

# **Succession and the Transfer of Social Capital in Chinese Family Businesses**



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im Wittener Institut für Familienunternehmen (WIFU)

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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*To Leigh, Kayla and Luka*



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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, 2015<sup>1</sup>). 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 businesses<sup>2</sup>.”

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.

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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 21<sup>st</sup> 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.





## **Part I.**

### **The Question in Focus**



## 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*<sup>3</sup>, 个体工商户). Due to the deficiency of statistics as well as the complexity of firm registration realities<sup>4</sup>, 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, 2015<sup>5</sup>). 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

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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 businesses<sup>6</sup>.

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 demoted 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.