all the firm insiders, it is clear that the founder's only-child will take over the ownership and become the new boss one day. However, as the managerial control is delegated to the professional management team, whether Zhuang Junior is competent enough to take over the leadership of the management is still not clear.

7.6.4.3 Firm A31

Mr. Lu returned from the military service in 1989 and was assigned to work in a SOE in Chongqing. He chose to *xiaohai* in 1994 and after gained some business experiences in other industries, he finally began his agricultural business in 1997. "I chose agriculture because I had a long term vision. With 4 million cash at my hand – that was a lot of money back then – I had two options: to invest in property development or agriculture. I think if I chose property development, I would have become the market leader in this city as well. I chose agriculture because I saw this sector bearing more social responsibilities than other sectors. It was a good choice for self-realization. I persuaded my wife to quit her job and joined me as I could not run the business all on my own. Besides, I hoped we could work together towards the same end."

In 1999, he established the A31 Agriculture Development Co., Ltd., which now owns five large farms and operates in the following areas: vegetables and fruits production and distribution, flowers cultivation, hogs raising and agricultural tourism service. It used to employ around 2000 people, most of whom were farmer workers. Mr. Lu then changed the business model and turned these

farmer workers into individual contractors. Now the firm employs 200 people, whose main tasks are providing technical support to the farmer contractors and marketing. The annual turnover reached around 500 million yuan last year.

Mr. Lu has hired 38 relatives in the company and only one of them is in the management. “Their positions depend on their abilities. I used to serve in the army, so my company is different from the ordinary family firms. I won’t put an incompetent person in the important position as I can’t allow a relative to impede the development of the enterprise. I’d rather give him money to start his own business. The concept of relative doesn’t exist in work, only in private life.” He attached great value to good management. “Small firms are the result of hands-on doing, large firms managing. In the startup stage, family members are especially important. But when the firm develops, family members might be an impediment because they may not fit in the new management structure or they can’t rise to the new challenges. When they become stumbling blocks of the development of the enterprise, you have to kick them out.”

He has been cultivating a professional management team and establishing modern corporate institutions to improve the decision making and operation processes of the organization. “The traditional family business must be transformed into a modern corporation which embodies modern management in order to survive in the long run. Succession depends on modern management.”

Taking about his daughter, Mr. Lu said, “In my daughter’s generation, their values are different from ours. They are not like us. Our generation want to do something firstly for the society, secondly for the family (*jiazu*), and lastly for self-fulfillment. Our children, they are self-centered. They always think about what they want and what they like to do. They are independent even rebellious. Some of them think that taking over the *jiaye* their parents’ have created would hinder the realization of their own career dream. They need to achieve their own success.”

Mr. Lu’s singleton daughter just finished her master study of international finance abroad. She went abroad for studying after graduated from high school. The daughter has been quite independent, who once said to his father, “you can give me wealth, but you can’t give me abilities”, but she values her father’s opinion a lot. Mr. Lu has been actively involved in his daughter’s career planning. Before she applied for a master program, he urged her to think through what she really wants and make a clear plan accordingly. “You can’t spend years to study something you will later find out not matching the needs of your career.” He said to his daughter. These words led the daughter to give up her interest in studying history and choose international finance instead.

He plans to let her apply for a job outside the family business and work for maximum 3 years. “If she proves to have the ability to control an enterprise after 3 years, I will let her take over gradually.” On the other hand, Mr. Lu has an

ambivalent attitude about letting the daughter take over the management. “I don’t want my daughter to become too strong and tough, because when a woman is too strong, she can hardly have happiness in her family life as Chinese men don’t like strong women. But a woman without a strong character certainly can’t manage a large company. As a father, I am hesitating to let my daughter take over. It’s a large burden. But as an entrepreneur, I want her to succeed me. After all, it depends on how things evolve in the future. Currently she is actually not very interested in succeeding. So what I can do now is to improve the institutions and build a capable management team to share as much of her burden as possible.”

Chapter 8.

Nurturing and Grooming: The Transfer of Intangibles from Founder to Successor

The previous chapter has revealed the general patterns of ownership and management succession in Chinese family business succession. Most Chinese founders are prone to select their own children as the management successors. Holding responsible for the future of the business and the family, the successors are expected to be committed, competent and well prepared for their roles, so that they can lead the family businesses to further success after the takeover.

Unlike a paratrooper successor, who is supposed to be already competent and ready when she/he takes over the leadership, a family successor generally needs/has the founder's involvement in her/his development.

Some scholars have pointed out that in order to ensure a successful intra-family succession, besides ownership and management control, the transfer of intangible resources such as values, human capital (knowledge and skills), and social capital (*guanxi*) from the founder to the successor is also critical. This transfer, as well as the development process of the successor, however, has received limited attention in the family business literature. Many business families are actually fully aware of the importance and practicing sophisticatedly the cross-generational transmission of these intangibles.

This chapter thus is about how the founders of Chinese family businesses nurture and groom their successors and how the intangible resources are transferred from the founders to the next generation successors in the succession process. The transfer of these resources, unlike shares or a position which can be passed on to the next generation overnight, requires a long period of bilateral effort-making and effective interactions between the founder and the successor.

8.1 A General Development Program

After a successor is selected, the control, and usually also the ownership, will be passed on from the founder to the successor, gradually or promptly. Relinquishing power could be easily done at any time when the founder is willing or

forced to step down due to various reasons. Yet the transmission of power often lasts for a relatively long period, except for the case of sudden succession. As the decision on succession is mainly driven by the expectation of business continuity, the visionary entrepreneur will hardly transfer control to an unprepared successor, which could bring catastrophic consequences to the business and eventually the family. The founder thus normally plays a key role in the successor's training and development.

8.1.1 Desirable Attributes of the Successor

The knowledge, skills and abilities the successor is supposed to acquire before the control transfer differs from business to business, determined by the specific industry the business sits in, its size, the market condition and the complexity of management, etc. "By my standards, my son still needs more training before he can be the Chairman." said Mr. Xin (A32) who will pass the baton when he thinks his son is ready. The son has worked in the firm for 10 years. "Actually he is still unqualified to be the Chairman. He will keep on learning by practicing in the position." commented Mr. Cheng (A19) on his son, who was recently appointed the Chairman of the core business.

"It takes a long time to cultivate a chairman. I'm an all-around. I can lead a large company. A chairman has to be an all-around, who can do the jobs of a CFO, an accounting director and a human resource director and so on. This kind of talent is still absent in Fuyao, now and in the near future."²³ said Mr. Cao (Fuyao Group), whose successor is currently the Vice Chairman.

"My successor must have abilities, which include not only knowing the economics of the business, but also being proficient in the social and political sides of it. Only when the successor has these abilities, can the enterprise be continued for a long time. Being a boss is not easy, it requires comprehensive qualities and abilities, as well as great foresight." said Mr. Yuan (A18).

The above excerpts reveal that in most founders' minds, there is a set of standards that their successors should come up to before they finally pass over the control of their firms. Many years of experiences of running a business may help the founders formulate their own theory about the key requirements for successfully running a business, and consequently a theory about the desirable attributes of the next leader.

Each founder may insert a different set of variables to her/his theory. It is possible to identify a long list of the attributes the founders deemed important,

23 <http://money.163.com/11/0424/21/72EFDFKL00254M3E.html>.

which can be translated to integrity, relational competence, trustworthiness, diligence, risk-taking, intelligence, decisiveness, resilience, charisma, innovativeness, foresight, independence, sense of responsibility, commitment, knowledge, ability to learn, leadership, persistence, self-confidence, strong character, and policy sensitivity etc.

Some of these attributes are wrapped in a few indigenous Chinese concepts. The most frequently mentioned attributes in the interviews include the following:

(1) *Weiren chushi* (为人处世)

Weiren chushi is repeatedly mentioned in the interviews by some founders as well as successors. For instance, Mr. Chen (A1) mentioned,

“The most important thing is to learn *weiren chushi*. The key to do business is primarily *zuoren*. If you fail at your *weiren chushi*, you can’t get the trust and recognition from others. You will fail your business.”

Mrs. Wang (A28) also mentioned that,

“An entrepreneur must do well in *weiren chushi*, keep a low profile, be purposeful and eager to learn and to improve herself constantly.”

Weiren chushi is an overarching concept about one’s dealings. It is essentially about how to deal with *guanxi*, i.e. how to build up, maintain and further the *guanxi* with proper conducts. This requires the understanding of explicit and implicit social rules, the formation of one’s own styles and values, and interpersonal skills.

The phrase can be decomposed into two parts; the first is *weiren*, which literally means “become a person”. This “person” is a socially desirable person with “good” qualities such as being trustworthy, honest, moral, kind, loyal, and filial etc. These attributes are not regarded as inherent in one’s individuality, but residing in relationships, because they can only be sensible to the self and others in human interactions. The second part, *chushi*, literally means “being in the world”, i.e. knowing the world’s rules, finding one’s place in the social world and behaving accordingly.

Although the specific meaning and requirements of *weiren chushi* may subject to distinctive personal interpretation, it is essentially about how to deal with one’s relationship with others. Therefore, *guanxiability* (i.e. relational competence), which refers to one’s ability to master the rules of *guanxi* and *renqing* and to build and maintain *guanxi*, is key to *weiren chushi*.

A similar concept is *zuoren* (做人, become or be a person). “The key of being an entrepreneur is *zuoren*. When you succeed in your *zuoren*, you succeed in your business.” Mr. Cao Dewang (Fuyao Group). “In China, *zuoren* and doing

business are inseparable. The guiding principle of being an entrepreneur is that, *zuoren* is the premise of doing business.” Mr. Zhao (A24)

(2) *Chiku nailao* (吃苦耐劳)

The second is *chiku nailao*, which literally means, “eat bitterness, endure hard work”, i. e. hardship bearing and hard working. The “bitterness” can be physical but it is more about psychological suffering caused by e. g. adversity, pain or great pressure.

Hardship-bearing and hardworking might be regarded as positive qualities in any society, however in the Chinese culture, it is an especially emphasized and highly praised quality indispensable for success. A large portion of the first generation Chinese entrepreneurs started from scratch and have endured a lot of hardship thus highly value such qualities as hardworking and persistence. Many founders believe that *chiku nailao* is one of the most important qualities that led to their success, while it is a quality usually lacked in their post-80s children. As Mr. Lu (A31) said,

“We all want our children to be competent. The primary ability required is *chiku nailao*. Few of our next generation have it because they have been brought up overly protected.”

Some founders intentionally put their children through adversity, as they believe that bitterness teaches, strengthens and improves people’s character. For instance, Mr. Wang wrote about his mother-in-law, the founder of Firm B6, with admiration that,

“She encourages us to *chiku* and to experience ordeal and frustration, so that our willpower will be enhanced and our experience will be widened.”²⁴

(3) *Danda xinxi* (胆大心细)

“Doing business requires you to be *danda xinxi*, to dare to break through, to seize the opportunities and bear the risks, but always be cautious.” Mr. Li’s (A15) words make good annotation for the word *danda xinxi*. *Danda* literally means having a big gallbladder. In the Chinese language gallbladder is a metaphor for the place where one’s courage comes from. *Danda* denotes risk-taking, dashing, decisive, and innovative. *Xinxi* means careful, thoughtful and cautious. *Danda xinxi* thus means being bold, courageous and brave while at the same time cautious, wise and not reckless.

There are many circumstances that require the entrepreneur to be cautiously bold, as Mr. Gao (A27), who has built everything from a scratch step by step since he was 17, said,

24 http://www.zjsr.cn/show_hdr.php?dname=PP2V311&xpos=2.

“In fact, being an entrepreneur is very hard. It is very risky with very high pressure. Every decision, new idea and new project involves some degree of risk. An entrepreneur won’t be scared, he is *danda xinxi*, and decisive, and he strives for his ideas.”

(4) *Zhahui* (智慧)

Zhahui is a concept that combines the meaning of intelligence and wisdom. It is a complicated concept with rich connotations. In everyday use, it mostly refers to the ability to think, reason and understand in order to gain and create knowledge, and the ability to use accumulated experience and knowledge to make sensible decisions or judgments. *Zhahui* is closely related to *zhishi* (知识, knowledge). It is often associated with insight and foresight.

“If your child has *zhahui*, he won’t need your wealth. When he doesn’t, you give him wealth, he will eventually lose it.” Mr. Li (A15).

“In our generation, business success can be attributed to opportunity, our own *zhahui* and good policies.” Mr. Mou (A29).

“20 years ago, success depended on *danda* and *chiku nailao*. Now *zhahui* and knowledge have become more important.” Mrs. Wang (A28)

(5) *Leadership*

Leadership includes various attributes such as being charismatic, insightful, visionary, and decisive, the willingness to take responsibility as well as the ability to take overall control, to communicate effectively and to influence others.

“The leader is the heart and soul of the firm. All depend on the leader’s charisma.”, said Mr. Yuan (A18).

“What you can really accomplish with the business depends on your personal abilities and charisma.” Mr. Cheng (A19)

(6) *Policy sensitivity*

Policy sensitivity is a particularly important ability to the Chinese entrepreneurs, especially for firms operating in real estate, agriculture, international trade, and manufacture etc.

“The primary requirement for doing business is policy sensitivity. You need a good understanding of the policy of the government. The second is idea. You need to know the purpose, requirements and objectives of your venture. The third is the support from your friends.” Mr. Tan Senior (A22).

“I started from construction industry, which requires an in-depth understanding of the industry and professional knowledge and *chiku nailao*. Doing the real estate business, the key is to keep abreast of government policies.” Mr. Gao (A27)

“The development of private enterprise depends on the government guidance. It can’t grow into large enterprise if the entrepreneur doesn’t follow the policies. When the government wants an enterprise to fall, it falls. When the government wants it to develop, it rises. Government policy is extremely important.” said Mr. Sun (A12).

(7) Commitment

“An important requirement of the successor is that he must be voluntarily interested and motivated to succeed the business.” (Mr. Chen, A1).

“You can’t force your child into succession if he is not interested. If he is not interested, he can’t run the business well.” (Mr. Xin, A32).

Being interested in the business and entrepreneurship is an important ground for the successor’s commitment toward the family business. Commitment has been identified as a key desirable attribute of the successor, which refers to the successor’s willingness to invest personal resources including time, effort, labor, knowledge, skills, financial resources and *guanxi* to the firm. The next generation not necessarily has the willingness to take over the family business, especially when the founder parents don’t intentionally cultivate the offspring’s interest in the business. Many founders indeed have faced the situation that their children are unwilling or unmotivated to succeed their career.

The above mentioned attributes are just examples of important business related attributes. Generally, the founders’ emphasis lays largely on personal qualities and abilities instead of specific knowledge and skills. The reason might be that knowledge and skills can be relatively easily acquired in a short period of time, while traits and abilities generally require a long time to develop.

Some of these traits and abilities are often thought to be lacked in the next generation. For instance, Mr. Xin (A32) said,

“Many Chinese family businesses share a common problem. The first generation entrepreneurs have many good qualities. Their persistence, *chiku nailao*, insight and ability to control are the key for the survival of their businesses. The next generation, the post-80s, generally is not as *chiku nailao*, dashing and persistent as their parents. This may become a problem for succession.”

The founder’s theory of desirable attributes of the successor is based on her/his subjective judgments and experiences and often includes her/his own attributes, which are deemed as important contributors to her/his current business success.

The theory could play an important role in the founder’s various succession related decisions. The first application of the theory is that it provides criteria for assessing a given heir’s competences and suitability for the role of leader in the family firm thus affects the successor selection. When there is only one successor candidate available, then the assessment may determine the final “succession or non-succession” decision.

However, to most founders, there is only a very small pool of candidates, thus they are not given much latitude in successor selection. Moreover, competent and well-prepared successor is often the result of nurturing and training, which enables the founder to mold a desirable successor in accordance to his standards. Therefore the more important application of the theory is in the training process, in which the aim is to help the successor develop these necessary attributes.

8.1.2 Four Stages of Successor Development

The development path of the Chinese family business successor can be generally decomposed into four stages (see Figure 6).

Stage 1	Stage 2	Stage 3	Stage 4
Childhood and Adolescence (until 18)	Higher education/ Specialization (19–25)	Successor grooming (external, internal)	Leadership transfer
Nurture		Training	Transition

Figure 6: Four Stages of Successor Development.

Stage 1

In the first stage, the heir receives family socialization and schooling until he is around 18 years old (the common age of high school graduates). In the daily exchange between the parent and the child, some of the founder's values are transmitted, intentionally or not, to the children. Some general business-related knowledge, as well as a small part of the guanxi network may be transferred as well and the successor's interest in the family business might be deliberately cultivated.

In almost all cultures, parents are naturally given the responsibility to socialize their children. Family is the first and a key locus of socialization where a person forms his value structure and acquires the knowledge about the world, including a culture's values, norms, and ethics, from her/his parents. The values the parents impart are "in accordance with their own location in the social structure, and also by virtue of their individual, biographically rooted idiosyncrasies" (Berger & Luckmann, 1966). That is to say, the values a person selectively internalizes are largely determined by her/his parents' values. For instance, Ms. Mi (A6) said,

"My father has greatly influenced my character. He taught me that a person must be trustworthy, hardworking and courageous when I was little. For instance, I learned from him that a person must rely on her own efforts to achieve her goals, no matter how hard it is. I can still remember the scene I saw when I was in high school. I went to see him at the construction site when he was doing a project. I sat in his road roller and watched

him working the whole day until midnight. That was when I learned how hardworking, persistent, hands-on and detail-oriented he is. ‘Work hard and be persistent’ has also become my motto.”

In addition to the parents’ values, the heirs may also be naturally exposed to business-related knowledge. Take the post-80s for example, normally their parents started the family business when they were little thus they generally witnessed the development of the family business in their up-growing and got to know some general aspects of the business in this stage. For instance, Mrs. Liu (A16) sometimes asked her only daughter, who was then in junior school, to stay with her in the office when school was over, so that they could spend more time together. The daughter enjoyed coming to the office to see how her mother worked and she also liked to visit the workshop. “Maybe my daughter’s experience in the company had made her interested in the textile business. So when she went to high school, I started to explain to her about the operation of the business from time to time.” said Mrs. Liu. This is how the daughter-successor got her initial knowledge about the business as well as management. This knowledge, however, is often very limited and fragmented.

Some founder-parents have also purposefully started their successor cultivation plan in this stage. Taking the children to the worksites to show them the aspects of the business and teach them knowledge of how to run a business is one of their ways. Some heirs were asked to present and observe board meetings at very young age. For instance, when Ms. Yang Huiyan was 13, her father Mr. Yang Guoqiang, the founder of the Country Garden Group, began to take her to board meetings. After the meetings, the father explained to her why he said certain things in the meeting and how to manage the subordinates. As another example, Mr. Liang Yezhong, the son of the founder of Sany Group (a construction machinery manufacturer founded in 1989), has been requested to attend board meetings since he was 16. He commented,

“Eight years’ experiences of attending the board meeting have provided me the important trainings of strategic thinking. It is very important. When I started to work, I found I could skip many phases of training because I’ve already known them.”²⁵

An important goal in this stage is to cultivate the future successor’s interest in family business. McMullen and Warnick (2015) pointed out that “it is possible through early succession planning to influence not only the child’s ability to become the successor of the firm, but also his or her desire to do so.” This viewpoint is also shared by many founders. Talking about his experience of developing the successor, Mr. Chen (Sanquan Foods) said,

25 <http://finance.sina.com.cn/review/essay/20081104/08455465057.shtml>.

“A key to successful succession is to cultivate the children’s interest in the business. A successor must firstly have a great passion for the business.”²⁶

Some founders, on the contrary, may prefer to keep the children fully focused on their academic performance. Mr. Ran (A21), for instance, said that he has rarely talked to his son, who is now 18, about the business. “His main task is studying. He doesn’t need any distraction by the business.” Mr. You (A5), a second generation, said, “I had no idea what my father was doing before I went to college, except for that he was running a real estate development company.”

Stage 2

In the second stage, the heir specializes her/his knowledge structure in college. Higher education is an important component of human capital. “Educational attainment is believed to indicate an individual’s knowledge, skills, receptivity to innovation, and cognitive and problem-solving abilities” (Chrisman et al., 1998). The majority of the post-80s heirs have college degrees. Very likely, their parents played an important, even dominant role in their choice of specialties. Many heirs have studied the family business or management related degrees. During this stage, some of the successors begin to do part-time job, internship or vocational job in the family business or other firms. Others might begin to create their own businesses. Generally, this is the stage of transition from adolescences towards adulthood and maturity when the heir is prepared for the subsequent entry into the professional world.

Stage 3

In the third stage, the successor has finished her/his higher education and begins his formal training by joining the professional world as an employee or self-employed. She/he might be trained firstly outside the family firm before entering the family business or start right from the beginning in the family firm. This is the stage when business-related knowledge and guanxi are intensively transmitted.

Most of the family businesses in my sample have chosen to train the next generation directly inside the businesses. The majority of the graduated second generation of the family businesses investigated in this research joined their family businesses shortly after their graduation.

Entry in the family firm indicates that the successor has somehow been committed to the family firm. Therefore, this stage is more about fostering the competence of the future leader. There is normally no formal program to train a successor, but a frequently used training strategy is bottom up rotation. The successors are asked to start from the frontline and the bottom level of the

26 <http://finance.sina.com.cn/leadership/mrlzy/20121015/114413369382.shtml>.

organizational hierarchy and rotate to different departments until they are promoted to top management. The idea is to let the successor gain an in-depth, detailed and comprehensive understanding of business – its product, history, management structure, key stakeholders, organizational culture, industry etc. – in a relatively short time. Moreover, frontline experience is seen as an important way for fostering *chiku nailao*.

For instance, Ms. Tu (B6) began to work in the family business after college. She started from the bottom as a saleswoman, and then worked in different departments. She appreciates this experience, as “I think what young people lack are experiences. Sometimes you won’t learn by others giving you the answers, you have to experience and find the answers yourself. My experience on the frontline made me understand the hardship of the bottom level workers, so I asked the middle management to treat them well. More importantly, because I worked from the bottom up, I know all the procedures and processes of the business. So when a problem occurs, I can quickly find its real causes and formulate feasible solutions.”

An alternative strategy is assigning a relatively high starting position to the heir, i. e. the heir is directly appointed as middle level or even top level manager. Mr. Chen Junior (A19) started directly in the top level management. His father wanted him to learn by doing at a high position. Mrs. Liu’s daughter (A16) was also directly trained by her mother step by step on the General Manager position.

Some successors (e. g. Zhuang Junior of Firm B10) are asked to work outside for a few years before they enter the family businesses. Mr. Lu (A31), for instance, plans to let her daughter work outside the family firm for 3 years.

“You can’t train your successor well in your own firm,” said Mr. Lu, “because everybody in the firm will treat her like a little emperor. Nobody will let her take any responsibility. She will be a flower carefully protected in a glasshouse, which can’t survive the storm of the real world. After working outside, she will have a better understanding of management and learn how to *zuoren*. And she will appreciate what her parents have built. The world is different now, but in every era, the requirements for success are similar.”

External experience helps the successor develop independence, self-confidence and identity, understand different management styles and organizational culture and improve problem-solving ability. After the successor joins the family business, she/he will be further trained to assume the leadership. The training stage often lasts for a few years until the successor is regarded fully-prepared for the leader position.

“I will delegate the decision making to my son after he has worked in the business for three years. He has just finished study and has a lot to learn. I think three to five years of training and grooming is necessary for him to gain a deep understanding of the firm. I will let him play the main actor after five years.” said Mr. Gao (A27).

Stage 4

In this stage, the leader position is assumed by the successor. There may be a short founder-successor partnership period before the managerial control is fully transferred from the founder to the successor. The transfer normally happens in the successor's 30s. For instance, Mr. Mao Zhongqun (Fotile Group) took the helm at the age of 36, Mr. Tan (A22) at 35, Mr. Hu (A25) at 30 and Mrs. Tu at 34. After the transition, the founder might still keep an advisory role.

In each stage, there can be distinctive goals of training and practices of re-sources transfer based on the preference of the founder-parents, the willingness and abilities of the successors and the nature of the parent-child interactions (relational distance). The preference of the founder-parents is critical because the founders can largely determine the development path of their children.

8.1.3 Controlling vs. Laissez-Faire Founder-Parents

When the founder has a strong desire for successful intra-family succession, as most Chinese founders do, he is very likely to be highly involved in the next generation's development.

“Every entrepreneur will carefully cultivate the next generation. Why? Because it is very hard to build up a business, thus she/he naturally hopes that the second generation is capable of succeeding it. So the cultivation must start as early as possible.”²⁷ said Mrs. Cheung Yan, the founder of the Nine Dragons Paper Group (NDPG).

Established in 1995, NDPG has become one of the world's largest linerboard manufacturers. The NDPG is based in Hong Kong with a few subsidiaries operating in the mainland and went public in 2006.

“As a mother, I will of course influence the children's direction of development. Every parent does that. I hope my sons can succeed me. I want NPD to last for over a hundred years.”

To this end, Mrs. Cheung Yan has intentionally cultivated her both sons' interest in papermaking since they were little because, as she said,

“My sons' interest is very important. [...] I can't force them to join NDPG. I suggest them to come and if they do, it's a good thing. But I can't force them to do it just because I am their mother.”

The elder son, who had been “very interested in papermaking and working in NDPG”, became board member in 2006 as part of his training and was appointed as an executive board director in 2009.

27 <http://news.sohu.com/20100302/n270504041.shtml>.

A founder, as the parent, is often presented with the opportunity to mold his child into a desirable successor. On the one hand, she/he could inculcate his values and impart his knowledge and skills personally to his child. On the other hand, she/he can purposefully arrange the child's development program – formal education, training, etc. – so that the child will have the desirable knowledge and skill-set as she/he wishes. However, whether the successor develops as he designed is often a big question mark.

Despite this, some founder-parents, who demonstrate zealous passion in interfering with child's life (thereafter called the controlling-parents), prefer to take control of the development of the heirs. Parents are supposed to be responsible for the children's welfare (mainly material) according to the traditional familism, thus arranging for the children's lives gained validity in many founder-parents' eyes. Many Chinese founders I interviewed believe that they should intervene in their children's life choices. Some of them purposively cultivated their children's interest in the business like Mrs. Cheung and decided their children's majors in college and their training plans, while children exhibit little autonomy.

The controlling-parent has a clear goal of letting the heir succeed the family business and restricts the heir's development path (subtly by influencing the heir's preference or coercively by direct command or demand) accordingly with low tolerance for the heir's deviation.

In most cases, the controlling parent is paternalistic, who utilizes his parent authority and the heir's sense of family obligation to achieve his goal. Thanks to the inculcation of the Confucian value of *xiao* (filial piety) and familism, the children tend to be obedient and silent to the parent's authority and demand.

A typical case is Mr. Cao Dewang (Fuyao Group), who believes that, "The parents will never be wrong. It's always the children's fault." Grown up under his father's paternalism, Mr. Cao Dewang became a paternalistic father himself. His son, Mr. Cao Hui has been very obedient and followed almost all of the father's arrangements about his life. Hui has always respected and even feared the paternalistic father. "I feel very nervous when I speak in his presence."

Whether or not the parents choose to mold their children into successors depends on their own values and philosophies. For instance, the controlling founder-parents generally follow the Confucian *youwei* (有为, action) which emphasizes positively taking actions to archive desired ends. They believe that all the necessary attributes (qualities, abilities, skills and commitment etc.) required for running the business could be acquired and developed through training. The child's interest in business, for instance, can be nurtured or is just irrelevant.

Different from the Confucian *youwei*, the Taoist school, the arguably second most influential Chinese philosophy, emphasizes *shunqi ziran* (顺其自然, let nature take its course) and *wuwei erzhi* (无为而治, govern by doing nothing that is against nature).

Following this thought, the laissez-faire parents don't interfere in the children's career choices. They tend to believe that whether a child wants to be and can be a good successor is in the nature of the child. They refuse to interfere in the nature of the children, therefore tend to let the children develop and choose their own paths freely. Even when the parents hope the children to succeed the business, they let the children decide what they really want to do. For instance, Mr. Cui (A30) said,

"I would like my daughter to take over the business. But I won't force her. It's her choice. She is very independent. For instance, she chose her own major and rejected my suggestion to study something business-related. When she finally decides not to succeed, that's OK. I am still far from retiring age. When I am old, I will sell the business."

Mr. Tan (A22), who is the second generation successor, is also one of the laissez-faire parents, said,

"I will not make any training plans or future planning for my children. I don't need them to be excellent in school, as long as they are healthy and moral. I don't like the idea that children live as planned by their parents. They should choose how to live and who they want to be. When I have to retire, I won't force them to take over the business if they don't like it."

Another successor, Mr. Hu (A25) has similar ideas.

"Concerning my children's development, I think we need to *shunqi ziran*. Whether my children will succeed the business depends on their own choice in the future. What we can do is to build a path. They can choose whether to follow this path or choose another path they like. It's all their own choices. I am not like my father. If I hadn't chosen to succeed, he would have forced me to anyway. I will not force my children."

The laissez-faire parents tend to believe that a qualified successor is impossible to be trained as leaders are born to be leaders or naturally made to be by life. As each person has unique life experiences even when they are from the same family, the founder's leadership and success can't be replicated. Key qualities such as guanxiability, risk-taking, ability to control, and charisma are endogenic and naturally acquired in one's life course, thus it is hard to be learned through training.

Moreover, the heir's interest is also a natural attribute and is beyond the parent's control. The majority of the founders I interviewed seemed to be unsure about whether the children's interest and commitment in family business could be intentionally fostered. As Mr. Cai (A4) said,

"As the parents, you can't place too much hope on what you child will do. Whether my son will take over the family business depends on his own interest. He is not very interested now. Maybe he will change his mind in the future."

Only when succession is in accordance to the child's nature, e.g. when he is interested and exhibit the potential to be a leader, will the parent take the actions

to foster the child's development through training and to facilitate the succession process. Parents are thus friendly supporters for the children's ambitions instead of masters of the children's destinies.

In summary, the controlling and laissez-faire founder-parents have different attitudes and strategies towards the development of the next generation. The majority of the first generation Chinese entrepreneurs tend to exhibit some degree of controlling, as making arrangement for the children is a norm of the traditional father-child relationship.

Case: Training a Successor

When Mrs. Tu (B6) started to work, she was not interested in her mother's business at all. "I saw how arduous it has been for my mother to run the business. I didn't want to be so tired being an entrepreneur like my mother; instead I wanted to do something I really like." Her mother, Mrs. Shen, didn't disprove this thought directly but asked her to do an internship in the family business before she made her career choice.

Mrs. Tu was sent to the frontline to learn from the senior workers and then she was assigned to different jobs inside the firm. "The job rotation training gave me a better understanding of the firm and let me know the value of teamwork." Her mother then gradually cultivated her interest in silk. "She turned a person who was indifferent to silk into someone who loves silk so much that she can't live without it." wrote Mrs. Tu.

In order to broaden her horizons, Mrs. Shen sent her to Japan and then Hong Kong, "the frontiers of world fashion" where Mrs. Tu got to know the modern art concepts and business model, which has influenced the direction of the company's silk business.

"I have followed my mother working in B6 for 18 years. I have learned so much from my mother's words and deeds." She claimed to have been strongly influenced by her mother in her personal character molding and she had learned bit by bit from her mother much of her leadership skills, knowledge of the industry and the business and management skills. "My mother is my mentor in life, who has been fully dedicated to cultivate me into a good person, and a good entrepreneur."

8.2 The Transfer of Human Capital

Besides commitment and the desirable personal traits, knowledge and skills are the basic requirements for a successful succession.

The main objective of training is to increase the human capital of the successor, which is a key variable of the competence of the successor. Human capital

is defined as “the knowledge, information, ideas, skills, and health of individuals” (Becker, 2002). A part of the founder’s human capital, such as his knowledge (e. g. know-how, key information) about the business, managerial skills, and experience can be imparted to the successor to increase his human capital stock. This is the direct way of human capital transfer.

There is also an indirect way of transferring human capital, which is performed when the founder utilizes his resources (mainly financial capital and social capital) in exchange of desirable education (such as costly foreign education) and training for the successor. As such, the founder’s financial and social capital is converted into the successor’s human capital. For instance, Mr. Li (A15) said in the interview that his son would soon go to a summer school of the Stanford University in the US.

“This kind of experience won’t be available to most children. It is just an example of preferable resources I brought to him for his development.”

A founder with a strong desire to intra-family succession might incline to put a lot of effort in nurturing and grooming a qualified successor, with great attention paid to the transfer of human capital. The motive of the founder’s action of transferring human capital to the successor is based on the parent-child relationship and mainly altruistic. Especially, the direct transfer is embedded in the daily interactions of the parent and the child, thus the effectiveness and efficiency of human capital transfer is largely affected by the quality of the parent-child relationship, which can be captured by relational distance between the two actors. When there is a lack of interactions between the parent and child (thus large relational distance), the transfer may turn out to be ineffective.

Every founder might have her/his unique way of nurturing and training, of which *yanchuan shenjiao* is a commonly practiced means.

8.2.1 Direct Transfer: Yanchuan Shenjiao

The transfer of values and knowledge from the founder-parent to the successor-child is through *yanchuan shenjiao* (言传身教). *Yanchuan* means imparting the values and knowledge to the children explicitly by words and verbal instructions. *Shenjiao* refers to teaching by personal example. Values, knowledge and skills are expected to be conveyed by the parent’s conducts. The tacit knowledge can only be imparted by *shenjiao*. *Yanchuan* and *shenjiao* are two fundamental methods of teaching, which are often simultaneously employed.

The Confucian doctrine emphasizes the parents’ obligation for teaching their children, as the *San Zi Jing* (Three Character Classic, a classic Confucian textbook for children) writes, “to feed without teaching is the father’s fault”. The primary

goal of teaching is let the child learn how to *zuoren* (做人, become/be a person), i. e. to mold a good character of the child. Imparting of specific knowledge and skills is generally regarded as secondary.

Yanchuan shenjiao indicates the parent's direct, personal involvement in the development of the successor's human capital. Generally speaking, *shenjiao* is considered more important than *yanchuan* by many founders, especially those who are not good at articulating.

“How to teach your children? You set the role model for them. If you don't want your children to have a bad habit, you have to show them that you don't have it.”²⁸ (Mr. Cao Dewang).

As another example, Mr. Chen, the founder of Firm B3, believes that the father must set a role model to his children himself with high moral standards and good habits. He has paid a lot of attention to the education of his two sons and one daughter. His training method is mainly *shenjiao*, to instruct and influence the children by his own words and deeds.

Yanchuan shenjiao is an important part of parenting and family socialization. However intergenerational teaching often continues into adulthood. According to the Confucian values, parents are supposed to be the mentors and role models for their children throughout the whole life. Therefore, *yanchuan shenjiao* can last across the whole process of the successor's development.

Influenced by the idea of *yanchuan shenjiao*, founder-parents are generally highly devoted to the nurturing and development of the successor. The majority of the founders mentor their successors personally and actively in the third stage of their development.

In each stage of the development of the successor, the content of *yanchuan shenjiao* varies. In the first stage, the content of *yanchuan shenjiao* is mainly values and the general knowledge about the world. Some founders have tried to actively participate in the children's nurturing in this stage. For instance, one of Mr. Wang's (A11) everyday routines since many years ago has been talking to his son for at least half an hour, no matter how busy he is. However, more often than not, the founder-father has a very limited degree of involvement in the Stage 1 because he is overly occupied by the businesses thus there is little time left for the children. Female founders may be more concerned in participating the children's upbringing. Mrs. Liu (A16) for instance, tried to extract as much time as possible to stay with her daughter.

In the traditional family system, parenting is mainly the job of the mothers. As Mr. Li (A15) said,

28 http://news.cb.com.cn/html/economy_9_23203_1.html.

“The enterprise is my sole business. My wife is a housewife. I don’t like that she gets involved in the business. She doesn’t have the capability and I don’t need it. Her main task is to take good care of our son and to teach him well. That will be her greatest contribution to our family. I think she is doing fine in this respect.”

Mr. Li is a typical supervisor-father who sets the general goal and controls the strategic decision making regarding his son’s development, and then monitors the process and checks him from time to time. Execution is mainly the mother’s job and he is only occasionally involved in direct interaction with the child.

“My son is 13 and his current task is to focus on his schooling. I set a threefold goal for him: a moral character, high academic performance and physical health condition. So far, he has met my expectations in the three aspects.”

Many of the second generation complained about being overlooked by their overly busy business running parents. Mr. Tan’s (A22) words may represent the second generation’s view on their hardly-present fathers.

“My father didn’t contribute much to my upbringing and education. He only attended the parents’ meetings once when I was in junior high. It was rare for him to be concerned with my academic performance, because he was too busy. When I was young I didn’t have much conception of the father figure as he was always not at home. We didn’t share a close bond. I didn’t see him much and every time he came back he would give me a lesson I didn’t like. We didn’t have any true communication. In contrast, I have a very close bond with my mother. However, as I grew up and became mature, mainly after when I went to college, I gradually began to understand him. Running a business was not easy.”

Mr. Tan’s father didn’t impart much knowledge about business to him when he was a teenager. This situation changed after he went to college. The father began to teach him personally and they had a lot of communications.

“After he joined the firm, I started to teach him every aspect of the business, as well as how to *weiren chushi*, how to deal with complicated situations and solve problem.” said Mr. Tan’s father.

The *yanchuan shenjiao* of business-related knowledge normally happens intensively in the third stage when the successor enters the firm. Most founder-parents have a high degree of involvement in this stage, so that the knowledge can be effectively and smoothly passed on to their next generation.

Mr. Lu Guanqiu’s son, Lu Weiding, was a rebellious high school adolescent who had a passion for motorcycle racing when he was sent by his father to Singapore to learn business administration. At that time, he was indifferent to the family business. Half a year later, Lu junior was called back and began to work in the company. Mr. Lu put a lot of efforts in his son’s training – he took the son to

the company every day and taught him step by step about how to manage the business. At the age of 23, Lu junior became the President of the group.

After graduated from college, Mr. Gao's son (A27) joined the business.

"I told him to learn more about industry related knowledge, advanced management knowledge. And also he was asked to participate in the social activities and firm activities. Now I am showing him every aspect of the business. It is faster for him to get to know the business when some specialist helps him. If he is trying to learn all by himself, he will move much slower and suffer a lot." said Mr. Gao.

Generally speaking, Chinese founders are very devoted to teaching and training their children personally and strictly. However, sometimes *yanchuan shenjiao* and the transfer of knowledge can be ineffective due to large relational distance caused by generation gap, insufficient interaction (little time spend together, little communication) etc. Besides, a great entrepreneur is not necessarily a great educator. Many Chinese founders are actually at the end of their means about how to pass their experiences, values such as attitudes about wealth, and knowledge such as management ideas and leadership skills effectively to their children. Therefore, they may choose to outsource part of the training to the training schools tailored for the second generation of the entrepreneurs, which might explain the sudden flourishing of these training schools in China in recent years. Moreover, they also place great hope on the formal education, especially the management related higher education, which is supposed to equip their children with advanced, high quality management knowledge.

8.2.2 "How to be a boss": Investment in Education

Beside *yanchuan shenjiao*, the Chinese generally attach great importance to education thanks to the Confucianism doctrine and 1300 years of *keju* – the imperial examination system, which was the major path to office and higher level in the social hierarchy.

Unlike the first generation Chinese entrepreneurs, many of whom had a very humble start with grass-root backgrounds, the second generation mostly grew up in affluent conditions with access to advantageous educational resources, both formal and informal.

Many Chinese family business founders in my sample originated from the rural area, and owing to historical reasons, they didn't have the chance to receive much formal education. Many attended only elementary or junior high school. Their lack of education, however, has made them attach great value to the education of their next generation. Higher education is already a must-have for the

second generation born after 1980. The majority of the successors born between 1980 and 1995 have got university degrees.

There are two trends regarding the next generation's formal education. The first is that business families tend to send the heirs abroad to receive education.

The educational resources are thought to be generally superior in the developed countries than that of China, thus the experience of studying overseas has been highly valued in the Chinese society. From 1978 to 2014, there has been over 3.5 million Chinese who have received education overseas.

Sending children abroad to study has been considered as a privilege of richer families from the middle or upper classes – though it has become more and more affordable and common to the working families in recent years. A large portion of these foreign-education seekers are the daughters and sons of business families. It seems to be an implicit rule for business founders to send their children to developed countries, mostly North America and Europe (especially the UK), to study and gain life experiences.

Many business families in this study have sent or are considering sending their children abroad to study. For instance, Mr. Zhao (A24) admitted in the interview that he was considering sending his eldest daughter to the UK to study while Mr. Ran (A21) wanted to send his son to the US. Six of the second generation (Ms. Mi (A6), Mr. You (A5), Mr. Lu's daughter (A31), Mr. Lu' son (B8), Mr. Cui's daughter (A30), and Mrs. Liu's (A16) daughter) have studied or are studying in the US and some others have studied in e. g. Germany, Singapore, and Japan. The majority of the second generation of the family businesses in List C (Wanda, Wahaha, Wanxiang, New Hope, Country Garden Holdings, Chongqing Cygnet Group, Fuyao Group, Mission Hills Group etc.) has got experiences of studying-abroad.

Many of the second generation were sent abroad at a relatively young age – quite often around 15 to attend high school and the subsequent higher education. For instance, Mr. Wang Jianlin's son, Wang Sicong (Wanda Group), attended elementary school in Singapore and received his subsequent education in the UK. Wang Jianlin said in an interview that,

“At that time it was a trend to send children abroad. People thought that foreign degrees were golden medals. I was also slightly influenced. Besides, I thought it would be beneficial for him to master more languages. [...] In terms of education, the foreign countries were doing better, and they still are.”²⁹

Besides the belief that the quality of the Western education system is much superior than that of China, the parents might also want their children to grow up in a Western environment independently, so that they could immerse in the

29 http://news.ifeng.com/a/20150303/43258916_0.shtml.

Western culture, have a broader horizon and outlook, expand their social network, and finally develop into genuine internationalized elites.

The preference for foreign education may firstly reflect the worship of the Western world, especially the Western style management. To many, the Western connotes the modern, advanced and the better.

“After my child studied abroad and learned the advanced Western management, he will come back and be trained a little bit. This will make him extraordinary.” said Mr. Yuan (A18), who is planning to send his youngest son abroad to “learn how to be a boss”.

Secondly, it may be influenced by the force and need of globalization. Many founders have seen the trend and necessity of internationalization. The heir’s foreign experience is expected to be a facilitator to the internationalization of family business after she/he joined the management. Furthermore, the entrepreneurs’ feeling of insecurity in the Chinese environment might encourage them to consider alternative options, such as emigration or transfer of wealth and estate abroad. Thus a more covert reason might be that the children could help with paving the path for transferring wealth abroad or emigration.

A foreign education, especially when the children were sent abroad at a relatively young age, might render the successor overly “Westernized” so that they are not familiar or can’t identify with the traditional culture and the Chinese way of doing things, which might be regarded as a disadvantage for doing business in China. Mr. Wang Jianlin, for instance, seemed to regret a bit for having let his son grow up abroad since primary school, “I think it was a not so well conceived move. Judging from my experiences, maybe it is better to send the children abroad after they finished high school in China.”

Ms. Liao Weijia, the daughter of the founder of the Cygnet Group, studied and lived in the US for 11 years. After she came back to China to take over the family business, there had been a “clash of cultures” between the two generations, which pushed her to leave the family firm and start her own business.

The second trend is that the heirs tend to study family business-related or management related majors. For instance, the core business of Mr. Gao’s A27 Group is construction, thus his son studied a construction related major out of his own interest in college. Ms. Mi (A6) studied law in a Chinese university and then studied business administration in the US because her father thought it would be beneficial to her future management. Mr. Chen (A1) said,

“The three children of my *jiazu*, my son and my nephews. They all have grown up under my guidance. I asked them all to study the related specialties and they all have developed very well.”

This trend could be attributed to their controlling parents, who will not allow the children to study what they really like. Hoping their children to take over the

family businesses, the controlling parents usually persuade or even push the heirs to stick to the career plan they choose for their children, of which a family business related higher education is an essential part. While some successors might not be forced but choose willingly a related major out of their own interest or sense of obligation to their family businesses.

Ms. Liao Weijia has been one of these heirs. Going abroad at 15 was Weijia's own idea. Her parents approved her plan, with a binding condition that she must return to China and take over the business after she finishes her study.

“I have known my responsibility since I was little. The Chinese tradition is *zicheng fuye*. I am the only-child, so this idea has been ingrained in my mind. I was brought to the top management meetings by my parents at the age of 7, as they wanted me to have a preliminary understanding of management. So I have always known what I need to study and which path I need to follow. I liked acting since I was a child and I had the dream of being an actress. But I knew acting could only be a hobby, I am bounded to the family business. So I studied economics and business administration in college.”³⁰

8.3 The Transfer of Guanxi

Besides human capital, the transfer of social capital, i. e. guanxi, to the successor in the intergenerational transition is often another central concern of the founders.

8.3.1 The Importance of Business and Political Guanxi

Guanxi, especially business ties and political ties, has been identified as a key factor in business success in China as well as a source of sustainable competitive advantage. For instance, Luo, Huang, and Wang (2012) reviewed 53 empirical studies to investigate the relationships between two types of guanxi (business ties and government ties) and organizational performance and their results suggested that guanxi at the firm level can enhance firm performance (both in economic and operational terms). Thus, guanxi has become the “lifeblood of social interactions and business conduct in Chinese society” (Luo et al., 2012). “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” (Park & Luo, 2001).

On the one hand, in the early stage of the reform when the institutional infrastructure was underdeveloped, the local governments have control over the

30 <http://www.hbrchina.org/2015-10-15/3479.html>.

allocation of almost all the important resources such as the usage rights of land, natural resources, licenses, etc. Especially the distribution power is held in the hands of a few local government officials. Thus maintaining a good relationship with the officials is critical to entrepreneurial activities as these political connections could give entrepreneurs preferential access to the resources.

Mr. Mou (A29), for instance, gave an example of his own experience.

“I just filed a lawsuit against a client of my small loan company. He couldn’t make repayment and wanted to deduct the principal by interest paid. Whether the judge would rule in favor of me depends largely on his personal judgment. Therefore, I mobilized two *guanxi* of mine, who can approach the judge to give little help on my case.”

On the other hand, business ties (with business partners, suppliers, clients, peer entrepreneurs, etc.), which are built based on trust, prove to be the basis for cooperation, transactions and information exchange. Unlike in a government *guanxi*, where there tend to be an asymmetry of power and status (officials often have a superior standing), the parties in a business *guanxi* are generally equal. Chinese entrepreneurs often refer to their business *guanxi* (sometimes also political *guanxi*) as *pengyou* (朋友, friends). The *pengyouquan* (朋友圈, the circle of friends), which refers to the network of friends one is embedded in, is often highly valued by entrepreneurs as a source of important resources such as information.

Most founders I interviewed agreed that *guanxi* is dispensable for doing business in China. For instance, Mr. Tan Senior (A22) said,

“When I started my business, my *pengyouquan* (friends circle) played a very important role. They shared with me a lot of important information. Now I still keep very good *guanxi* with these friends. Most of them are from the same industry. We often gather together. For instance, when someone has a project, we talk about the possibility of cooperation. Therefore, *pengyouquan* is an important source of information and other resources. The *guanxi* with officials must also be maintained. I don’t have a close relationship with them, but maintaining the *guanxi* is imperative. The support from the government is absolutely necessary in doing business, especially in the construction and real estate industry.”

The following excerpts are some other examples:

“*Guanxi* is productivity. It is important to know the *guanxi* philosophy.” (Mr. Mou, A29).

“Chinese entrepreneurs have to walk with two legs, one is the market, the other is *guanxi*. Especially in the startup stage, you have to maintain *guanxi* with many related parties, the government in particular.” (Mr. Li, A15).

“In the Chinese context, firstly you have to keep a good *guanxi* with the government, so that you can get approved and supported. Secondly, you have to maintain good *guanxi* with your clients. The interest of us and our suppliers and distributors are tied together.

So when our cooperation goes on well and the guanxi reaches a certain level, it's natural for us to cross-hold each other's equity. We have a good private guanxi to most of our suppliers and distributors. Some of them have become our good friends." (Mr. Yin, A17).

Except for acknowledging the importance of the government guanxi, most interviewees were reluctant to go deep into this topic; they generally evaded talking about their government guanxi.

Mr. Lu's (A31) political identity as the Party member and the representative of the People's Congress in Chongqing and the government ties it brings might have contributed to the business development by facilitating the acquirement of government supports, which include e. g. funds, technical support, preferable tax treatment and land use permission. He dodged to talk about this issue, however, the media has reported that the company has been a receiver of the pairing-assistance of Tianjin city, and listed by the State Council's Three Gorges Reservoir Area Office as a key project, which all imply preferential treatments to the company. On the other hand, he formulated this relationship in a very official tone. "Agricultural business is heavily impacted by government policies. Enterprises must help the government to solve problems," he said, "creating employment and increasing the income of the farmers are surely important ways."

There are many ways to build and maintain guanxi. An interesting example is "drinking tea together". For instance, Mr. Chen (A1) said, "My *pengyouquan* is consisted mostly of entrepreneurs. We often drink tea together, communicate and share information." Mr. Xiong (A2) said, "The most important thing is *renmai* (人脉, guanxi network), you have to get in the circle. When you have *pengyouquan*, you have a network of information. It is crucial to maintain guanxi. So we often have dinners, drink tea together."

8.3.2 Three Phases of Guanxi Transfer

Similar to knowledge and skills, guanxi can be transferred. As Steier (2001) contended, "For family firms with long-term continuity goals, the transfer and management of this largely intangible asset are a most significant activity." The aim of guanxi transfer is to foster the guanxi building of the successor with the founder's guanxi parties so as to retain the resources embedded in the founder's guanxi network.

A typical guanxi transfer process generally undergoes three phases. In the first phase, the successor is introduced by the founder to one of her/his guanxi parties, G. The founder's role is on the one hand to bridge the two previously uncon-

nected individuals. On the other hand, he is also the guarantor who provides a foundation of trust to the successor and G.

In the second phase, the successor starts to build up his own *guanxi* with G through *guanxi* building activities such as dining or drinking tea together, gifting, favor exchange etc. In this phase, the founder normally keeps monitoring the successor's *guanxi* exchange activities with G and may provide guidance and advices to the successor until he believes that the successor is capable of dealing with *guanxi* independently.

In the third phase, when mutual trust between the successor and G is established, the *guanxi* stabilizes itself and is maintained through continued exchange activities. The transfer is finally completed.

In phase 2 and 3, the successor's ability to build and maintain *guanxi*, i. e. *guanxiability*, is critical. Without sufficient *guanxiability*, *guanxi* transfer can't succeed. Therefore, before the actual transfer takes place, there is often a phase of intergenerational transfer of *guanxi* knowledge, including *guanxi* philosophies, rules and *guanxi* skills.

To have a strong *guanxiability*, one must master the rules of *guanxi* and *renqing*. Teaching the children about *guanxi* is an important part of *yanchuan shenjiao*.

“My son will take over the business in the future, so he must master the traditional Chinese *renqing*. He must learn *weiren chushi*, proper social manners, *guanxi* making, and dealings. It is important to learn how to deal with people of various kinds. So I often ask him to join networking dinners and activities. Of course it also depends on whether it is suitable to let him involve.” said Mr. Gao (A27), “I take him with me most often when there is the occasion for new friends making, *guanxi* building. It is always beneficial to build connections. It is not for any purpose or direct benefit. *Shuren* (acquaintances) are always more trustworthy than *shengren* (strangers).”

Mr. Yuan (A18) is also a knowledgeable *guanxi*-teacher.

“I told my children about social network. I said the key is the exchange of resources and making use of each other. *Renmai* (人脉, *guanxi* network) is indispensable. *Renmai* resource is about mutual utilization. You have to learn how to use the resources.”

The theoretical part of *guanxiability*, such as the philosophies and basic rules of *guanxi*, can be directly imparted; however, the practical part can only be improved through practice in real *guanxi* building and maintaining activities. Therefore, good *guanxiability* is the result of learning by doing.

The founder's primary role in the *guanxi* transfer thus is the *guanxi*-teacher, and the teaching relationship may last until the successor is regarded as having mastered the art of *guanxi*.

The second role is the bridge. After he introduced the successor to his *guanxi* parties, the successor's task is to maintain these *guanxi* through exchanges.

Ms. Mi (A6), whose father had been deliberately teaching her guanxi philosophies since her childhood, said,

“My father only built up the bridge by introducing me to the guanxi parties, but I have to maintain my own guanxi with them. Whether you will be accepted depends on your own *weiren chushi*.”

Due to the dyadic nature of guanxi, the transfer of the founder’s guanxi network is normally done on a one-on-one basis. Some of the founder’s guanxi such as close friends might be introduced to the children in the nurture stage. In China, children are taught to call the adults from their parents’ generation uncles or aunts, even though they are actually friends or unrelated acquaintances, so that a family-like guanxi between the children and the unrelated adults can be formed. However, guanxi in equal stance only form after the children become independent adults.

“I have known some of my father’s friends when I was a child. I have kept very good relationships with them. Some of these uncles and aunts have seen me growing up, so they know me well and trust me. Now we are like friends, we sometimes do business projects together.” (Ms. Mi, A6)

The transmission of the important business ties and political ties normally happen intensively in the training and transition stages.

In the last few years, Mr. Cheng (A19) has been gradually transferring his guanxi to his successor, who has been working in the family business for five years.

“He has been attending guanxi building and maintaining activities since he joined the firm. Since two years ago, I have been letting him do the year-end visits alone, which is an important guanxi maintaining event. Most of my guanxi now recognize my son as my successor. They generally give credit to him just as they have trusted me.”

The underlying motive of guanxi transfer is the potential benefit of retaining the accessibility to valuable resources which are held by the guanxi parties. Therefore, the intergenerational transfer is regarded as effective when the majority of the key guanxi is succeeded by the successor, since completely transferring the founder’s guanxi to the successor is impossible.

The effectiveness of the guanxi transfer is largely determined by the founder-successor relationship. As pointed out by Sharma (Sharma, 2004), “A supportive relationship characterized by mutual respect enables the smooth transition of knowledge, social capital, and networks across generations”.

For instance, Mr. Wang Jianlin (Wanda Group) has met some problems transferring his guanxi to his son, Mr. Wang Sicong, who grew up abroad with very limited time spent together with the father. So far, Mr. Wang Sicong hasn’t followed the normal path of *zicheng fuye*.

“Sicong was sent abroad too young. He is greatly influenced by the Western education, thus doesn’t know much about the Chinese renqing and social rules. But he is now in China, and he can’t deal with things following the Western way.”³¹ said Mr. Wang Jianlin.

Some of the second generation, especially these born after 1980, hold a different attitude towards business and government guanxi compared to their founder-parents, which may hamper the transfer of guanxi. For instance, Mr. You (A5), who went to college in the US, found the Chinese guanxi activities very disturbing.

“As the only-child, I am supposed to take over the real estate development business. However, I can never get used to these guanxi building occasions my father forced me to attend. So I want to start my own business, and to do things in my own way.”

The successor of Haixin Steel, who had been very distant to his father, failed to develop his guanxiability and rejected to maintain important guanxi after the sudden succession. The absence of effective guanxi transfer might have contributed to the final failure of the company.

8.4 Intangible Transfer and Three Succession Patterns

The succession can be categorized into different types and exhibit different patterns depending upon the effectiveness and the ways of intangible transfers from the founder to the successor; the most typical ones are the smooth, the lagging and the sudden successions.

8.4.1 Smooth Succession: Fotile

The case of Fotile presents a perfect example of smooth succession, with the successor well prepared for the leader role and the founder know wisely when it is the right timing to let go.

In 1985, Mr. Mao Lixiang started the business, which produced components for television, at the age of 44. A year later, the business went through a crisis resulted by industry overcapacity. Mr. Mao quickly adapted and moved to a newly invented product – kitchen lighter. This new product made great success and the firm became the world’s largest kitchen lighter manufacturer and exporter around 1990. Before long, due to the intensifying competition in the kitchen lighter industry, Mr. Mao Lixiang shifted focus and founded the Ningbo Fotile Kitchen Ware Co., Ltd (Fotile for short) in 1996, which has become the

31 <http://finance.sina.com.cn/leadership/crz/20150512/223522164543.shtml>.

leading kitchen appliance brand in China with over 12,000 employees and a turnover of ca.7 billion yuan in 2015.

Nurture

The son-successor, Mr. Mao Zhongqun, was 16 when Mr. Mao Lixiang started the business. Before his entry in the firm, the successor had already gained some knowledge about the family business from his father and his own experience in the firm as he had made frequent visits to the business during school vacations. Mr. Mao Zhongqun acknowledged the family influence on his character and as well as entrepreneurship,

“I grew up at my grandmother’s house. Her sincerity and honesty have greatly influenced me. I went back to my parents after I went to elementary school. My father often told me his strenuous entrepreneurial experiences. Gradually, his entrepreneurial spirit exerted a subtle influence on me. My mother’s kindness also affected my character.” said Mr. Mao Zhongqun³².

Training

After received his master’s degree in Power Electronics, Mr. Mao Zhongqun joined the business in 1994, at the age of 26. In his first year working in the business, the successor gained a thorough understanding of the family business and carried out a market research aiming at identifying the future direction of the business. The results of the research laid the groundwork for the shift of core product from kitchen lighter to range hoods.

After Fotile was established, the successor was directly appointed as the General Manager as part of the training plan, with Mr. Mao Lixiang being the Chairman. The son was put in charge of the R&D department and a few months later, his R&D team successfully developed a star product that made the Fotile brand famous. “My educational background gave me advantage in R&D, but I didn’t have a clue about management. So I started focusing on R&D, and then in charge of branding and marketing, and after that I gradually got involved in management.” The competence of the successor developed quickly in this learning by doing process.

The success in this stage enhanced the successor’s self-confidence and exhibited the successor’s good qualities such as persistence, innovativeness and hardworking and his potential to be a good leader, all of this strengthened Mr. Mao Lixiang’s commitment to succession.

32 <http://www.hbrchina.org/2015-10-15/3478.html>.

Transition

In 1999, Mr. Mao Lixiang decided to delegate the decision making authority to the successor and shifted his role to a supportive supervisor. Soon the successor started to professionalize the management system and build up the professional management team. He brought in many “paratroopers”, some of whom were former employees of Fortune Global 500 companies. And gradually he transformed Fotile into a modern family business.

His reform had undergone some resistance from the veterans. However, the father firmly supported his strategies. In this transition stage, the father’s involvement in the firm decreased. “In terms of management, I don’t have a lot in common with my father. My father represents the first generation Chinese entrepreneurs who are typically paternalistic, autocratic and unfamiliar with modern management. I prefer modern management.” Said Mao Zhongqun, “but in terms of the importance of corporate culture, we share the same ideas.”³³

In 2002, the son took over the Chairman position and the managerial control was fully transferred to him. Mr. Mao Lixiang no longer participated in the management and decision making.

Post-succession

After handing over the scepter, Mr. Mao Lixiang became a researcher and writer on family business management, governance and succession and began his new venture by founding a successor training school in 2006 at the age of 66. The successor, meanwhile, has successfully led the Fotile to grow into a leading brand in the kitchen appliance industry.

The experience of the Mao family is a good example of smooth intergenerational succession. A key reason for the success seems to be the founder’s openness and his trusting and supportive attitudes towards the successor. Mr. Mao Lixiang developed his own theory of succession which suggests that the succession should go through three phases: “three years of coaching, three years of assisting and three years of advising”, and in the assisting and advising stages, the founder-parents should “fearlessly, resolutely and thoroughly” delegate responsibilities and authority and transfer the control to the successors.

His positive attitudes might also be resulted by the successor’s firm stand to his own ideas and effective communication between the father and the son. The two key actors in the transition process had been pulling in the same direction and adapted to their role-change quickly and timely. In other words, smooth succession needs concerted efforts from both the founder and the successor.

33 <http://www.hbrchina.org/2015-10-15/3478.html>.

8.4.2 Lagging Succession: Three Cases

The founder's reluctance to let go has been argued by many scholars to be a major impediment to succession. In a lagging succession transition, the founder is reluctant, or even refuses to relinquish control to the successor, despite that the successor has entered the firm for a long time, because of such reasons as his attachment to the firm, fear for losing identity or status, or lack of confidence in the competence of the successor etc.

Case 1: Alan's Confusion

Mr. Alan Zhu was forced into the family business by his parents in 2006 because his elder brother, who now runs a textile firm, was not so obedient like him. Alan's parents became the owners of the former township enterprise through management buyout in 1990s. Now the high-tech firm mainly produces circuit boards and has made a turnover of ca. 160 million yuan and employs 300 workers. After graduated from college with a degree in software programming, Alan was "forced" to work in another firm in the same industry for one year to gain experiences. Then he came back to the family firm to help his father. He is now the General Manager in charge of day to day operation including production, sales and finance etc. However, important decisions are made by his father, the founder and Chairman, who steers the firm's direction and takes care of guanxi with government and clients. The firm has got a lot of support from the government in preferable tax treatment, land and infrastructure etc. Yet the successor hasn't involved much in these guanxi activities, thus the guanxi transfer is lagged behind.

After 10 years of working in the firm, Alan is still not sure about his father's succession plan. The father has never talked with him about when and how to transfer the managerial control and the arrangements of ownership, and he would never ask about it because it would be deemed very improper unless the father brings up the topic himself. Alan is lack of confidence and confused about the future succession arrangements. He is not sure whether this lagged succession is due to his incompetence or his father's misjudgments about his capabilities.

Case 2: Mr. Xin's Concern

After a few years working as a farmer, Mr. Xin started working in a collectively owned construction firm (a TVE) in 1985. The firm was restructured as A32 Company in 1997. Currently, the A32 Group operates in real estate development, commercial properties, construction, steel trading, and investment etc. and has 500 employees and around 1 billion yuan assets.

Mr. Xin was glad that his son had been interested in the family business and studied a construction-related major in college. “According to the traditional Chinese culture, you have to consider first about letting your son succeed you. You consider his abilities and competence, and whether he is voluntarily interested in it. You have to respect his choice.”

Mr. Xin’s only son, aged 34, joined the family business after graduated from college. After working in the firm for 10 years, the son is currently the Vice General Manager. Mr. Xin said that he would have given the son the GM position if there hadn’t been a sudden economic downturn in the last two years. “He still has a lot to learn, but he’s doing much better comparing with some of his peers, and he is trying his best.” The economic downturn brought great pressure to the operation of the business. Mr. Xin felt that the son was still not able to handle the situation well. “When the situation gets better, I will let him exercise decision making.”

Mr. Xin clearly knew the importance of his delegation to the development of his successor, as he said, “The management and operation of business can only be learned in practice. Because the company will always come across some problems, only when he deals with these problems himself, will he improve his abilities to solve, foresee and prevent problems.” However, his action has been lagged behind. The delegation hasn’t really happened in the past ten years, and it is still not clear whether it will happen in the near future. “Generally, I don’t have any concrete plan. He will take over when both the internal and external situations permit. We just do our best and see what happens.” said Mr. Xin.

Case 3: Mr. Tan’s Strategy

Mr. Tan (A22) also faced a “lagging” father who was not willing to relinquish control, but he took a more initiative approach. “My father actually didn’t want to let go. So I had to resort to outflanking tactics and make him gradually get used to letting me make decisions.” said Mr. Tan. He first tried to take an intransigent attitude to his father’s reluctance, but that only made things more difficult. “Sometimes he knew that he was doing something wrong, but he insisted on doing it because he wanted to hold the power in his hands.”

Mr. Tan’s father used to veto his proposals and it was almost impossible to persuade the father to change his mind. “What mattered to him was not the right or wrong of the decisions but that he still had the power to make decisions.”

After figuring out the psychological grounds behind his father’s stubborn attitude, Mr. Tan adopted two tactics to deal with it. The first was to resort to his mother, as the mother’s words were more acceptable to the father. The second was to pretend a complying attitude towards the father’s plan. However, in implementation, he stuck to the plan which he believed was the best. “Eventually, he got to know that I was right when I had success. This kind of roundabout strategy

is much better than direct conflict. After all, as the son, you should not demand an immediate transfer of all power. The parents can hardly accept that. They have the authority for their whole life. No matter how mature you are, in their eyes, you are still their child.”

8.4.3 Sudden Succession: Haixin Steel

The unexpected sudden death or severe illness of the founder can be catastrophic to the firm if a prepared, competent successor is not in place. The following figure illustrates such an extreme case of the Haixin Steel. The training and transition phases are lacking due to the sudden death of the founder and the successor was directly given the control of the firm.

Haixin Steel was a famous name in China because its successful founder, Mr. Li Haicang was murdered in his office at the age of 48 in 2003. Since he started his first factory in 1987, Mr. Li Haicang had led the business group, located in northern China's Shanxi province, to become the largest private steel mill in China before his death, with nearly 1000 employees and an asset of around 4.3 billion yuan. The sudden death of the founder not only shocked his family and employees of Haixin Steel, but also left them a difficult question: who should succeed the leadership and the 90 % interest of Haixin?

Successor selection

Liu and Bian (2005) revealed some details of the sudden succession. Because there was not any known plan or will made by the founder, the decision depended on the founder's family. The initially considered management successor was among the 5 brothers of the founder who all worked in Haixin group in higher level management before the succession: the eldest brother Li Tiancang was one of the four founding members who had left the General Manager position later; the fifth eldest brother Li Tianhu was the succeeding General Manager and the youngest brother Li Wenjie just joined the company a couple of years earlier.

The founder Li Haicang, Li Tianhu (fifth eldest brother) and another non-family founding member, the Vice Chairman Xin Cunhai, who was a sworn brother of Li Haicang, formed the trio core of leadership before the murder. Thus Li Tianhu and Xin had been the most supported candidates of the successor. However, the brothers couldn't reach an agreement.

The head of the Li family, the Li brothers' father, Mr. Li Senior stood out and played a decisive role. After a lot of discussion in the family meetings, he decided to choose Mr. Li Haicang's 22-year-old son Li Zhaohui as the successor. His ground for the decision was “*zicheng fuye*”.

Li Zhaohui was studying in Australia and had known little about the business when his father died. In fact he had been distant to his strict father who had paid little attention to his up-growing. “At that time, I had never thought about taking the Chairman position. I didn’t think I had this ability. There were too many people that were better suited for the role. I was weak. I didn’t want to ‘eat the bitterness’, I wanted to run away. My uncles, who were not as good as my father, were definitely far better than me.”³⁴ said Li Zhaohui in a later interview. Although the tremendous pressure of assuming the successor role nearly overwhelmed him, he was pushed by the family to take the Chairman position 28 days after his father’s death. The traditional idea of *zicheng fuye* played an important role, as Li Tianhu said, “This enterprise was founded by Zhaohui’s father. According to Chinese tradition, he should succeed, so that others won’t argue against it. There is no dispute about that.” (Liu and Bian, 2005) This ideology might have not helped the family business to find the most competent successor; but it did silence the contention and shift the attention from succession to the survival of the business.

Power struggle/ In-fighting

The top management team was committed to assist the inexperienced new leader. “We will assist him. For the first two years, the new Chairman may not be competent enough to make big decisions, but he has us.” said Li Tianhu. Although Li Zhaohui was appointed as Chairman, the power of the firm was still largely in the hands of the leadership team headed by his uncle, Li Tianhu, though not for long. Quickly the successor experienced conflicts of ideas with the leadership about running the business and became unsatisfied of being without any real power. Consequently, in the first year after Li Zhaohui took the throne, with Mr. Li Senior’s support, he deprived Li Tianhu’s power in Haixin Group by kicking him out of the game and let Li Wenjie (the founder’s youngest brother, who joined the company a couple of years ago), who had a much closer relationship to him, took the General Manager position. In the second year, some of the top management members including Xin Cunhai were also expelled from the core decision making body. After these moves, Li Zhaohui centralized all power in his own hands and drastically changed the way the business was running. The centralization seems to be out of his lust for power as well as his fear of losing ownership, which, however, might have harmed the business in multiple ways.

34 <http://news.sina.com.cn/o/2014-11-21/065031179886.shtml>.

A Different Leader

Li Zhaohui ran the business quite differently from his father. Li Haicang attached great importance to *guanxi*'s role in doing business, thus kept an especially good relationship with the local government as well as suppliers and clients. Li Zhaohui, however, showed his disdainfulness towards *guanxi*. He distanced the family business from the local government, which had been a key facilitator of Haixin's development in the founder's era. His anti-*guanxi* manner was believed by some commentators to be a side-effect of his acceptance of the Western culture during his living and studying in Australia, which also affected his ideas about running a business.

Secondly, Li Zhaohui seemed uninterested in Haixin's main iron and steel business. He authorized his younger sister to run the business and almost 'disappeared' from the company a few years later. Instead, he put most of his efforts in the capital market. His deviated interest made him neglect the development of the major business on the one hand and crippled the family business on the other hand as he extracted large amounts of capital from the main business to fund his investments, most of which failed. Consequently these moves burdened the group with serious management problems and heavy debt.

Bankruptcy

In November 2014, Haixin Steel, which halted production and defaulted on 3 billion yuan a few months earlier, officially started bankruptcy proceedings³⁵. Commentators pointed out that the woes of the whole steel industry resulted by industry overcapacity as well as the state's measures to tackle pollution could have been external causes of the failure of Haixin, but the fundamental reason was the incompetent leader who had made the business too fragile to withstand a blow.

35 <http://www.bloomberg.com/news/articles/2014-11-18/haixin-enters-bankruptcy-proceedings-amid-steel-industry-woes>.

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Chapter 9.

The New Blood: The Transition and Transformation of Family Business

In previous chapters, the patterns of the transfer of ownership and management as well as human capital and social capital from the founder to the successor have been examined mainly from the founder's perspective. The founder's decisions are in focus because she/he is generally the dominating decision maker in the pre-succession stages. However, this founder-focused approach might leave the impression that the next generation seems like a passive receiver of the resources and the founder's arrangements. This might be true in some cases but we should never ignore the fact that the succession process is the result of interactions of many family business stakeholders in which the heirs and successor also play critical roles. The family business succession process can't be fully understood without examining the role of the next generation.

In the transition stage, the successor gradually ascends to power and becomes the key agent of the firm and thus the center of the new structure of the firm network. To the business family, the second generation may be the new blood which could bring in vitality and freshness to the family business.

The transition from the traditional to the modern family business through management professionalization becomes necessary from the perspective of internal management capacity. The changing market condition, however, necessitates the transition of business model, strategy and technology. Many family businesses belong to the traditional industries such as manufacture and real estate development/construction etc., which have faced the problems of over-capacity, dropping profits etc.

These problems are very likely to be the burden and challenge of the successors who are expected to have the capacity of adaptation to cope with the changing market and economic environment. They may face much higher pressure and challenges compared to their predecessors.

9.1 Follower, Reformer, *Chuangerdai* and Change

Just like the older structure is largely defined by the founder, the post-transition structure is characterized by the successor. While the successor's role becomes more and more central to the family business since the beginning of the transition stage, the old structure gradually shifts to a successor-centered new one. How different the new is from the old structure largely depends on the characteristics of the new leader.

There are three types of the next generation family business successors, namely, the follower, the reformer and the *chuangerdai* (创二代, the second generation entrepreneur, SGE for short) based on their particular behavioral patterns.

The follower runs the business more or less the same way as her/his predecessor. She/he chooses or is obliged to follow the founder's approach and to keep the business' main features, such as key stakeholders relationships, strategy, key rules, vision, management system and business model etc., set by the founder from changing in a significant way. She/he might adopt the leadership style of the founder as well. The new structure is similar to the old one, thus there are few conflicts and the transition process tends to be smooth.

A reformer is strongly unsatisfied with the old structure and she/he strives to improve it from within the family business system, gradually or radically, through strategic change such as business model adjustment, policy, mission and target market shifts, and professionalization. She/he represents a major force of change to the old structure.

While both the follower and the reformer belong to the family successors commonly studied in the literature who take over their family businesses, the SGE is a special type of successor that hasn't drawn much attention of the researchers.

Like the reformer, the *chuangerdai*, or SGE, also disapproves of and even tends to fully reject the old structure; however, she/he seeks an entrepreneurial solution instead of reform. In contrast to the follower and reformer, both of whom put their focus on sustaining or improving the family business established by their parents, the SGE strives to establish a new business venture outside the family business system, which can be aimed at, for instance, replacing the old structure, engendering a thorough transformation or remaking of the family business into a completely new one, or simply realizing one's own ideas or self-fulfillment.

Each type of successor may show distinctive features and behavioral patterns in the transition and post-succession stage. However, the three types are not completely mutually exclusive as a successor may shift to a different type over time. A successor's decisions and behaviors are the result of many factors working together.

Take the follower as an example, firstly, the successor may choose to follow the founder's approach of running the business due to her/his identification with the founder. Since many successful entrepreneurs are strong figures with extraordinary qualities and remarkable achievements, they could easily become the role models of their children.

Secondly, the old structure may have been proved efficient by the founder's success, therefore there is no need for major changes in the eyes of the successor. For instance, Mr. Cheng Jr. (A19) has generally followed his father's approach in the transition stage.

"I am gradually taking over more control but I still have a lot to learn from my father about how to run the business. I sometimes have some different opinions but generally, I think my father knows the best about the business. I don't expect any major change of the business in the next few years."

After all, the old structure is not necessarily weak in adaptation, innovation and consequently competitiveness. The founder might have embarked on a transformation of the business into one that is able to innovate and adapt to the changing environments and stand up to new challenges. Mrs. Wang (A28) is one of these adaptive founders.

"We have been in a traditional industry. But now I am thinking about how to leverage the internet and external capital in the future. If I insist on the current business model, the business will be obsoleted in five years. The era of excessive profits has ended, as things are getting more and more transparent. So I am pursuing a new business model focused on the industry that I am familiar with. The future model should integrate the resources such as the internet and new technologies and have multiple sources of profit. I am also professionalizing the business to solve the succession problem."

Thirdly, the successor might have been assimilated by the founder's nurturing and training. Although the second generation is generally shaped by some different values, they may gradually accept the business-related values and logics of founder over time and share similar knowledge structure and guanxi network, all of which could result in similar judgments and methods of problem solving.

Lastly, the follower-successor's decisions could also be resulted by her/his lack of motive or capability to bring major changes to the firm even though the need for change has been recognized. For instance, as many founders are determined to choose their own children as successors due to reasons such as nepotism or non-availability of non-family successor, some successors are impelled to take over the business despite that they are uninterested or not competent enough to make the business thrive or even survive. The follower might be an obedient child who has always followed the arrangements of and shadowed by his paternalistic father and lacks the courage to challenge the father's way of doing things. In this case, the follower may be a semi-reformer who has desires and plans for changes

but fails to put them into practice because of the lack of a firm stand and/or the presence of various hindrances such as the founder's strong objection to major changes of the business. When these hindrances are removed, e.g. when she/he finally takes full control, the semi-reformer may turn into a reformer.

In the context of the Chinese family business, the change-bringers – the reformer and the SGE may be worth of more attention as changes are often inevitable and imperative due to various reasons. A few external and internal change-bringing factors are discussed firstly now.

9.1.1 A Time of Rapid Change

It is almost impossible for the businesses in our times to escape from the impacts of the sweeping globalization and the rapid technological changes. This is also the case when it comes to the Chinese family businesses. Many family businesses which experienced a period of rapid growth and high profit rate in the 1990s and 2000s are now facing new challenges brought by the transition of the Chinese economy, the globalization in the economic, social and political dimensions, the advances in communication and information technology, new social trends and changing consumer preferences.

Firstly, competition in both foreign and domestic markets has been intensifying. Take the manufacture industry as an example, the majority of the Chinese family businesses is labor-intensive and manufacture low-end to mid-range products. In the domestic market, due to the low threshold of market entry, the number of competitors has drastically increased. The influx of goods supply scales down the price and reduces the profit. Compare to one or two decades ago, competition with local firms has also largely intensified, especially in many traditional industries where overcapacity has been present.

Moreover, the emerging Chinese market, for instance, has attracted many global enterprises to compete in the mid or high end products market. These competitors, who are usually large multinationals equipped with e.g. abundant financial resources, high quality human resources, advanced management and marketing systems and mature business models, often enjoy competitive advantages and present serious pressure and threats to the local firms.

Secondly, many family businesses operating in traditional industries such as manufacturing face rising costs due to the increasing prices of energy and raw materials etc., heavy tax and regulatory fees, and in particular, the continually rising labor costs. Many export-oriented family firms including OEM manufacturers are losing their competitive advantage – low labor costs – to competitors in e.g. Southeast Asia, India or Africa.

Thirdly, rapid and relentless technological advancements in many areas, especially the information and communication technologies, have been transforming the business landscape as well as the consumer behavior. They have not only given birth to and fostered the expansion of new industries and new ways of value creation, but also have been altering the traditional ways of doing business and disrupting the status quo. For instance, the sales of E-commerce are anticipated to have reached 4 trillion in 2015³⁶. The rapid growth of E-commerce urges the traditional business to rethink their business models and to remake and adapt the marketing strategies.

The shifts in consumer behavior may also attribute to the spiraled spending power of the Chinese consumers. There has been a rapid emergence and explosive growth of the middle class in China as the result of the rapid economic growth. According to the estimation of the Credit Suisse Wealth Report (2015)³⁷, the number of middle class adults in China may have reached 108 million in 2015, leapfrogging the 91 million in the US as the largest over the world. The percentage of the emerging middle class in the population is supposed to continually grow. This means, more and more Chinese consumers are shifting their preferences from low-end mass-market goods to middle to high-end, branded products and services. Moreover, with the post-70s and post-80s as its representatives, the rising new generation who has distinctive preferences and spending patterns is becoming the major consumers. The change of consumer behavior requires the companies to adapt by e.g. developing new products or services and marketing strategies to remain competitive.

In short, due to the growth of the economy, the deepening of globalization, technology revolutions and the shifts in consumer behavior, the market has become more and more complex and challenging to the Chinese family businesses. The external force of change is unstoppable and the firm's ability to adapt is critical for its survival and continuity. Many founders mentioned that doing business has been much harder and more challenging than before. For instance, most property developers I interviewed have been under great pressure in the last two years. This means that business as usual may not work anymore.

36 <http://www.mofcom.gov.cn/article/ae/ai/201512/20151201220442.shtml>.

37 Global Wealth Databook 2015, retrieved from: <https://www.credit-suisse.com/ch/de/about-us/research/research-institute/publications.html>.

9.1.2 The New Blood

The changing market condition and business environment have made it more challenging for the family businesses to remain profitable. Besides the impacts of the ever-changing market conditions that necessitate adaptation, business encounters different challenges at different stages in its developmental life cycle. The previously worked management system and structure may not work anymore and must be adjusted when the business moves to the next developmental stage. As the natural result of competition, the businesses no longer competitive will wither and only those successfully adapt and keep their competitive edges will survive.

Some family businesses, especially the small to medium sized ones, may face some internal problems and obstacles which may have threatened their survival at present or in the long run.

Some aspects of the status quo of some family business, such as founder centrality, family management, *renqing* governance, weak planning and controlling, might have turned to disadvantages and obstacles.

These problems include:

- (1) managerial constraints of the founder and the family;
- (2) inefficient management due to disadvantages of *renqing* governance, the lack of clearly defined processes and procedures, poor planning and control, the absence of strategic planning, lack of strong corporate culture etc.;
- (3) the lack of quality human capital due to the failure to bring in new managerial resources;
- (4) outdated equipment, methods and technology;
- (5) inability to innovate, obsoleted business model (e.g. no-longer-fit positioning and marketing strategies);
- (6) lack of financial capital, etc.

Some founders of the family businesses might have lost their entrepreneurial innovative edge after many years of business-running experiences and embraced conservatism. As Zahra (2005) argued that the concentration of powers in the founder's hands might "intensify conservatism and stifle entrepreneurship" and the long tenures give some founders time "to institutionalize their systems and processes" which could possibly reduce the company's adaptability.

In some founder-led family businesses, there is a lack of mechanisms to initiate change if the powerful founder, who has been used to making decisions all by her/his own, is not the initiator. The adaptability of the family business, in this case, is actually fully determined by the adaptability, insight, and personal capability of the founder. When her/his mindset gets fixed, she/he may fail to recognize the necessity for change. The founder may even indulge in the status

quo and refuse to make any change out of complacency or worries about uncertainty. It's also likely that the founder has sensed the shortcomings of the business structure, yet she/he is unable to change it. In both cases, the successor can be the new blood needed by the family business.

Why is the next generation more responsive than their parents to these changes? This might attribute to their deeper understanding of the new age as they are themselves an important part of it. The second generation, who has grown up in different social environments with different educational backgrounds, is affected by modernization, globalization and technology advancements in a more significant way compared to their parents. There is little doubt about the divergences of values, preferences, attitudes, perceptions and knowledge structures between the founder and the successor generations.

The first and second generations of the business families tend to have different values and attitudes towards, for instance, entrepreneurship, *guanxi*, internationalization etc. The first generation entrepreneurs may value such qualities as *chiku nailao*, *weiren chushi*, detail-orientation, devotion to work and hands-on doing, while the next generation is likely to attach more importance to innovativeness, knowledge, self-fulfillment, the application of up-to-date technology and concepts, and the adoption of modern management etc. And they prefer new technologies-based and emerging industries such as IT and finance.

In terms of *guanxi*, the new generation resorts to a new type of social network that doesn't quite follow the traditional *guanxi* and *renqing* principles. In particular, they are prone to keep the government *guanxi* at a distance. As an example, Ms. Zong Fuli, the daughter-successor of Zong Qinghou (Wahaha Group) claimed to be vexed by the entanglement of the business with government *guanxi*, "I think the government has to face our generation. We can never be like our parents."³⁸

She believes that the second is profoundly different from the first generation alongside the divergent attitudes towards *guanxi*.

"The major difference of the two generations, I think, lies in their different angles of perceiving the world and problems. Our parents' generation rose from adversity. They value collectivism, sacrifice and compliance. Our generation, in contrast, attaches great importance to individualistic personality, and has an opener and more flexible mindset and an international horizon."³⁹

Moreover, the new generation tends to put more value on work-family balance. For instance, Mr. Hu's father (A25) insisted that he should go to the production worksite as frequently as possible because otherwise he can't keep control of the

38 http://paper.people.com.cn/zgjjzk/html/2014-01/20/content_1382127.htm.

39 http://www.nfpeople.com/story_view.php?id=5478.

business. However, Mr. Hu wanted to spend more time with his two young children. Therefore, he established a set of formal institutions to govern the firm so that he has more time for his family.

In short, the new blood becomes the change-bringer on the one hand as response to the external forces and internal deficiencies of the family business that necessitate changes, and on the other hand as the result of the distinctive mindset, values and characteristics of the successor.

9.2 The Reformer

The first way of bringing changes to the family business is reform. The primary goal of the reformer is to improve the structure of the family business network so that the resources necessary for building up or enhancing the competitive advantages of the firm can be acquired and efficiently allocated.

9.2.1 The Reformer's Strategies

There is a high contingency of strategies and measurements adopted by different reformers due to the heterogeneity of the family businesses, depending on the particular industry in which the family business operates and the specific problems the firm faces. However, the reform generally relates to the improvement of internal processes and structures through such means as management professionalization, and/or the transformation of business model through strategic planning, market repositioning, diversification by e. g. climbing up the value chain, and innovation by e. g. leveraging new technologies etc.

9.2.1.1 Professionalization

Management professionalization is a key means of the reformer, who wants to upgrade or optimize management in order to adapt to the ever changing market environment and to remain competitive. It involves the building up of professional management team and modern management system, the replacement of *renqing* governance with institutions, and the infusion of talents, new managerial resources and external sources of expertise, and the emphasis on branding and marketing etc. The aim is to increase organizational efficiency, to build up the firm's adaptability or to rejuvenate the family firm.

Generally, the successor is often more motivated than the founder to professionalize the family business. Besides the impacts of external forces for

change, a fundamental reason might be that the next generation hardly identify with the traditional way of management.

The next generation is generally much less indoctrinated by traditional Chinese values compared to their parents, and is more likely to be individualistic, anti-authoritarian and less *guanxi*-oriented. Therefore, they are prone to refuse the paternalistic and *renqing* management style. For instance, as Aronoff (1998) observed, “Increasingly, particularly in second-generation family businesses, business leadership rests with a team.” The next generation is prone to resort to the team approach instead of strict hierarchy and power centralization.

Moreover, the next generation might have accepted the public discourse which has portrayed the traditional management as outdated and inferior to the alleged modern management. Formal institutions and professionalism are deemed necessary. This impression is augmented when they have received a formal education on business management, which generally promotes modern management practices, especially when the education is accomplished abroad. Many second generation heirs have received higher education in developed countries. When they come back to their family firms, they often take a criticizing attitude towards their parents’ traditional management. For instance, Ms. Mi (A6), as a post-80s mentioned,

“I had contempt for my father’s management style when I returned from the business school in the US. He is autocratic, making all the decisions by himself. He relies on relational governance instead of formal institutions. Besides, he is too hands-on. I deemed his management as chaos. But gradually, I began to understand, that’s his way of getting things done. I will do things very differently because I have quite different values.”

Since modernizing the family business through professionalization is regarded as a beneficial strategy, many successors resort to it, with the hope of installing a new well-functioning management system. Mr. Hu (A25) and Mr. Tan (A22), for instance, both mentioned reform of the old structure through professionalization, formalization and innovation. After joined his father’s company, Mr. Hu (A25) found that his father had been overwhelmed by many trifles due to the absence of formal institutions.

“The older generation entrepreneurs like my father think it is very difficult to use formal institutions to govern people because in Chinese culture, *renqing* is much more important than institutions. They believe that purely relying on institutions will never work well. However, *renqing* governance is actually inefficient. I believe that formal rules and regulations should be gradually established and conformed to govern the employees, just like the constitution of the company. So I did it. Many responsibilities have been delegated to middle level managers, so I could focus on more important things. Now, the performance of the firm has been improved.”

9.2.1.2 Business Model Transformation

Business transformation is a major concern of many family businesses. In the rapidly changing environment, formerly viable business model may have faced a crisis thus a transformation of business model becomes imperative and critical. For instance, intensifying competition and rising costs force the family firms to find new sources of profits by e.g. climbing up the value chain, technical innovation and strategic transformation. As Mr. Hu (A25), a textile manufacturer commented,

“Cost control can hardly work in manufacturing as it is hard to reduce the costs without degrading the quality of their products. The way out is to increase the added value through innovation in technical aspects and marketing.”

As another example, the founder of the Firm B6 had taken a diversification strategy and made the later developed businesses the key profit-generators and to some degree marginalized the silk business. After the successor Mrs. Tu took over the business, she reoriented the firm to the silk business and tapped the potential of value creation around the core business through technical and cultural innovation and branding.

Reform through both professionalization and business transformation can change not only the routines of the business but also fundamentally alter the firm's relationships with its key stakeholders. New stakeholders can be brought in while older relationships might be terminated. Restructuring the firm network structure means reshuffling the current resource allocation system thus inevitably lead to conflict of interests and resistances. Sometimes the reformer might surrender to these conflicts and resistances. The final result depends on her/his resolution for reform and personal skills in solving complicated issues.

9.2.2 The Tug of War

In the transition stage, the reformer is given some decision making authority and hence the chance to put her/his own ideas and plans of change into practice. However, a common problem most reformers may have to face is the resistance of the old structure to change. As delicately articulated by Kepner (1983), “All change in living systems involves a conflict between two opposing tendencies: the pull to remain the same and defend the status quo and the push to change its processes and structures and move on to a new level of differentiation and integration. Maintenance of the status quo is comfortable; it is supported by well-established, semi-automatic, and dependable behavior patterns requiring minimal effort and low risk. Change, on the other hand, is energizing but challenging.

Because there is always the risk of failure, change is experienced both as a danger and as an opportunity and thus is approached with ambivalence.”

The conflicts of interests are essentially the conflicts between the force of change and the resistance of the old structure. The role of the founder can be either change facilitator or resister, while the latter is more common. To many reformers, the biggest resistance comes from the founders.

When the pressure of change is not high enough for the founder to sense that there will be a crisis for the survival of the business, it can be harder for her/him to give up the structure that has worked so far and to turn to something unfamiliar, uncertain and risky. Therefore, the forward-looking reformer may experience many more resistances than the crisis-responding reformer from the founder, who is attached to the old structure and prefer to maintain the status quo.

As the child, the successor is expected to be respectful to the father's authority and ideas, which may result in a follower successor. However, the reformer is much more self-confident, strong-minded and persistent to her/his own ideas. For instance, Mr. Hu (A25) talked about his relationship with his father in the transition stage that,

“Sometimes we fight about how to deal with things. My father is a typical authoritarian parent. He thinks he is always right about everything and I have to listen to him and comply because I am his son. But I think I have to fight for what I think is right.”

The reformer may enter into a tug of war with the founder in the stage of transition as mentioned by Wong (1985). The founder who disagrees with the reformer's ideas and ways of doing things and lacks confidence in the reformer's plans will hardly give out control, which may be a factor among others that lead to a lagging succession. The reformer, on the other hand, wants to gain control as soon as possible so as to carry out his plan for reforms.

The tug of war may consume the energy of the reformer, slow down the pace of change, force the reformer to compromise and give up better strategy, and finally prevent the firm from adapting timely and effectively. Consequently the firm could be trapped in the old structure and gradually wither. A short period of tug of war could also be constructive as it prevents the reformer from getting unrealistic or reckless. When the founder and the reformer have a short relational distance, they are more likely to be on the same page and reach consensus more quickly through effective communication.

Resistances may also come from other key stakeholders, in particular the powerful veterans such as family members in high level management. For instance, family employees sometimes become roadblocks to reform because they gradually become entrenched in the family business and turn into an impeding force against change in order to protect their vested interests, thus the successor's decision making and implementation might be disregarded or undermined by

the senior family members. Moreover, the veterans may see the successor as a junior, who is lack of experiences, and expected to be obedient to the elders, instead of a boss or a leader. The words of Mr. Tan (A22) are a good example, “Often family employees speak to me in an uncle manner in the firm. I can’t question his manner directly because it will hurt his face.”

Mr. Tan’s solution was professionalization. After taking over the management of the family business, Mr. Tan quickly put formalization and de-familization on the agenda.

“The largest impediment I came across after I took over was the resistance from the veterans, who had followed my parents since the founding stage. 80 % of them are my relatives, who have entered their middle age. Some of them were stubborn and opponent to many of my management ideas. My solution was to relocate the elder generation including my uncles and aunts to a hotel owned by my family. If they wanted to work there, they could. They got salaries no matter whether they actually worked there or not. And then I bought social insurances for them as well. When they reach the retirement age, I let them go. A few of them who could adapt with an open mind and play a role in the business were then rehired. Meanwhile, I hired a lot of non-family employees, so that everyone would be managed by the same rules.”

Although there has also been a tug of war between Mr. Tan and his father, Mr. Tan has managed to win the support of his father for his reform, which has made the problem much easier to be solved as a top-down reform is often more efficient when the power is concentrated.

It can also be the case that the reformer finds it extremely hard to conduct a reform thus takes an alternative solution and becomes a SGE.

9.3 The *Chuangerdai*/ SGE

Recently, *Chuangerdai* has become a buzzword as the children of some first generation entrepreneurs, most of whom were born in 1980s, have begun to come to the fore in the business world with their own creation of enterprises. This group draws the public attention because their identity is linked to their entrepreneur-parents and family businesses.

A *chuangerdai* is different from a successor or an entrepreneur in the common sense. In the discourse of family business succession, the successor’s main task is management – to maintain and develop the family business – instead of entrepreneurship. For instance, Mr. Tan said,

“Compared to my father’s generation, we are more managers than entrepreneurs. We can’t be as audacious as our fathers. Instead, we have to think more about controlling risks. Our prior mission is to keep the business going, to maintain and add value to what they have achieved. After we can do the job well, we then try to develop some new

businesses, with great caution of course. We will never chase a very high return, because we think sustainability before profitability.”

The SGEs are not conventional successors as their primary role is entrepreneur. They start and run their own businesses instead of joining an existing venture. Even when they are not going to take over the management of the family businesses, I still consider them successors of the business families as on the one hand, they succeed the founders’ entrepreneurial spirit and skills. And on the other hand, they inherit many resources from the family and they are often to some extent supported by their family businesses, which also differentiates them from their starting-from-scratch entrepreneurial counterparts.

9.3.1 The Succession of Entrepreneurship

Why does the second generation choose to become an entrepreneur instead of directly taking over the existing family businesses? The answer to it must take into consideration of the complexity of the internal motivations and external stimulations.

The venture creation of the SGE is primarily driven by the intentions to realize her/his own ideas which she/he may not be able to realize inside the family business.

Most family businesses operate in traditional industries such as manufacture, retail, real estate, construction, agriculture and catering industry, while many of the next generation are more interested in emerging sectors such as finance, E-commerce, IT, Internet etc., which are regarded to have great potential and vast opportunities. Therefore, the SGE may have started the new venture because she/he has a genuine passion for it.

For instance, Mr. Wang Sicong, the only son of Mr. Wang Jianlin (Wanda Group), is currently not interested in succeeding his father as Wanda’s next leader. Although he has become a board member of Wanda Group after he graduated from college, he is not assuming any duty. Mr. Wang Jianlin said in an interview that he gave his son 500 Million yuan as start-up capital so that the son could learn from his own entrepreneurial experience. Wang Sicong has used the money to start up a private equity fund, the Prometheus Capital, which has been reported to be very successful so far.

In a different scenario, the SGE refuses to live under the founder’s shadow. She/he may want to prove herself/himself and achieve independence. Influenced by their parents’ entrepreneurial experiences, values and spirit, the second generation of the business family may turn into a person with high entrepreneurial spirits, who wants to create something by herself/himself. She/he

may also be a frustrated reformer who has found that the founder is overly dominant in the family firm, where there is little room left for her/his independent decision making and the realization of her/his own ideas, or that the conflicts or problems are beyond her/his capability. Therefore, starting a new business is a better option.

Mr. Zhang's son (A26) worked in the car dealership owned by the family after graduated from university. Quickly he found that it was "boring to work in his dad's firm" and wanted to create something by himself, thus he left and started his own business, a pet shop, with his dad's funding.

"Starting a business will be a valuable experience. So I supported him. There are many things that can only be learned by doing it yourself, even if it would turn out to be a failure." said Mr. Zhang.

More often than not, the SGE's new venture is also a result of the founder's succession strategy. And most SGEs get support or help from their entrepreneur-parents. A reason for the first generation entrepreneurs' support for the second generation's entrepreneurship might be the great value they ascribe to entrepreneurial spirits, but generally, their decisions have more specific reasons.

Firstly, the SGE's entrepreneurial activities can be a way of training – the founder may believe that it's a good way for the successor to learn how to do business in depth, gain invaluable real world experiences through creating a venture themselves. In this scenario, the SGE will eventually take over the family business, who is supposed to learn from the entrepreneurial activities so that she/he can perform better after taking over the family business. Entrepreneurial experiences are thus highly valued.

Secondly, when the founder who doesn't believe in sibling partnership has a few heirs and the family business is regarded as undividable, she/he may choose to select one heir as the management successor and encourage or even urge the others to create a new business.

Lastly, new venture creation is some business families' strategy to cope with the rapidly changing market conditions. Many family business founders and their children are seeking opportunities to enter other industries. Especially, great expectation is placed on the second generation, who are better educated, more innovative, with international experience and keep pace with the technology and information age. For instance, being pessimistic about the prospect of the real estate development business, Ms. Mi's father has been thinking about entering into other industries and the mission has been given to Ms. Mi.

"My father thinks that the real estate industry is shrinking, so we are preparing for a business transformation. We are now working on a new venture in the health care industry. In the meanwhile, I am also in search of other new business opportunities."

Similarly, Mr. You (A5), the only son of the founder of a real estate developing company, has been granted a funding of 5 million from his father for his entrepreneurial tryout.

In sum, the venture creation of the SGEs is mainly driven by their own motivations but could also be encouraged and supported by the founders. From the SGE's perspective, the new venture is about self-fulfillment or gaining recognition of the founder and the world. The self-motivated SGE may take the founder as a role model or a challenge. The founders may intentionally foster the entrepreneurial spirit and pave the way for their SGE's entrepreneurial activities.

9.3.2 Characteristics of Entrepreneurial Succession

The SGEs tend to start businesses in emerging sectors such as high tech or finance that their parents are not so familiar with. Most of them obtain their funds and other types of resources such as *guanxi* from their somehow "old-fashioned" family businesses. Through this way, their family businesses may enter new sectors and realize structural transformation. Despite being firmly supportive, some founder-parents don't count on the success of their children's new businesses. The key idea is to let the children learn by doing, trial and error, in the real business world. If they do succeed, it will be a welcomed by-product. Nevertheless, the SGEs may have a great chance of success as they enjoy a few advantages compared to their entrepreneurial peers.

Firstly, the second generation's entrepreneurial activities are normally financed by the parents. Many SGEs receive free funding from their entrepreneur parents. Many people fail to start up or sustain their new ventures due to the lack of capital and further financing. This, however, is generally not a problem for the SGEs.

Secondly, the SGEs may learn knowledge and skills about doing business and inherit the entrepreneurial spirit from the parents. Grown up in the business family, the next generation is likely to have been instilled with the entrepreneurial spirit. Impacted by the parents' entrepreneurship, the second generation may have a high degree of risk-bearing and innovativeness which are important qualities of entrepreneurship. Being the children of the entrepreneur may also enjoy an advantage: the knowledge, skills and experiences learned from their founder-parents may increase the chance of success of their startups.

Lastly, they can inherit the social capital of the founder parents, which can facilitate their entrepreneurial activities. Moreover, being the second generation of the business family may have granted the SGEs more chance to build connection to people with high resources stock. For instance, Mr. You is planning to start a new venture with one of his SGE friends.

“Many of my friends are the second generation of business families like myself. Some of them are children of my father’s business partners. Others were schoolmates or club-members who became my friends due to similar experiences. We are not only friends, as we can also be business partners.”

9.3.3 Two Cases of SGEs

9.3.3.1 Entrepreneurial Succession: The Carrier Builder

Mrs. Liao Weijia is the only-child of Mrs. He Yongzhi (aged 63), the “Hotpot Queen” of China. Mrs. He Yongzhi is the founder of the Cygnet Group, who opened her first hotpot restaurant in 1982 and has made the business a large hotpot chain spanning to more than 380 restaurants in China. Weijia went to the US out of her own will when she was 15 and 11 years later, she returned to China together with her husband Joe in 2008 to succeed the family business due to her mother’s request. “I have known that succeeding the family business is my responsibility since I was little. *Zicheng fuye* is the Chinese tradition and I am the only-child. So this sense of responsibility is rooted deeply in my heart.” Weijia was taken to meetings of the management by her parents as early as she was 7. The idea was to give her a basic understanding of managing a business. “So I have always known what to study and which path to follow.”⁴⁰

Weijia’s parents didn’t have a formal succession plan. Their grooming approach was simple and straightforward: Weijia was directly appointed as Vice President being in charge of human resource upon her joining in the family business, while her husband Joe was made the director of the strategic planning department, which was non-existence before Joe joined. The founder seemed to hope that the next generation could “watch and learn”, thus the two positions didn’t have any real decision making authority. Therefore, nearly all of Weijia and Joe’s Western styled reform plans were voted down by their parents.

Ten years’ studying and living experience in the US had made Weijia extremely unfamiliar with their parents’ “Chinese way” of doing business, while the lack of good communication with her parents for years also contributed to the conflicts of management ideas of the two generations. The clash of Western and eastern cultures and tradition and modern ideas had been frequently put on the show in the family.

Mrs. He regretted a little bit in her daughter’s foreign education, “I sent her abroad when she was young, so that she is too Americanized. Maybe she was sent to the US too young, so that the West has great influence on her.” said Mrs. He,

⁴⁰ <http://www.hbrchina.org/2015-10-15/3479.html>.

“We are both forceful and none of us like compromising.”⁴¹ She often thought Weijia’s ideas as idealistic and ignorant to the Chinese reality and thus disapproved them.

Being frustrated by their experience in the mother’s company, in 2010, Weijia and her husband left Cygnet and founded the NenlüTea, a modern style teahouse chain. The 5 million yuan start-up capital was borrowed from the mother, who initially wanted to invest the money in return of 70 % ownership. This request was declined by Weijia because she didn’t want her mother’s interference in their business. Their goal was to prove their management ideas and abilities to their parents. “My parents’ company is like an aircraft carrier. Joe and I were paddling a small boat, thus we could never change the carrier’s direction. But if we build a carrier with the same size, or even bigger, we could lead my parents’ carrier to the right haven.”⁴²

Weijia’s entrepreneurship was actually aimed at a better succession. In addition to running the NenlüTea, Weijia has kept her title of the Vice President and participating in the operation of the Cygnet Group.

Until 2015, NenlüTea has opened 16 branch stores and become a trendy brand in China, which has greatly impressed Mrs. He, who once predicted that the daughter’s business wouldn’t last beyond half a year. She commented that her daughter had gained valuable knowledge and experiences running her own business which couldn’t be learned in Cygnet. “I have seen my daughter’s growth and development in her entrepreneurial process. [...] After she started her own business, she said to me, ‘I now really understand you and your entrepreneurial experiences.’ If she directly takes over the business, she would not love the firm very much because it is not her ‘child’. Now she has her own child, she will learn how to love it and she will grow up very fast. She has learned a lot, such as location selection and cost control.”⁴³ Currently, Mrs. He has been gradually transferring the managerial control of the Cygnet Group to the daughter.

9.3.3.2 Entrepreneurial Training: The Kite Flyer

Mr. Chen Zhixian founded the predecessor of Sassin International Electric Co., Ltd. in 1993, which has developed into one of the largest industrial electric manufacturers in China.

Mr. Chen has encouraged his children (two sons and two daughters) to create their own ventures. Except the youngest daughter, the other three have all gained entrepreneurial experiences.

41 <http://www.iceo.com.cn/mag2013/2014/0416/287729.shtml>.

42 <http://www.hbrchina.org/2015-10-15/3479.html>.

43 <http://www.iceo.com.cn/mag2013/2014/0416/287729.shtml>.

“I am worried to pass on such a large enterprise to my children. They must be trained by the experience of running a business. I never forced them to study abroad, instead, I encouraged them to start their own businesses according to their interest.” Mr. Chen provides startup capital to his children in the form of loans with an annual interest rate of 12 %. “I hope they can gain business experiences in the real world with real money. Alongside providing them financial support, I also keep abreast of the progress they have made in running their businesses. It’s like flying a kite. I send it up high so that it can have a feeling of the sky. However, I always hold the string. When I think the children have been high enough, I pull them back to take over the management of the family business.”

Mr. Chen’s eldest son, Chen Gao borrowed 5 million from him and started an advertising company. After the company had made significant success, Mr. Chen called Gao back to the family business to assume the vice GM position. “This experience proved Gao’s competences. If I didn’t pull him back timely, maybe he would have broken loose from me.” said Mr. Chen.⁴⁴

The younger son, Chen Dong, have also started two businesses, who is supposed to join the family business later as well. Dong’s investment of 50 million yuan borrowed from the father in a hotel failed shortly, which had greatly frustrated him. The father encouraged him to try again and Gao became a successful private equity investor. “Without failure there is no progress. The 50 million of cost is worth it.” said Mr. Chen. Currently, Mr. Chen has transferred a part of the ownership equally to his two sons (with each son holding a 24 % interest of Sassin and Mr. Chen and his wife each holds 27 % and 25 % respectively.)

44 <http://finance.sina.com.cn/leadership/jygl/20100601/17358040380.shtml>.

Chapter 10. Conclusion

This study was set out to investigate how the key decision makers of Chinese family business deal with the issue of succession and the factors influencing their succession decisions.

Being aware that the decision making process is specific to each family business as the decision makers have distinctive personalities, values, preferences and motivations and are confined by various external factors, the author identified a few general patterns and features of Chinese family business successions as well as the possible underlying factors leading to these patterns and features.

Special attention was paid to the economic, social, cultural and political embeddedness of the stakeholders of the family business that shapes their decisions and behaviors. For instance, a few prominent traditional cultural values and norms such as familism, *guanxi*, *zicheng fuye*, and *yanchuan shenjiao* have provided important explanations for the decisions and behaviors of the decision makers.

Whether to succeed the family business may be a question that the founder and the second generation have to ponder with caution and revisit repeatedly before the final decisions are made. Generally, most founders are highly motivated to keep the control of the family business in the hand of the family. Only a few founders who are less optimistic about the future of the family firms are reluctant to let the second generation succeed. The second generation may decide to succeed out of the sense of obligation to their families or as the result of a careful calculation of the situation. They may choose to create their own business instead of taking over the family business when their interests, ideas or values diverge from their parents' and the family businesses.

Due to familism, it is a norm for the founders of Chinese family businesses who typically own the majority of the equity of the firm to pass the ownership to their children. When the founder has only one child, the ownership is normally fully transferred to the child after the successor has taken over the managerial control. When the founder has more than one child, the traditional equal inheritance system and the practice of *fenjia* come into play. Ownership is normally divided more or less equally among all heirs. A family business consisting of

more than one company may be divided into a few independent firms. In many cases, the traditional equal inheritance system has been modified to legitimize daughters as heirs, which reflects the rise of the status of daughters in the gradually modernizing China.

Despite the trend towards more gender equality, sons are still widely preferred as management successors to daughters, unless male heirs are absent due to e. g. one child policy or the sons are considered incompetent. I found that the selection of management successor tends to follow the principle of differential mode. Son-succeeds-father has been the mainstream succession mode, which reflects the effect of the traditional ideology of *zicheng fuye*. The founder's relational distance to the successor candidate as well as the candidate's gender, birth-order, competence and willingness are all potential factors that impact the founder's decision on successor selection.

A family business successor typically goes through a few stages of development, namely the nurture, training and transition stages. The Chinese founder-parents are either controlling or laissez-faire, implying two contrasting types of attitudes and strategies towards the development of their children, especially in the nurture stage. Controlling founder-parents begin to mold and groom their successors since the successors were at very young age. The transfer of human capital (directly and indirectly) and social capital from the founder to the successor is critical for the development of the second generation. Overseas education, bottom up trial and *guanxi* lessons are commonly used successor development strategies. *Yanchuan shenjiao* and *guanxi* transfer can help reduce the successor's relational distance to the firm, and they are more efficient when the relational distance between the founder and the successor is smaller.

Successful succession is not about simply transferring the ownership and/or managerial position such as the General Manager from one person to another. It's about making the business system keep functioning as it has been or even in a better way.

The intergenerational transition of many Chinese family businesses normally takes two forms: the transition of leadership and the transition or transformation of the business from the traditional family business to a modern one that is able to adapt to the ever-changing market environment through professionalization of governance and management structure and strategic transformation of business model.

The profound differences between the founder and the successor generations may facilitate change, as the reformer and the SGE can be the new blood that could rejuvenate the family business. However, differences also imply conflicts and resistance and the tug of war over control may jeopardize the family business. The relationship between the first and second generation is critical in determining the final outcome.

Appendix

Please note: As a supplement to part III which has been shortened you will find here the additional chapters explaining the theoretical framework in full length.

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Chapter A.

A Social Capital Approach: Relationships and Resources

A.1 Theoretical Approaches to Succession

The succession literature is mostly based on empirical work thus tend to neglect the application of established theoretical frameworks. Only a few scholars have tried to employ some theoretical frameworks and approaches to explain how and why family business stakeholders make certain succession decisions.

For instance, Cabrera-Suárez et al. (2001) adopted the resource-based and the knowledge-based view of the firm to examine the succession process and pointed out that the tacit knowledge needed to be transferred from the founder to the successor in the intergenerational transition so as to sustain the competitive advantage of the firm.

Lee et al. (2003) applied a game theoretic approach to examine the issue of successor choice and showed that both the degree of idiosyncrasy of a family business and the ability of the family's offspring could affect the successor choice: an offspring-successor is preferred to an outside agent (professional manager) when business idiosyncrasy is high unless the competency of the offspring is too low.

Having reviewed 117 papers on family firm succession published between 1974 and 2010, Nordqvist et al. (2013) proposed to understand succession from an entrepreneurial process perspective, "where both the entry of new owners and exit of old owners are associated with the pursuit of new business opportunities".

Utilizing the socio-emotional wealth (SEW) theory, Minichilli et al. (2014) suggested that family owners tended to have both financial and non-financial (i.e. SEW) concerns when making decisions regarding CEO succession and found through an empirical investigation that the three succession mechanisms (relay succession, 'horse race', and the appointment of a non-family CEO from the outside) can mitigate the negative effect of CEO succession on financial performance by balancing the financial and non-financial SEW motives.

The different approaches mentioned above have been very useful for improving our understanding of family business succession process; however, none

of them has developed into a comprehensive and coherent theoretical framework, which is ready to encompass the multi-level, multi-player dynamics of succession as well as the impacting contextual factors.

Therefore, I propose to utilize the social capital theory as the theoretical framework, which takes into account in a dynamic manner the attributes of the key actors in family business succession process, their relationships and interactions in both the family and business systems, and the cultural and social embeddedness of those interactions.

A.1.1 A Social Capital Approach to Family Business Study

The rationale behind the emerging interests in the study of family business is based on two postulates: first, family business has its distinctive features comparing to non-family business, and second, this distinctiveness affects performance or outcome. So the general family business literature is the endeavors to identify and explain the distinctiveness, to excavate the relationship between the distinctive features and firm performance, as well as to search for ways of managing it with the aim of achieving better firm performance or maintaining the family control over the firm.

Adopting a resources-based view, scholars such as Habbershon and Williams (1999) found that family business disposed a unique bundle of resources and capabilities which were the source of its distinctiveness as well as competitive advantage compared to non-family business. Accordingly, they introduced the concept of “familiness” to describe the idiosyncratic firm level bundle of resources and capabilities resulted from family involvement in business as well as interactions between the family system and the business system (Habbershon & Williams, 1999; Habbershon et al., 2003). Being cognizant of that “the unique behavioral and social resources that constitute familiness have not been identified, and the nomological net of familiness has not been sufficiently conceptualized”, Pearson, Carr, and Shaw (2008) provided an extension to the conceptualization of familiness with the help of social capital theory. Social capital theory comes into play as the most distinctive resources constituting familiness are not financial or human capital, but family social capital which exists within family relationships and can be transformed into organizational social capital (Arregle, Hitt, Sirmon, & Very, 2007).

In fact, deploying social capital theory in family business research is a rather recent phenomenon, though the potential of employing a social capital approach to studying family business has been recognized earlier. Grounded on a review of the most cited papers applying the social capital concept to family business studies, I found Steier (2001) is one of the pioneers to explore this area. On the

basis of interviews on next-generation entrepreneurs in 18 different firms, he identified the ways in which social capital was transferred, created, and managed in family business succession process. Similar to Steier, Dou and Li (2013) scrutinized intergenerational transfer of entrepreneurs' guanxi – an indigenous Chinese construct of social capital – in the succession process of Chinese family businesses based on case studies.

Generally speaking, the application of the social capital approach on family business studies is still in its infancy. Only a small number of scholars have contributed to the development of this area of study and very limited knowledge has been generated. Despite of the richness of the social capital theory, the application is rarely sufficient. Moreover, very few of these studies have focused on family business succession (exceptions see Steier, 2001; Perricone, Earle, & Taplin, 2001; Dou and Li, 2013; Deng, 2015).

A.2 Definition of Social Capital

Social capital theory gained popularity in 1990s and has been a fast-growing industry. The conceptualization of social capital is diverse, but most scholars refer to the three seminal writers on social capital: Pierre Bourdieu, James Coleman and Robert Putnam.

Bourdieu defined social capital as, “the sum of the resources, actual or virtual, that accrue to an individual or group by virtue of possessing a durable network of more or less institutionalized relationships of mutual acquaintance and recognition” (Bourdieu, 1986).

Coleman's (1988) conceptualization emphasized the social structure, defined social capital as the entities which “consist of some aspect of social structures”, and “facilitate certain actions of actors – persons or corporate actors – within the structure”. He further pointed out that “social capital inheres in the structure of relations between actors and among actors” and identified three forms of social capital: obligations and expectations that based on trust and trustworthiness of the social environment, information channels, and social norms (Coleman, 1988).

Putnam referred to social capital as “features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions” (Putnam, 1993), and later he refined it as “connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them” (Putnam, 2000).

Although these conceptualizations have different focuses, they share the core idea that social relationships are valuable because they provide resources that facilitate social actions. As Nan Lin pointed out, “Bourdieu, Coleman, Lin, Flap,

Burt, Erickson, Portes, and others all share the understanding that social capital consists of resources embedded in social relations and social structure, which can be mobilized when an actor wishes to increase the likelihood of success in a purposive action.” (Lin 2001)

A key concept in these definitions is social structure, which has provided the playground for social network analysts. Burt (2000), for instance, defined social capital as competitive advantages derived from better locations in social network. Structural holes, for example, “are the source of value added, but network closure can be essential to realizing the value buried in the holes.” (Burt, 2000)

Following Burt, Lin (2001) explicitly adopted an social network approach to social capital and claimed that social capital “should be conceived in the social network context: as resources accessible through social ties that occupy strategic network locations (Burt) and/or significant organizational positions (Lin)”, thus he adopted an operational definition of social capital as the “resources embedded in a social structure that are accessed and/or mobilized in purposive actions” (Lin, 2001, p 29).

After more than two decades of development, a universally accepted definition of social capital is still absent. Therefore, I adopt Nahapiet and Ghoshal’s (1998) definition, which resembles the definitions provided by Bourdieu and Lin and is arguably one of the most comprehensive definitions of social capital.

Nahapiet and Ghoshal (1998) defined social capital as “the sum of the actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit. Social capital thus comprises both the network and the assets that may be mobilized through that network.”

They also separated three dimensions of social capital analytically: the structural dimension which refers to “the overall pattern of connections between actors” (who you reach and how you reach them); the relational dimension which refers to “the assets created and leveraged through relationships” (trust and trustworthy, norms and sanctions, obligations and expectations and identity and identification); and the cognitive dimension which refers to “the resources providing shared representations, interpretations, and systems of meaning among parties” (shared language, codes and narratives) (Nahapiet and Ghoshal, 1998).

It can be argued that the meaning of formulating the concept of social capital and the ground for its popularity lies in the disclosure of the utility of interpersonal relationships by social capital theory. This does not mean that networks of relationships have been regarded useless before the invention of this concept. In fact, the importance of social relationships has been the central theme emphasized and studied by, for instance, sociologists. The new excitement of social capital theory, then, arises from the explicit statement that social relationships

enable access to valuable resources such as knowledge and information, which could help individuals or collectivities to achieve desired goals or get to desirable ends. Without the social relationships, these resources are either impossible to be accessed, or could only be accessed with high costs.

Social structure including social relationships is capitalized through the construction of social capital, although not necessarily in an economic sense. It's not surprising that the intellectual experience with economic capital has helped and shaped the understanding of social capital. For instance, like other forms of capital, social capital can be convertible to or facilitate to the formation of other forms of capital such as financial and human capital, as an important argument made by Coleman (1988). Moreover, there are means to invest in, get return from and accumulate social capital.

While sharing some common aspects with other forms of capital, social capital has its unique attributes. For example, social capital can't be completely owned by individuals because it relies on the relationships with other actors for existence.

Consequently, the development of social capital theory provides another important variable – after human capital – for economics and business management scholars, who have recognized the embeddedness of economic activities, to decipher individual and organizational behaviors and performances.

A.3 Social Capital Theory

A.3.1 Functions of Social Capital

Resources are critical to the survival and success of individuals and organizations such as family firms. Social capital is a crucial source of the resources that individuals and organizations could utilize to achieve their own goals.

Scholars have identified many functions of social capital (see Adler & Kwon, 2002 for a review). Coleman (1988) showed that social capital within the family and wider community could be an important factor in the development of human capital. Social capital can, for instance, promote co-operation between individuals thus reduce transaction costs (Fukuyama, 2001) and facilitate knowledge sharing and creation (Nahapiet & Ghoshal, 1998).

In particular, the accumulation and utilization of social capital, e.g. through networking activities, has been identified as a central component of entrepreneurial activities. The resources that entrepreneurs may access through their personal networks enable them “to identify new business opportunities, obtain resources below the market price, and secure legitimacy from external stakeholders” (Stam, Arzlanian, & Elfring, 2014). The information accessed

through networks, for instance, could facilitate the Schumpeterian entrepreneurial behaviors, i.e. the identification of economic opportunities and innovation (Schumpeter, 1934).

It must be noted that social capital may also have negative consequences, as “a given form of social capital that is useful for facilitating certain actions may be useless or harmful for others” (Coleman, 1988).

A.3.2 Typology of Social Capital

Scholars of social capital mainly distinguish two types of social capital, namely “bonding” social capital and “bridging” social capital. Putnam (2000) defined bridging social networks as “outward looking and encompass people across diverse social cleavages” (Putnam, 2000), while “bonding” social capital consists of inward looking networks which tend to reinforce exclusive identities and homogeneous groups (ibid).

This typology is better understood with the help of Granovetter’s (1973) work on strong and weak ties. Strong ties refer to relations between family members, close friends, and neighbors etc. “Bonding social capital refers to the links between like-minded people, or the reinforcement of homogeneity. It builds strong ties, but can also result in higher walls excluding those who do not qualify” (Schuller, Baron, & Field, 2000).

Bonding social network mainly consists of strong intra-community ties among “people alike”. It is often a network closure, which “affects access to information and facilitates sanctions that make it less risky for people in the network to trust one another” (Burt, 2000). Bonding social capital, closure or denser networks may have a relative advantage to preserve or maintain resources (Lin, 2001).

Weak ties, meanwhile, refer to acquaintances, more distant friends, associates, and colleagues etc. (Granovetter, 1973; Woolcock, 2000). Bridging social capital thus refers to extra-community networks among “people unlike each other”, which are usually weaker ties. The importance of bridges in networks in facilitating information and influence flows has been well stressed in literature (Lin, 2001). In his classic work of *The Strength of Weak Ties*, Granovetter (1973) showed that weak ties are “important resource in making possible mobility opportunities.”

Bridging social capital mainly consists of weak ties is an important argument made by Granovetter. “A strong tie can be a bridge, therefore, *only* if neither party to it has any other strong ties, unlikely in a social network of any size (though possible in a small group). Weak ties suffer no such restriction, though they are

certainly not automatically bridges. What is important, rather, is that all bridges are weak ties.” (Granovetter, 1973, p1244)

Bonding and bridging social capital can provide different types of resources thus play different roles in the actor’s life.

A.3.3 Sources of Social Capital

According to the definition of social capital, networks of interpersonal relationships are the source of social capital. Despite that strong ties (e. g. family ties and close friends) and weak ties are divergent types of relationships, they are both the source of social capital.

Then the question comes up: why is relationship resource-bringing? Social exchange theory suggests it is because that the formation and maintenance of relationships are always accompanied by the exchange of resources – material or symbolic.

Interpersonal relationships/ties may appear kaleidoscopic as each relationship is determined by the personal traits, motives, values of the two connected persons as well as the social contexts, such as culture and norms, in which they are embedded. There are generally two ways to form a relationship: ascribed or achieved. For instance, every person is born to have the relationship with her/his family and when she/he goes to school, she/he is ascribed the relationship with teachers and classmates. One can also initiate and achieve a relationship with a stranger. The maintenance of a relationship, however, is an ongoing process of interactions which involves investments of time, energy and other resources in heterogeneous forms.

The social exchange theory offers a way to explain how relationships are formed and maintained through exchanges of various types of resources between the two parties connected by a relationship (see Homans, 1961; Blau, 1964, 1994). The resources involved in social exchange can be material goods as well as intangible resources such as knowledge and information, feelings of understanding and support, and companion, which are most frequently exchanged.

Social exchange is closely intertwined with the concepts of trust and norms of reciprocity. The two parties of a relationship are involved in a social exchange relationship based on the rules of reciprocity, which is different from the economic exchange relationship.

For instance, Blau argued that social exchange is different from economic exchange as it “entails unspecified obligations”, “involves favors that create diffuse future obligations” and “only social exchange tends to engender feelings of personal obligations, gratitude, and trust; purely economic exchange as such does not” (Blau, 1964, cf. Cropanzano & Mitchell, 2005. Social exchange is

characterized by trust and mutual investment, diffuse and open-ended obligations, as well as indefinite timing and form of the return but usually a long-term orientation. Economic transactions of the two parties, in contrast, are impersonal, financially oriented interactions with clearly defined time frame, obligations and contents (Shore, Bommer, Rao, & Seo, 2009), and ensured by formal institutions such as laws or regulations.

A.3.4 Trust, Norms, and the Structural and Individual Approaches

Trust and norms both affect interpersonal interactions which form the basis of relationships. Social capital is often studied with relation to these two concepts. For instance, Putnam (1995) defined social capital as “features of social life—networks, norms, and trust—that enabled participants to act together more effectively to pursue shared objectives.” Generalized trust, which is the trust towards members of the groups one belongs – from small groups such as clubs to large ones such as society, thus has been used as a cardinal – in many cases the only one – indicator for measuring group-level social capital in given organizations, or even societies. Fukuyama (1995) contended that the level of trust in a society significantly correlated to its economic success. Norms and generalized trust emerge not from any one relation but from networks of individual who are interconnected, i.e. more general social structure, as the result of long-term interactions of large number of actors across time. Therefore, many researchers take a structural approach to social capital.

The structural approach generally views social capital as a collective good, which could be accessible to all the members of a group, or a network. Following this vein, the complex network structure of social relationships inside and between groups and its implications are the focal point. Indeed, the whole society could be perceived as a giant network consists of sub-network structures with all its members interconnected. Applying network analysis methods, many scholars have contributed to improve our understanding of the network structure by introducing concepts such as bonding and bridging social capital (Putnam, 2000), centrality (Freeman, 1978), structure hole and closure (Burt, 2001). As a result, the structural dimension of social relations has been dominating the social capital literature.

The other stream of scholars adopting an individual approach to social capital argue that social capital is best understood from the perspective of interactions and relationships between individual actors instead of focusing on the more general structure (see for example Lin, 1999; Glaeser, Laibson, Scheinkman, & Soutter, 1999; Glaeser, Laibson, & Sacerdote, 2002). Here, the dyadic relationship, i.e. a tie and the two individuals connected by the tie, is the focal point. Per-

sonalized trust is both the basis and outcome of interpersonal interactions in the form of social exchange between the two parties of dyadic relations. Norms are underlying factors that confine interpersonal interactions. In this approach, social capital is the relationships possessed by actor as the result of his active endeavors to build trust by assuming his obligations and following the norms of reciprocity. Social capital thus is instrumental and important for the realization of individual goals.

The two approaches are not antithetical but rather a matter of viewing the same thing from different angles. The Chinese perspective on social capital is in line with the individual approach, thus I follow the individual approach in this study, which will be further discussed in Chapter 5.

Applying the social capital theory to family business succession has two major implications. One is that family business succession is seen as the transfer of critical resources from incumbent to successor. The other implication is that the relationships between key actors, e. g. the founder and the successor, in the family business succession process are in focus because these relationships affect the pattern and efficiency of resources transferring. Before going further to the more detailed description of the social capital approach to family business succession, the cultural embeddedness of social capital must be addressed.

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Chapter B.

The Triangular Model of Family Business Succession

Last chapter reveals that the egocentric network of an actor (an individual or a firm) is composed of ties of different qualities. I propose a new concept – relational distance to capture this complexity of the network. In this chapter, I firstly define the concept and based on it and the egocentric view of social capital, the triangular model of family business succession is developed.

B.1 The Concept of Relational Distance

The relational distance between two parties indicates the characteristics and quality of their relationship. It is to some degree similar and related to the concept of tie strength studied in social network analysis. The seminal work of Granovetter (1973) defined the strength of a tie in terms of its indicators as “a (probably linear) combination of the amount of time, the emotional intensity, the intimacy (mutual confiding), and the reciprocal services which characterize the tie”. Granovetter’s definition proposed four possible indicators for an evaluation system of tie strength. However, he did not elaborate the measurement system, stating that “discussion of operational measures of and weights attaching to each of the four elements is postponed to future empirical studies.” Nevertheless, it was sufficient for Granovetter to identify a given tie as strong or weak. Subsequent works are mostly based on this dummy variable view of tie strength, although some attempts have been done to elaborate the measurement system to better distinguish strong from weak (see for example Marsden and Campbell, 1984; Marsden & Campbell, 2012).

The tie strength concept has been very helpful in describing interpersonal relationships. However, there are a few deficits in terms of its suitability to capture the characteristics of Chinese guanxi.

Firstly, although tie strength was originally proposed as a linear variable, the literature has generally made it a dummy variable. At least in the Chinese context, the strength of a tie has clearly more levels than just strong or weak. To most

Chinese, *guanxi* is a continuous variable. A *guanxi* moves itself forwards or backwards between the two extremes: from no connection to the strongest *guanxi*. Different locations of the *guanxi* imply differential strategies of actions. Adopting a new concept instead of the concept of tie strength can help break the strong-weak dichotomy.

Secondly, tie strength is a rather abstract and intangible concept. Distance, in contrast, is a more visible concept which conjures a geographical structure and can be exhibited in the egocentric *guanxi* network.

Furthermore, relationships often involve geographical approximation. When two persons are regarded as close, or *qinjin* (亲近) in Chinese, they are emotionally intimate and physically near to each other. Proximity is important because it's very hard for two persons to maintain a deep *guanxi* if they always keep a very large spatial distance and hardly meet. For instance, generally, the Chinese value kin ties very much, however, they also believe that a neighbor nearby is more helpful than a family member far away (*yuanqin buru jinlin*, 远亲不如近邻).

Lastly, there is a tradition in Chinese culture to describe relationships with distance scale. In the Chinese language, the adjectives used to describe a *guanxi* is usually “*jin*” (近, close, near) or “*yuan*” (远, distant, far way), “*shen*” (深, deep) or “*qian*” (浅, shallow), which in fact belong to a spatial scale based on distance. For instance, relatives are called “*jinqin*” (近亲, literally “close relative”) if they have close blood relation, while “*yuanqin*” (远亲) when they are distant relatives.

Due to the above-mentioned reasons, I propose the concept of relational distance due to its potential in better depicting the nature of relationship in China. This concept embodies two underlying assumptions: (1) relational distance is measurable and (2) relational distance affects the resource exchange thus indicates resource accessibility.

As a matter of fact, most socially competent Chinese are capable of evaluating the relational distance between themselves and their *guanxi* parties. According to Jacobs' (1982) investigation of Mazu residents, “any outsider able to observe social interaction between those having *ganqing* or a *guanxi* can evaluate the relative ‘goodness’ of the *ganqing* or the relative ‘closeness’ of the *guanxi*”.

However it must be noted that people actually make evaluations subjectively and emotionally. In other words, the two parties could have asymmetric evaluations of their *guanxi*. In each interaction between the two *guanxi* parties, one's action is based on her/his own subjective evaluation of the *guanxi*. She/he might adjust her/his evaluation and change her/his action in the next round of interaction according to the feedback she/he received from the other party. It is a possible scenario that A, being confident about his *guanxi* to B, asks B for a favor. B turns down the request because he perceives the *guanxi* otherwise. The unforeseen result, nevertheless, helps A to revise his evaluation of the *guanxi* and

adjust his actions accordingly. This example suggests that both parties reach more or less equivalent perceptions of their guanxi through repeated interactions. Accordingly, I posit that guanxi are generally symmetric.

If a guanxi becomes deeper, closer or better, the two parties of the guanxi have a shorter relational distance, implying more sentimental bonds, more intensive interactions and greater commitment to the other party, as well as more investments (e.g. time) made to the guanxi. Consequently, they both have greater accessibility to other party's resources as well as greater ability to influence the other party's value orientation and decision making.

Moreover, relational distance is a comparative assessment rather than an absolute measurement. Base on the comparison of relational distances, it is not very difficult for the ego to tell whom among a few persons she/he has the smallest relational distance to, although she/he may not express it publicly. For instance, in the egocentric guanxi network, of the two guanxi parties of the ego, actor B and actor C, actor B has a shorter distance, thus is closer, to actor A compared to actor C.

The relational distance of a given relationship, such as the founder-successor relationship, is determined by the three dimensions of relationship: the normative, sentimental and instrumental dimensions. Each of the three dimensions of guanxi presents a few predictors of relational distance, i. e. (1) normative type of guanxi, where family guanxi are closest and guanxi with acquaintances are the most distant; (2) subjective evaluation of sentiment and trust; and (3) the history of exchange, i. e. time spend together, frequency of interactions and favor exchange history.

B.2 Relational Distance between the Stakeholder and the Firm

According to the egocentric network view of the firm, each firm stakeholder has her/his own relational distance to the firm. The difference is reflected in the hierarchical structure of influence. Smaller distance implies a higher degree of investment of personal resources to the firm, which can include human capital (e.g. knowledge, skills, abilities, time and labor), financial capital and social capital. It also implies stronger influence on the business system as well as legitimate claim to more returns – pecuniary wealth and socioemotional wealth which includes social status, prestige, identity, influence, self-fulfillment etc. – from the firm. The founder as the owner-manager is much closer to the firm than a department manager, while the latter is less distant to the firm than an ordinary employee. How the egocentric network of the firm is configured depends on the organizational structure – some are more hierarchical whereas others are flatter.

The relational distance between a stakeholder and the firm, which is mainly determined by the exchange of resources, depends on two variables: commitment and competence.

B.2.1 Commitment and Competence

The concept of commitment in the business context often refers to organizational commitment. There has been a large body of research focusing on organizational commitment, which has been defined as a psychological state, or mindset that “(a) characterizes the employee’s relationship with the organization, and (b) has implications for the decision to continue or discontinue membership in the organization. [...] it can reflect a desire, a need, and/or an obligation to maintain membership in the organization” (Meyer & Allen, 1991).

The concept of organizational commitment must be extended so that other types of stakeholders can also be included. Based on the social capital approach adopted in this study, I define commitment as the willingness to invest personal resources – knowledge, skills, abilities, time and labor, money, social capital etc. – to the firm. Thus commitment indicates a stakeholder’s level of willingness to initiate, maintain or improve the relationship with the firm.

The ground of one’s commitment to a firm can be various. In the case of family firm, the successor’s commitment has been used as an important predictor for the successor’s decision to take over the family firm and her/his post-succession performance (McMullen & Warnick, 2015). Following Meyer & Allen (1991), Sharma and Irving (2005) identified four types of the successor’s commitment to the family firm: affective, normative, calculative, and imperative commitments. Affective commitment refers to a “strong belief in and acceptance of the organization’s goals, combined with a desire to contribute to these goals, and the confidence in one’s ability to do so”, while normative commitment refers to the feelings of obligation to work in the firm in order to foster and maintain good relationship with the senior generation. Calculative commitment is based on perceived opportunity costs involved while imperative commitment involves the perceived need to work in the firm (Sharma & Irving, 2005).

One’s commitment is not only determined by her/his subjective will to conduct an action (e.g. investing resources to a firm), but is also based on the assessment of the feasibility of that action. For instance, when an initially committed successor candidate comes to the conclusion that he won’t be selected as the successor in the end, he may lower his commitment subsequently.

Competence, on the other hand, is defined as the stock of resources one possesses which are needed by or valuable to the firm. One’s stock of personal resources confines the actual amount of resources that one can possibly con-

tribute. Resources can be the tangible financial capital as well as the intangible human capital (knowledge, skills, abilities, time and labor etc.) and social capital. This definition implies that whether one is regarded as competent actually depends on the specific firm's need. A person's skill-set, for instance, might not be needed by firm A but is highly valued in firm B. However, some basic types of resources are commonly valued by most firms.

Commitment and competence are both variables that change through time, thus the stakeholder's resources investment to the firm also varies at different time point.

B.2.2 Relational Distance, Influence and Control

A stakeholder's relational distance to the firm reflects the stakeholder's degree of influence to the firm. Although the firm is viewed as an actor, it is after all not a real person who can feel, think and make decisions. Intuitively, we know that the firm is often controlled by a real person or a group of people – the controller – who makes decisions and decides what the firm should do.

Every key stakeholder has a certain degree of influence on the firm, while the controller – the founder in the case of first generation family firm – is the most salient influencer who can greatly shape the objective, decisions and organization of the firm.

In the firm-stakeholders network, there are transactions between the stakeholders (employees, suppliers, clients etc.) and the firm happening every day. The management's role is to operate these transactions, namely to act on behalf of the firm to negotiate and decide the content of the transactions and to make sure the success of the transaction, i. e. the actual exchange of resources as expected. In the founder-led firms, most of the important transaction decisions are made by the founder. Therefore, firm, as an actor, is often perceived as interchangeable with its agent, i. e. the owner-manager.

In the family firm, where the ownership and control concentrate within the family, the family generally has smaller relational distance to the firm compared to other stakeholders. The alignment of interests of respective family members could render a concentration of critical resources to the family firm, thereby enhancing and facilitating firm's development. The founder of the family firm often locates in the innermost circle of the egocentric network of the firm as she/he has the shortest relational distance to the firm.

B.3 Relational Distance and Family Business Succession

B.3.1 The Triangular Model of Family Business Succession

Integrating the concepts of relational distance, personal social capital and firm social capital, I propose an analytical model – the triangular model of family business succession – to capture the dynamics of the interactions of the key actors in the succession process.

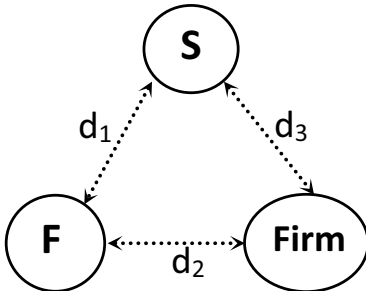


Figure 7: The Triangular Model of Family Business Succession. Source: the author.

This basic model specifies the starting point of the investigation of family business succession in China, i.e. actors and relationships. As illustrated in Figure 7, it consists of three key actors in the family business succession process, i.e. the founder (F), the (potential or actual) successor (S) and the family firm (Firm), and the relations between each pair of them: the relationships r_1 between F and S with their relational distance marked as d_1 ; r_2 between F and Firm with d_2 , and r_3 between S and Firm with d_3 . Noting that d_1 , d_2 and d_3 vary themselves (become larger or smaller) over time.

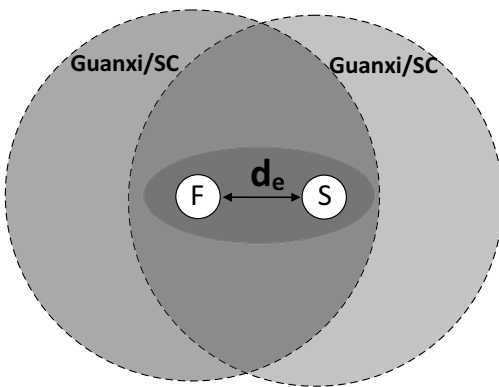
The three actors possess resources that constitute their own stock of financial, human and social capital. Their ties with each other channel critical resources among them. While d_1 is determined by the three dimensions (i.e. *qing*, *yi* and *jiao*), both d_2 and d_3 (i.e. the founder's and the successor's respective relational distance to the firm) are determined by their commitments and competences, namely their willingness to invest their own human, social and financial capital to the firm and their competence such as entrepreneurship and management skills, which determine how much they can actually contribute to the firm.

Generally, the family business succession can be viewed as a process in which the founder distances herself/himself from the firm, i.e. d_2 increases, while the successor reduces her/his distance from it, i.e. d_3 decreases. The movement pattern of d_2 and d_3 is firm-specific because in each family firm, both the founder and the successor have their distinctive attributes and behavioral preferences.

Moreover, the founder-successor relationships as well as other contexts that constrain or affect the succession process are also diverse. However, many of the family firms may be expected to follow some general patterns of succession as they might face similar situations and contexts.

B.3.2 The Transfer of Resources

In the succession process, the human capital and social capital are transferred from the founder to the successor. Those transferred resources could enlarge the successor's resource stock thus enhance her/his competence and commitment to the firm. In turn, the successor can invest more in the firm, thus d_3 decreases. That is to say, the effectiveness of human capital (e.g. knowledge and skills) and social capital transfer affects d_3 . In other words, the effectiveness of the resources transfer from the founder to the successor is of vital importance in the succession process, as it could largely determine the success of family business succession.



($d_e < d_1$)

Figure 8a: Effective Transfer. Source: the author.

Meanwhile, the effectiveness of resource transfer is affected by the relational distance between the founder and the successor (d_1). Take the transfer of social capital as an example, as shown in Figure 8, the red (left) circle represents the guanxi or social capital the successor possesses, while the blue (right) circle represents the founder's guanxi or social capital. As it is clearly shown in the Figure 8a, when the relational distance between the founder and the successor is small (as denoted by d_e), which may due to close sentimental bond, intensive interactions and shared values, the purple overlapping area of guanxi is large,

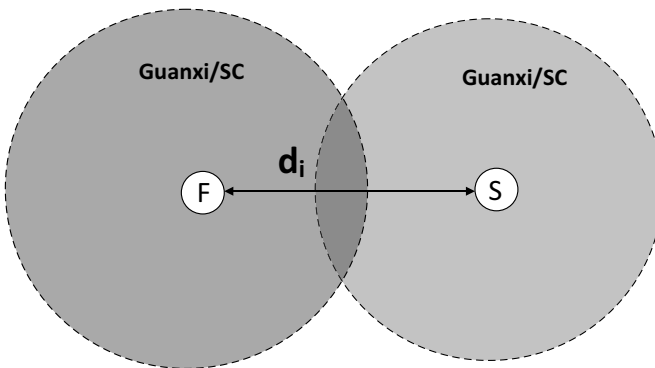


Figure 8b: Ineffective Transfer. Source: the author.

which stands for effective guanxi transfer. On the contrary, as shown in Figure 8b, when relational distance is large (as denoted by d_i), the size of the overlapping area is small, which indicates ineffective guanxi transfer between the founder and the successor. Figure 8a and 8b exemplify the extreme scenarios when the guanxi transfer is most effective or ineffective, in reality, the effectiveness of guanxi transfer lies somewhere in between the two extremes.

To summarize, the relational distance between the founder and successor (d_i) could greatly impact the successor's relational distance to the firm (d_3), while the latter is a good indicator for the success of succession.

B.3.3 The Selection of Management Successor

The talent pool of potential successors is in different situations for each family firm. In order to reduce the complexity of analysis, I posit in this model that the founder has dictator power to decide on the selection of the management successor from available candidates. Literature reveals that the key factors impacting the successor selection decision are the talent pool size (i.e. the number of potential successors), the relationship between the potential successor and the founder and the capability of the successor candidate etc. (Chrisman, Chua, & Sharma, 1998; Cabrera-Suárez, 2005)

An extended version of the basic model can enclose these three factors. For example, a family firm has three potential successors, i.e. his son (S_a), his nephew (S_b) and a non-family manager of the firm (S_c), as illustrated in Figure 7.

As perceived by the founder, each of the three has distinct relational distances to him, i.e. $d_{a1} < d_{b1} < d_{c1}$. Meanwhile, each of them has different experiences

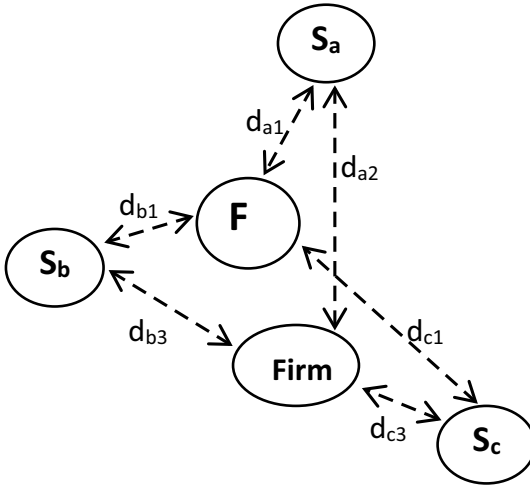


Figure 9: Successor Selection. Source: the author.

related to the firm. The manager has worked in the firm for a long time and is most committed and competent. Their respective distances to the firm have the following relation: $d_{c3} < d_{b3} < d_{a3}$. In this situation, which candidate is the best choice for the founder is debatable. In accordance with the traditional norm of “son succeeds father”, the son would be the only legitimate successor. Meanwhile, from the perspective of economic outcome, the nephew or the manager might be the better choice.

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Glossary

bainian laodian	百年老店	a store, a brand or a business that has been operating for at least one hundred years
baoban hunyin baoda chiku nailao	包办婚姻 报答 吃苦耐劳	arranged marriage requite, repay eat bitterness, endure hard work; hardship bearing and hard working
chuangerdai ci	创二代 慈	the second generation entrepreneur kindness; parents obligation to nurture and educate their children with kindness
citang danda xinxi	祠堂 胆大心细	ancestral hall being bold, courageous and brave while at the same time cautious, wise and not reckless
fenjia	分家	family division; the process and mechanism of the reconfiguration of family properties as well as domestic power
ganqing geren duzi qiye geti gongshanghu	感情 个人独资企业 个体工商户	sentiment sole proprietorship individual industrial and commercial businesses
gufen youxian gongsi guiju hehuo jia jiachan jiao jiaren jiating	股份有限公司 规矩 合伙 家 家产 交 家人 家庭	stock company explicit rules, set by the ancestors or patriarchs partnership family family properties exchange family members people who are related by blood, marriage, or adoption and live in the same household
jia wenhua jiaye jiazhang jiazu jinqin jituan lian lunli mianzi pengyou	家文化 家业 家长 家族 近亲 集团 脸 伦理 面子 朋友	family culture the business of the family family head common origin and ancestor close relative group (of companies) one's moral face Confucian ethics one's social reputation friends

pengyouquan	朋友圈	the circle of friends
qian	欠	owing
qin	亲	close
qing	情	sentiment, personal feelings
qu jiazuhua	去家族化	de-familize
renqing	人情	the sentiments, feelings and emotions underlying human relationships and interactions
renmai	人脉	guanxi network
shengren	生人	strangers
shu	疏	distant
shuren	熟人	guanxi parties or ordinary acquaintances
siying qiye	私营企业	private enterprises
tongju gongcai	同居共财	common living and common budget
wairen	外人	non-family members
weiren chushi	为人处世	how to deal with one's relationship with others
xiahai	下海	entrepreneurial activities, literally: go into the sea
xiao	孝	filial piety; respect, obedience and care to one's parents, elders and ancestors as the obligation of the children
xin	信	trust; trustworthiness and fidelity
yanchuan shenjiao	言传身教	imparting the values and knowledge to the children explicitly by words and verbal instructions as well as teaching by personal example
yangyu zhien	养育之恩	the kindness of the parents for raising and nurturing the child
yi	义	righteous; what is considered as right, just and moral attitudes and behaviors of both parties in different types of relationships; obligations
yijia zhizhu	一家之主	master of the house
youxian zeren gongsi	有限责任公司	limited company
yuanqin	远亲	distant relatives
zhiduhua	制度化	institutionalization
zhihui	智慧	intelligence and wisdom; the ability to think, reason and understand in order to gain and create knowledge, and the ability to use accumulated experience and knowledge to make sensible decisions or judgments
zhuzi junfenzhi	诸子均分制	equal inheritance system
zicheng fuye	子承父业	son succeeds father
zu	族	lineage
zuchan	族产	lineage estates
zuoren	做人	become or be a person
zupu	族谱	common genealogy
zutian	族田	land owned by the lineage
zuzhang	族长	patriarch for the whole lineage

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